

**FL MASTER SHERMAN, LTD.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2008**

The following management discussion and analysis of the financial condition and results of operations prepared April 29, 2009 should be read together with the FL Master Sherman, Ltd. unaudited consolidated financial statements and notes thereto for the year ended December 31, 2008 and 2007. All financial information is reported in accordance with Canadian generally accepted accounting principles.

This discussion may contain forward-looking statements which are based on our expectations, estimates and forecasts. These statements are subject to risks and uncertainties that are difficult to predict or control. These risks and uncertainties could cause actual results to differ materially from those indicated. Readers should not place undue reliance on any such forward-looking statements.

**Description of Business**

Master Sherman was formed on December 15, 2006, for the purposes of acquiring direct and indirect ownership interest in, or other economic exposure to, income-producing real property, including through (i) acquiring equity ownership interests in other entities within the First Leaside Group which own Property ("**Property Vehicles**"), (ii) lending to Property Vehicles and (iii) conducting such other activities as may be necessary, advisable, convenient or appropriate to promote or conduct the business of Master Sherman (including, without limitation, property rehabilitation). While the long term objective of Master Sherman is direct and indirect ownership of Property, Master Sherman may utilize all or substantially all of its available funds from time to time to make loans on an interim basis as it assesses other opportunities.

An investment in Master Sherman is intended to provide investors with the opportunity to receive cash distributions originating from the ongoing operation of properties acquired, the opportunity to receive, in certain circumstances, the proceeds from a refinancing of mortgage loans, and the potential to realize capital gains upon the sale of any properties.

As of December 31, 2008, there are 2,845,156 limited partnership units of Master Sherman issued and outstanding. The partnership units were reduced by 293 during 2008 for proceeds of \$293. During 2007, partnership units were issued for proceeds of \$2,420 and in 2006 for proceeds of \$2,843,029.

As at December 31, 2008, the assets of Master Sherman consist of: (a) investment in Country Village LP which owns the Country Village Apartments, located in Sherman, Texas, USA; (b) investment in Creekview LP which owns the Creekview Apartments also located in Sherman, Texas, USA (collectively, the Country Village Apartments and the Creekview Apartments shall be referred to under this section as the "**Property Portfolio**"); and (c) loans by Master Sherman to its parent, First Leaside Properties Limited Partnership.

On December 29, 2006, Creekview LP completed the acquisition of the Creekview Apartments for a purchase price of \$7,345,000 plus closing costs and adjustments.

On December 29, 2006, Country Village LP completed the acquisition of the Country Village Apartments for a purchase price of \$5,655,000 plus closing costs and adjustments.

Property	Location	No. of Units	Acquisition Date	Purchase Price	Mortgage
Creekview	Sherman, Tx	144	December 29, 2006	\$7,345,000	\$5,650,000
Country Village	Sherman, Tx	148	December 29, 2006	\$5,655,000	\$4,350,000
Total		292		\$13,000,000	\$10,000,000

The Property Portfolio was purchased to and (after coverage of promissory notes payable, debt interest and any other expenses, but excluding certain one-time costs, incurred by Master Sherman) generated positive cash flows for distributions to Master Sherman limited partners throughout 2007 and 2008.

### Overall Performance

Master Sherman's primary asset is the Property Portfolio. The Creekview Apartments' occupancy rate as at December 31, 2008 was 99.3% (as at December 31, 2007 – 95.8%). The Country Village Apartments' occupancy rate as at December 31, 2008 was 95.9% (December 31, 2007 – 97.3%). The Creekview Apartments' average occupancy rate for 2008 was 98.7% (2007 – 96.4 %). The Country Village Apartments' average occupancy rate 2008 was 97.6% (2007 – 96.9%). The increases in occupancy rates, which increased in line with expectations, were the result of leasing initiatives undertaken by the Property Manager and management of Master Sherman GP.

Rental revenues from the Property Portfolio increased throughout 2008 both due to the aforementioned increased occupancy rates and an increase in average rents charged per unit. Rental revenues, in conjunction with other income and interest income led to total revenues of \$2,300,307 year ended December 31, 2008 (2007 - \$2,026,715).

### Selected Annual Information

	Year Ended December 31, 2008	Year Ended December 31, 2007
Average Occupancy Rates in Property Portfolio	98%	97%
Total Revenue	\$ 2,300,307	\$ 2,026,715
Net Operating Income	\$ 1,145,747	\$ 904,278
Net Loss	\$ (1,526,273)	\$ (478,100)
Net Loss per Unit	\$ (0.54)	\$ (0.17)
Total Assets	\$ 14,692,410	\$ 16,690,989
Total Liabilities	\$ 13,853,279	\$ 14,325,292

### Results of Operations

In 2008, total revenues were \$2,300,307 (2007 - \$2,026,715). Total revenues were comprised of (i) net rental revenues of \$1,930,863 for the year ended December 31, 2008 (2007 - \$1,879,165); and (ii) other income of \$124,469 for the year ended December 31, 2008 (2007 - \$111,209) and interest income of \$244,975 for the year ended December 31, 2008 (2007 - \$36,341). The rental revenues were earned from the Property Portfolio and increased throughout 2008 both due to increased occupancy rates and an increase in average rents charged per unit. The other income consists of miscellaneous items such as rents for parking spots and car ports. The interest income was earned from balances with certain related parties, which increased due to the principal balance being outstanding for a greater period of time. See

*“FL Master Sherman, Ltd. Management’s Discussion and Analysis Year Ended December 31, 2008 – Related Party Transactions”.*

Operating expenses include property taxes, utilities, property management fees, repairs and maintenance, insurance, advertising and leasing and administration expenses.

Property tax expense decreased in 2008 as a result of the Grayson County tax department revising the assessed tax value for the properties. The Assessed tax values have been revised to \$11,776,000, down from \$13,005,000 in 2007.

Utility expense for 2008 has increased by approximately 5% over 2007 due to general environmental conditions and increased costs for waste removal. The 2008 and 2007 seasons have been comparable and were not as hot as 2006, when utility expense was significantly higher.

Property management fees increased slightly during 2008 as a result in an increase in revenue. In accordance with the property management services agreement, property management fees are based on 4% of total revenues collected on a monthly basis, or \$3,000/month per property, whichever is greater. Due to the high level of occupancy rates, management fee expense was calculated on the basis of 4% of total income, rather than the minimum fee of \$3,000/month.

Repairs and maintenance expenses include general maintenance, equipment maintenance, cleaning, painting and landscape service.

Advertising and leasing expense includes advertising and marketing for new tenants, as well as promotional items for existing tenants. The advertising and leasing expense has decreased because less advertising is required when the occupancy rates are higher and there are less advertising and leasing requirements.

Operating income for the year ended December 31, 2008, was \$1,145,747 (2007 –\$904,278). However, Master Sherman incurred net losses of \$1,526,273 for the year ended December 31, 2008 (2007 - \$478,100). This loss was primarily due to i) non-cash items such as amortization of revenue-producing properties of \$270,462 (2007 – \$274,428), amortization of in-place leases of \$274,317 (2007 – \$274,318); ii) mortgage and other interest costs of \$960,335 (2007 – \$721,967) (which includes interest paid to FLP Fund of \$316,904 (2007 – \$67,868) of interest paid on the promissory notes); iii) other maintenance charges of \$90,415 (2007 - \$64,753); iv) an foreign exchange loss of \$9,599 (2007 \$54,969); and v) an offset by a gain from fair value change in call premium derivative of \$2,000 (2007 - \$8,000).

Also included in other expenses is professional fees of \$1,068,926 for the year ended December 31, 2008 (2007 - \$NIL) incurred for the Fund’s public offering. In accordance with the Note Purchase Agreement, Master Sherman is obligated to issue promissory notes payable to the Fund subject to acceptance by the Fund, equal to the gross proceeds received by the Fund in its public offering. As a result, Master Sherman entered into an agreement with the Fund effective September 30, 2008, whereby Master Sherman will reimburse the Fund for all of the costs and expenses arising from the offering of Fund units and any other costs incurred in accordance with the Declaration of Trust. This agreement terminates on July 3, 2037.

As at December 31, 2008, Master Sherman’s total assets were \$14,692,410 (December 31, 2007 - \$16,690,989) and total liabilities were \$13,853,279 (December 31, 2007 – \$14,325,292). The decrease in total assets was mainly due to amortization of revenue-producing properties and in-place leases, a decrease due to partial repayment of amounts receivable from related parties and an increase in deposits in escrow, which represent payments made to the mortgage holder for property taxes, insurance and repairs and maintenance. The decrease in total liabilities was mainly due to a partial repayment as well as the revaluation of the Canadian denominated promissory notes payable to the Fund at the December 31,

2008 U.S. Exchange rate, offset by an increase in accrued liabilities for audit and legal fees incurred in connection with the annual and interim financial statements and public offering and an increase in property tax liability, as property taxes are paid annually with funds held in escrow by the mortgage holder at the end of the year or one month following the end of the year. See “*FL Master Sherman, Ltd. Management’s Discussion and Analysis Year Ended December 31, 2008 – Related Party Transactions*”.

### Summary of Quarterly Results

	<b>December 31, 2008</b>	<b>September 30, 2008</b>	<b>June 30, 2008</b>	<b>March 31, 2008</b>
Average Occupancy Rate	98%	97%	98%	96%
Total Revenue	\$567,182	\$577,898	\$578,714	\$576,513
Net Operating Income	\$ 268,547	\$306,461	\$285,940	\$284,799
Net Loss	\$(337,042)	\$(958,837)	\$(93,245)	\$(137,149)

	<b>December 31, 2007</b>	<b>September 30, 2007</b>	<b>June 30, 2007</b>	<b>March 31, 2007</b>
Average Occupancy Rate	97%	95%	97%	98%
Total Revenue	\$532,651	\$501,040	\$497,927	\$495,097
Net Operating Income	\$250,358	\$206,663	\$218,147	\$229,110
Net Loss	\$(156,567)	\$(134,295)	\$(107,278)	\$(79,960)

As shown in the chart above, total revenues increased in every quarter of 2007 and 2008, except for the third and fourth quarter in 2008, where there was a slight decline. The increases were primarily a result of (i) leasing initiatives undertaken by the Property Manager and management of Master Sherman GP to reduce vacancies and increase net rental income; and (ii) interest income earned from related party balances.

The net loss increased significantly in the three months ended September 30, 2008, partially as a result of expenses incurred for professional fees of \$879,618 as a result of the cost reimbursement agreement with the Fund for the three months ended September 30, 2008 and \$189,308 for the three months ended December 31, 2008.

## **Liquidity**

Master Sherman has financed its operations to date primarily through the issuance of limited partnership units and receipt of the proceeds from the issuance of the promissory notes payable.

Master Sherman has and expects to continue to generate positive cash flows for distributions to Master Sherman limited partners after coverage of Promissory Note payable debt (plus mortgages payable and other long term debt) interest and any other expenses incurred by Master Sherman, excluding one time costs that include professional fees and related prospectus costs.

Each of Creekview and Country Village were acquired with the expectation that they would generate sufficient cash flows to finance their own operating costs. To date they have met this expectation and management of Master Sherman expects this to continue. Future properties which are acquired will also be acquired with the expectation that they will also generate sufficient cash flows to finance their own operating costs.

Master Sherman entered into a Note Purchase Agreement with First Leaside Properties Fund (the "Fund") whereby the Fund has loaned funds to Master Sherman through promissory notes bearing interest at 9%. The purpose of these funds received from the Fund are for Master Sherman to acquire direct and indirect ownership interest in, or other economic exposure to, income-producing real property, including through (i) acquiring equity ownership interests in other entities within the First Leaside Group which own Property, (ii) lending to Property Vehicles and (iii) conducting such other activities as may be necessary, advisable, convenient or appropriate to promote or conduct the business of Master Sherman (including, without limitation, property rehabilitation). While the long term objective of Master Sherman is direct and indirect ownership of Property, the Partnership may utilize all or substantially all of its available funds from time to time to make loans on an interim basis as it assesses other opportunities. Master Sherman is able to pay substantially all of the interest payable on the Fund notes through loans it has provided to FLP LP as well as cash flows from Creekview and Country Village.

Although the financial statements for the year ended December 31, 2008 indicate a net loss of \$1,526,273, there are non-cash items such as amortization of revenue producing properties and in-place leases of \$544,779, professional fees incurred for the Fund's public offering of \$1,068,926, foreign exchange loss of \$9,599 less a fair value gain in call premium derivative of \$2,000 that have resulted in the net loss for the year. Master Sherman's operations provided net operating income of \$1,145,747. After deducting mortgage interest of \$643,431 and other maintenance charges of \$90,415, there is net cash flow of \$411,901. This net cash flow is expected to be sufficient to cover principal mortgage payments which commence in February 2009.

It is management of Master Sherman GP's opinion that Master Sherman has sufficient funds to acquire additional properties and to cover anticipated costs associated with acquisition of and securing financing for additional properties.

The financial statements have been prepared on a going concern basis which assumes that Master Sherman will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

## **Capital Resources and Capital Management**

As of the date hereof, there are 2,845,156 limited partnership units of Master Sherman issued and outstanding. The partnership units were reduced by 293 during 2008 for proceeds of \$293. During 2007, partnership units were issued for proceeds of \$2,420 and in 2006 for proceeds of \$2,843,029 and were partially used to purchase the Property Portfolio.

Master Sherman’s capital management objective is to maximize limited partner returns while ensuring that the Partnership is capitalized in a manner which appropriately supports working capital needs and business expansion. Master Sherman’s capital management practices are focused on preserving the quality of its financial position by maintaining a solid capital base and a strong balance sheet. Capital of Master Sherman consists of long-term debt and promissory notes payable, net of cash, and partners’ equity.

Master Sherman’s capital structure is approved by its board of directors. There were no changes in Master Sherman’s approach to capital management during the nine months ended September 30, 2008.

The capital structure of Master Sherman consisted of the following components at December 31, 2008:

Capital		
	Mortgages payable	\$9,848,724
	Promissory notes payable	3,105,525
	Long-term debt, net of cash	470,382
	Partners’ equity	<u>839,131</u>
Total Capital		\$ 14,263,762

***Mortgages Payables on the Creekview Apartments and the Country Village Apartments***

Both the Creekview Apartments and the Country Village Apartments have mortgages payable, which are secured by these revenue-producing properties. The mortgages payable bear interest at a fixed rate of 5.8125% per annum. Only the interest component of the mortgages payable is payable until January 2009, at which point \$58,755, comprising interest and principal, is payable monthly, maturing January 5, 2017 (the “**Maturity Date**”).

The mortgages are closed, meaning that the lender on the mortgages (Merrill Lynch Mortgage Lending, Inc., “**Merrill Lynch**”) has no obligation to accept prepayment of the loan amount until three months before the Maturity Date. If Merrill Lynch does accept or collect prepayments made prior to three months before the Maturity Date, penalties apply. In addition, the mortgages provide for an increased rate of interest in the event of default.

***Long-Term Debt***

Under the terms of the acquisitions of revenue-producing properties, a total of 500,000 Class A limited partnership units were issued by FL Creekview, Ltd. and FL Country Village, Ltd., to the vendor in connection with the acquisition of the Creekview Apartments and Country Village Apartments. These Class A limited partnership units are characterized as long-term debt for the purposes of the consolidated financial statements and bear interest at 8% per annum and are due in December 2011. During the six months before the maturity of the units, the vendor has the option to convert the units into securities issued by First Leaside Properties Limited Partnership, the limited partner of Master Sherman.

***Promissory Notes Payable***

The promissory notes payable are unsecured and non-recourse, bear interest at 9% per annum and are due between December 31, 2017 and 2018. Series A and B promissory notes payable pay interest in cash at 9% per annum, due monthly. The Series A notes are denominated in U.S. dollars. The Series B notes are denominated in Canadian dollars. The Series C notes are denominated in Canadian dollars and do not pay interest in cash; rather, the interest is added to the principal amount of the promissory notes payable.

The promissory notes payable are redeemable in whole or in part, at Master Sherman's option, at any time prior to the tenth anniversary of the original issuance of the promissory notes payable, subject to a certain prepayment call premium. The prepayment option represents an embedded derivative that is to be accounted for separately at fair value. At December 31, 2007, the fair value of the embedded derivative asset is \$24,000, which increased to \$26,000 as at December 31, 2008. The increase in the fair value of the embedded derivative asset of \$2,000 for the year ended December 31, 2008 is recorded in the statement of operations. As a result of bifurcating the prepayment option from the promissory notes payable, a basis adjustment was added to the cost of the promissory notes payable. This basis adjustment is amortized over the term of the promissory notes payable using the effective interest rate method and is included in interest expense.

Master Sherman incurred interest expense of \$316,904 in respect of the promissory notes due to the Fund for the year ended December 31, 2008 (2007 - U\$67,868).

### **Off-Balance Sheet Arrangements**

Master Sherman has no contingent liabilities or off-balance sheet arrangements.

### **Related Party Transactions**

Master Sherman is related to Raintree, by virtue of having common owners. FLP is the sole limited partner of Master Sherman and is also the sole limited partner of Raintree.

The following transactions were measured at the exchange value, which represented the amount of consideration established and agreed to by the related parties.

The amount due from FLP bears interest at 7% per annum, are unsecured and due on demand. Amounts due from/to other related parties are due on demand, are unsecured and non-interest bearing as follows:

	December 31, 2008	December 31, 2007
Due from:		
First Leaside Properties Limited Partnership	\$ 2,325,324	\$ 3,466,329
FL Raintree, Ltd., a subsidiary of First Leaside Properties Limited Partnership	-	50,000
	<u>\$ 2,325,324</u>	<u>\$ 3,516,329</u>

Master Sherman earned interest income of \$232,009 in respect of the amounts due from FLP for the year ended December 31, 2008 (2007 - \$35,729).

### **Changes in Accounting Policies Including Initial Adoption**

Effective January 1, 2008, Master Sherman adopted the new Handbook Sections issued by The Canadian Institute of Chartered Accountants: Section 1535, Capital Disclosures, Section 3862, Financial Instruments - Disclosures, and Section 3863, Financial Instruments - Presentation. In addition, Master Sherman implemented the revised Section 1400, General Standards of Financial Statement Presentation.

Section 1535 establishes standards for disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what is considered capital, whether an entity has complied with

any capital requirements and consequences of any non-compliance. The adoption of this standard had no effect on the recognition or measurement of amounts recorded in the interim consolidated balance sheets and interim consolidated statements of operations and comprehensive income, partners' equity (deficiency) and cash flows.

See "*FL Master Sherman, Ltd. Management's Discussion and Analysis for the period ended December 31, 2008 – "Capital Resources and Capital Management"* for the effect of adopting this standard.

Section 3862 and Section 3863, which replaced Section 3861, Financial Instruments - Disclosure and Presentation, revised and enhanced the disclosure requirements, and continued the existing presentation requirements for financial instruments. These standards require disclosures about the nature and extent of risks arising from financial instruments and the management of these risks. The adoption of this standard had no effect on the recognition or measurement of amounts recorded in the interim consolidated balance sheets and interim consolidated statements of operations and comprehensive income, partners' equity (deficiency) and cash flows. See "*FL Master Sherman, Ltd. Management's Discussion and Analysis for the year ended December 31, 2008 – Fair value of financial instruments*" for the effect of adopting this standard.

Section 1400 was amended to include requirements to assess and disclose material uncertainties that may cast significant doubt upon an entity's ability to continue as a going concern. The application of this revised standard does not have a material impact on the financial position or results of operations of Master Sherman.

### **Future Accounting Changes**

#### **International Financial Reporting Standards**

The Canadian Accounting Standards Board (AcSB) has confirmed its plan to adopt all International Financial Reporting Standards, as published by the International Accounting Standards Board, on or after January 1, 2011. Master Sherman will be required to prepare IFRS financial statements for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require restatement for comparative purposes of amounts reported by Master Sherman for the year ended December 31, 2010.

We commenced a conversion project in 2008 which will address how IFRS will affect Master Sherman. The project consists of training and education, an assessment of the impact of IFRS on the financial statements, information technology, data systems, disclosure and control procedures, internal control processes, design and implementation of systems and process changes and a post-implementation review. Management is currently evaluating the impact of the new framework.

#### **Fair Value of Financial Instruments**

The carrying values of cash, accounts receivables and deposits, deposits in escrow, accounts payable and accrued liabilities and tenant security deposits approximate fair values due to the immediate or short-term maturities of these financial instruments. As at December 31, 2008, the carrying values of the mortgages payable and long-term debt is approximately \$9,700,000, based on rates of similar debt and credit risk. The fair values of promissory notes payable and due to/from related parties could not be reasonably calculated as no comparable commercial terms are obtainable.

The management of Master Sherman GP has the overall responsibility for the establishment and oversight of Master Sherman's risk management framework. Master Sherman's risk management policies are

established to identify and analyze the risks faced by Master Sherman, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and in response to Master Sherman's activities.

In the normal course of business, Master Sherman is exposed to a number of risks from its use of financial instruments. These risks, and the actions taken to manage them, are as follows:

***Credit Risk***

Credit risk is the risk that one party to a financial instrument will cause a financial loss for Master Sherman by failing to discharge its obligation. The nature and maximum exposure to credit risk as at December 31, 2008 is:

	Carrying amount
Cash	\$29,618
Accounts receivable and deposits	12,828
Deposits in escrow	305,745
Due from related parties	<u>2,325,324</u>
Total Exposure	\$2,673,515

The majority of the cash, escrow balances are held with highly rated financial institutions in the United States.

Credit risk arises from the possibility that tenants may experience financial difficulty and not be able to fulfill their lease commitments. The risk of credit loss is limited to the recorded amount of rent receivable. Anticipated bad debt loss has been provided for in the allowance for doubtful accounts. The risk of credit loss is minimized by performing a credit assessment of prospective tenants prior to entering into a rental agreement.

Master Sherman regularly monitors the credit risk exposure from related parties by monitoring their financial condition in order to mitigate the likelihood that these exposures will result in actual losses.

***Interest Rate Risk***

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. This risk is managed by having fixed rates on mortgages and promissory notes payable.

***Liquidity Risk***

Liquidity risk is the risk that Master Sherman will encounter difficulty in meeting its contractual obligations associated with financial liabilities. Master Sherman is subject to liquidity risk on its mortgages payable, long-term debt and promissory notes payable whereby it may not be able to refinance or pay its obligations when they become due.

Master Sherman manages its liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there is sufficient cash flow to meet operational requirements.

### ***Currency Risk***

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Master Sherman's exposure to foreign currency risk is as follows:

	December 31, 2008	December 31, 2007
	(Canadian \$)	(Canadian \$)
Due from related parties	\$ 2,822,050	\$ 3,316,151
Promissory notes payable	(3,762,506)	(3,629,087)
Net exposure	\$ (940,456)	\$ (312,936)

A US 10¢ strengthening of the U.S. dollar against the Canadian dollar at December 31, 2008 would have increased the loss for the period by approximately \$94,000 for the year ended December 31, 2008. This analysis assumes that all the variables, in particular interest rates, remain constant (US 10¢ weakening of the U.S. dollar against the above currency at December 31, 2008 would have had an equal but opposite effect).

### **Risks and Uncertainties**

An investment in the securities of Master Sherman includes, but is not limited to, real estate risks since Master Sherman invests in real property. General economic conditions, local real estate markets, supply and demand for leased premises, competition from other available premises and various other factors affect such investments by Master Sherman. Management believes Master Sherman's primary real estate risk is the potential for declining revenue arising from increased vacancies or declining rental rates.

An additional risk faced by Master Sherman is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. Master Sherman has provided certain parties with loans in the past and may continue to do so in the future, a failure of these parties to pay their principal and/or interest obligations might affect Master Sherman's ability to pay principal and/or interest to the Fund under the Master Sherman Notes.