



## **Builders Capital Mortgage Corp.**

Management's Discussion and Analysis  
Quarter Ended March 31, 2016

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) has been prepared by Builders Capital Mortgage Corp. (Builders Capital or the company) as of May 6, 2016. It should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the 12 months ended December 31, 2015 and our unaudited condensed consolidated interim financial statements for the three months ended March 31, 2016, which represents the first quarter of our 2016 fiscal year. Both may be viewed on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website at [www.builderscapital.com](http://www.builderscapital.com). The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and all financial information is presented in Canadian dollars.

### Notice Regarding Forward-Looking Information

Certain information included in this MD&A contains forward-looking statements within the meaning of applicable securities legislation, including statements with respect to management's beliefs, estimates and intentions, and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "expect", "intent", "estimate", "anticipate", "believe", "should", "plans", "continue" or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. These statements are not guarantees of future performance and are based on our estimates and assumptions, which are subject to risks and uncertainties, and could cause our actual results to differ materially from the forward-looking statements contained in this MD&A. Those risks and uncertainties include, among other things, risks associated with mortgage lending, competition for mortgage lending, real estate values, interest rate fluctuations, environmental matters and the general economic environment. We caution that the foregoing list is not exhaustive, as other factors could adversely affect our results, performance or achievements. Readers are also cautioned against undue reliance on any forward-looking statements. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

### Background and Overview

Builders Capital is a mortgage lender providing short-term course of construction financing, primarily to residential builders. The company was formed on March 28, 2013 and commenced active operations on December 12, 2013 on the closing of our initial public offering and our listing on the TSX Venture Exchange under the symbol BCF. The company is a mortgage investment corporation (MIC) within the meaning of Section 130.2(6) of the *Income Tax Act* (Canada) and is governed by the laws of the Province of Alberta.

As a MIC, Builders Capital is not subject to income tax provided that we distribute all of our taxable income as dividends to shareholders within 90 days of our December 31<sup>st</sup> year-end. For income tax

purposes, such dividends are generally treated by shareholders as interest income, so that each shareholder is in the same tax position as if their proportionate share of mortgage investments made by the company had been made directly by the shareholder.

The company is structured with two classes of shares, Class A Non-Voting Shares, held by the public, and Class B Non-Voting Shares, held by management and private investors. This two-tier share structure grants dividend priority to the Class A Non-Voting Shares, providing additional security of both principal and dividends to our public shareholders, as detailed under the section entitled Distributions later in this MD&A.

In addition to the Non-Voting Shares, Builders Capital has a limited number of Voting Shares, which are held by the company's principal shareholders.

## **Operations**

Builders Capital provides short-term, course of construction financing to builders of residential, wood-frame construction projects in Western Canada. We believe that staying focused on this niche market reduces overall risk and increases the potential return on our mortgage portfolio.

The portfolio is managed by Builders Capital Management Corp. (the manager). The manager sources and services mortgage loans and directs the company's business operations. Extensive experience in all aspects of residential construction and in-depth, up-to-date residential real estate industry knowledge ensure that the manager is able to make prudent mortgage underwriting decisions and efficiently manage potential mortgage defaults. The manager has the ability to complete any unfinished development projects that Builders Capital may acquire through enforcement proceedings or otherwise in a timely and cost-effective manner.

All investments are subject to a rigorous underwriting review. When sourcing investment opportunities, the manager will conduct an initial review to confirm that a mortgage prospect satisfies our lending criteria and Asset Allocation Model (AAM). The AAM dictates the allocation of the aggregate funded and committed assets, based on geographical, economic sector, term, borrower and loan-to-appraised value criteria.

The manager is then required to perform comprehensive due diligence of the underlying assets. The due diligence process revolves around the manager's system of underwriting loans and evaluating projects and borrowers. This process includes a detailed re-costing of each project based on the assumption that we are going to build it ourselves and an analysis or appraisal of what the completed project will be worth. This assessment gives us the information we need to ascertain the value proposition inherent in the project. We only loan on projects that we believe are economically sound and for which we have the capability to complete and sell if necessary.

All of our loans are secured by mortgages and none are written for terms longer than one year. While we sometimes continue to hold mortgages over completed properties, our goal is to keep the terms short and to have borrowers repay loans on completion of construction, either through the sale of the property or by refinancing with another institution.

Our investment objective is to maintain a portfolio of mortgages that generates attractive returns, relative to risk, in order to permit Builders Capital to pay distributions to our shareholders. We aim to achieve this objective while assuring capital preservation and staying within the criteria mandated for MICs.

## **Investment Strategy**

In order to deliver above average risk-weighted returns, our strategy is to invest primarily in short-term construction mortgages that are secured by development stage residential real property. Lending on development property is limited, with mortgages generally provided only in circumstances where a borrower intends to complete the development and build on the land.

Investments in our portfolio are strategically concentrated on:

- First or subordinate mortgages on real estate with a target of up to 75% of property value;
- Mortgages on residential wood frame construction projects; and
- Mortgages on properties located in typically more liquid and less volatile urban markets and their surrounding areas, with a geographic focus on Western Canada.

## **Investment Restrictions**

Our share terms provide for a number of investment restrictions that can only be changed by a vote of all of the shareholders:

- Builders Capital will not make any investment or conduct any activity that would result in the company failing to qualify as a "mortgage investment corporation" within the meaning of the Tax Act.
- We will not invest in asset-backed commercial paper or in securitized pools of mortgage loans, including securitized pools of sub-prime mortgages.
- We will not invest in securities other than first and subordinate mortgages secured by real property and, on a temporary basis only, interim investments consisting of cash and cash equivalents, Government of Canada treasury bills and Government of Canada bonds with a term to maturity of three years or less (although the company shall not be precluded from owning securities of our subsidiaries or affiliates).
- Builders Capital will not engage in securities lending.
- The company will not engage in derivative transactions for speculative purposes and will only take part in derivative transactions in order to hedge interest rate or exchange rate risk.

## Summary

### Performance Highlights

- Dividends of \$0.1973 per share were declared to Class A public shareholders of record on March 31, 2016, equating to an annualized return of 8% of the original \$10.00 issue price.
- Mortgage revenue of \$0.9 million represented 4.1% of share capital, roughly equivalent to the 4.2% of share capital achieved in Q1 2015.
- Our invested capital turnover rate was impacted by the considerably slower real-estate market in Alberta, decreasing to 19.3% from 35.7% in Q1 2015.
- We continued to enhance the geographic diversity of our mortgage portfolio.
- Management fees were more than offset by lender fees charged to borrowers.
- Operating expenses (excluding interest and funds set aside for potential loan losses) were consistent with Q1 2015 in dollar terms but slightly higher year-over-year as a percentage of revenue, increasing to 8.9% of revenue, compared to 8.2% last year.
- We added \$66,000 to our accumulated allowance of funds earmarked for doubtful accounts.
- We reduced our debt-to-equity ratio to 7.1% from 17.2% at March 31, 2015.
- Comprehensive income of \$726,000 was down by 6.3% from Q1 2015, due mainly to the slower Alberta real estate market and more cautious use of our line of credit.
- Income for the quarter exceeded that required to pay planned Class A Non-Voting Share dividends by a healthy 2.7 times.

### Business Environment

- In our primary southern Alberta marketplace, the low oil prices that have persisted since mid-2014 continued to have a significant economic impact through the first quarter of 2016.
- Uncertainty in the province's real estate market has lengthened the time it takes our borrowers to sell their completed inventory and made some builders more cautious about taking on new projects.
- While some construction lenders appear to be pulling back from lending in Alberta, we believe that the tighter economic environment creates an opportunity for us to increase market share.
- We anticipate a reduction in raw land costs, particularly in Calgary, our largest single market. With a concurrent drop in sub-trade costs as a result of decreased construction activity, we expect that margins on new construction will remain viable.
- While Canada Mortgage and Housing Corporation forecasts declining housing starts through 2016 in all of our western Canadian markets, except British Columbia, where little change is expected, we believe that the forecast levels will be more than adequate to support the growth and continued geographic diversification of our business.

## Financial Overview

	<b>Three months ended March 31, 2016 \$</b>	<b>Three months ended March 31, 2015 \$</b>	<b>Three months ended March 31, 2014 \$</b>
Revenues	898,301	964,301	786,410
Earnings and total comprehensive earnings	726,211	775,219	637,964
Total assets	24,485,930	27,553,849	24,542,111
Shareholders' equity	22,859,407	23,504,020	23,356,772
Basic and fully diluted earnings per share	0.31	0.32	0.27
Cash dividends declared	269,886	288,432	272,155
Cash dividends declared per Class A share	0.1973	0.1973	0.1973
Cash dividends declared per Class B share	0.3667	0.3945	0.3456

## Investment Portfolio

At March 31, 2016

Property Type	Mortgage Portfolio (No.)	Outstanding Principal (\$)	Total Committed Mortgage Principal (\$)	%	AAM Allocation*
<b>Residential</b>					
Single family – Detached	19	14,793,680	23,255,000	61%	100%
Single family – Attached	13	9,612,971	20,005,000	39%	100%
<b>Total:</b>	<b>32</b>	<b>24,406,651</b>	<b>43,260,000</b>	<b>100%</b>	<b>N/A</b>
<b>Geographic Location of Property</b>					
Calgary and Area	22	14,683,905	30,635,000	60%	100%
Edmonton and Area	2	3,170,755	3,750,000	13%	100%
Other Alberta	3	2,553,234	4,295,000	11%	100%
British Columbia	2	2,440,175	2,300,000	10%	50%
Saskatchewan	3	1,558,582	2,280,000	6%	25%
<b>Total:</b>	<b>32</b>	<b>24,406,651</b>	<b>43,260,000</b>	<b>100%</b>	<b>N/A</b>
<b>Interest Rate (excluding fees)</b>					
12%-12.99%	3	2,761,126	5,400,000	11%	N/A
13%-13.99%	24	17,745,447	32,410,000	73%	N/A
14%-14.99%	4	3,650,273	5,200,000	15%	N/A
Greater than 14%	1	249,805	250,000	1%	N/A
<b>Total:</b>	<b>32</b>	<b>24,406,651</b>	<b>43,260,000</b>	<b>100%</b>	<b>N/A</b>

\*Indicates the maximum percentage of the portfolio allowable under Builders Capital's Asset Allocation Model.

## Operating Results for the Three Months Ended March 31, 2016

Despite the economic difficulties that our primary Southern Alberta marketplace continued to experience through the first quarter, we maintained a full mortgage book. We remain comfortable with the value of our portfolio and our provision for mortgage losses, and confident in our ability to prosper through difficult times.

During the three months, we continued to focus on geographically diversifying our mortgage holdings. At March 31, 2016, we had reduced mortgages held on properties in Alberta to 84% of the portfolio's total value from 87% at the end of Q1 2015 and increased mortgages on properties in British Columbia to 10% of the portfolio's total value from 6% last year.

Cash advances and invoiced interest for the first quarter totaled \$4.2 million and were balanced by \$4.3 million in mortgage repayments from borrowers. Based on an average of these figures, or \$4.25 million, we turned over 19.3% of our invested capital during the three months. This was down substantially from Q1 2015, when we turned over 35.7% of our invested capital, and from our fiscal 2015 quarterly average turnover of 34.6%. The slower turnover is a reflection of the considerably slower real-estate market in Alberta, which has resulted in our borrowers taking substantially longer to sell their completed projects. We are hopeful that a somewhat recovered price for oil, combined with our ongoing geographic diversification, will push our capital turnover back towards our historical averages.

In tandem with underwriting mortgages, we regularly engage in the purchase and sale of mortgages to help ensure full cash utilization and create liquidity as required. During the first quarter of 2016, we purchased \$1.4 million and sold \$1.1 million in mortgages. All of the purchase and sale transactions during the year were conducted with Builders Capital (2014) Ltd., a privately held corporation owned by certain directors of the company.

During 2015, we foreclosed on one property, which is now listed for sale and is being actively marketed. Going into the second quarter of this year, we are closely watching several other projects that we believe are at risk of default. As the real estate market in Alberta has continued to slow, selling prices have dropped and marketing times have lengthened, driving our loan-to-value ratios higher than we would like. However, we believe that our accumulated allowance for doubtful loans, which stood at \$533,000 at quarter-end, will be adequate to cover any potential write-downs that we determine are necessary. Owners of our Class A Non-Voting Shares can also take comfort in the fact that their 8% return on the original \$10 share issue price will always be paid prior to any dividends being declared on the \$9.7 million in Class B Non-Voting Shares.

Further reducing risk in this somewhat uncertain market is our minimal use of leverage. Our debt-to-equity ratio at the end of the first quarter was 7.1%, down from 17.2% at March 31, 2015.

At March 31, 2016, the total value of our mortgage portfolio was \$24.4 million. This was down by \$3.5 million year-over-year, due primarily to the funds tied up in the foreclosed property, the application of generated cash to reduce our line of credit balance and the redemption of \$932,000 in Class A Non-Voting shares in Q4 of 2015. At the end of the quarter, we had 32 mortgages outstanding with an average balance of \$762,000.



## Revenue

Mortgage revenue for the three months ended March 31, 2016 was \$898,000, down by \$67,000 from the \$965,000 generated in the first quarter of 2015, but up by \$19,000 from the last three months of 2015. This represents annualized gross revenue of 15.4% of the weighted average gross share capital, down from 16.1% in Q1 2015. The 2016 Q1 revenue consisted of \$821,000 in interest and \$77,000 in lender fees charged to borrowers.

Lender fees are tied to the negotiation of new mortgages, generally at 1% of the approved loan amount, and are charged for an annual term to borrowers when new loans are made, or when existing loans are renewed. Lender fees are maximized when turnover in the portfolio is highest. As anticipated, and consistent with the slower real estate market, lender fees earned in the first quarter were down by 12.9% year-over-year. However, they still more than offset management fees paid during the three months, with lender fee revenue exceeding the management fees by \$19,000, or 32%.

## Expenses

Excluding funds set aside to provide for loan losses and interest expense, first quarter operating expenses of \$80,000 were unchanged from 2015, representing 8.9% of revenue, compared to 8.2% of revenue last year. The 2016 operating expenses were within expectations and compared favourably to the 10.7% of revenue we forecast.

The first quarter provision for loan losses of \$66,000 was estimated by management based on an analysis of the manager's historical bad debts and current analysis of the construction finance marketplace. This is a collective provision calculated by reference to the portfolio as a whole. To-date, we have accumulated a total of \$663,000 to provide for loan losses, of which \$130,000 has been applied against the foreclosed property discussed under Operating Results above. We believe this is sufficient to cover potential write-downs in the mortgage portfolio

Management fees were \$58,000 for the first quarter, calculated on the total gross amount of Class A and Class B Non-Voting Shares outstanding.

Interest expense applies to our operating line of credit, which we use as a cash flow tool to fund mortgage draws. A higher utilization rate for our capital will provide better returns in the form of additional interest income, but will also necessitate increased use of our line of credit for funding draws when our own funds are fully employed. As the real estate market in Calgary has slowed, we have actively focused on reducing our leverage and we plan to continue to closely monitor use of our line of credit over the next several quarters. For the first quarter, interest expense of \$26,000 was up from \$4,200 in the final quarter of 2015, but lower than the \$40,000 paid in the first quarter of last year.

## Comprehensive Income

As expected, the slowing of the Alberta real estate market had a negative impact on our comprehensive income in the first quarter, as did more cautious use of our line of credit. Due to the combined impact of these factors, comprehensive income for the three months of \$726,000 (\$0.31 per share) was down by 6% from \$775,000 (\$0.32 per share) reported for Q1 2015.

Our share terms call for annual dividends of \$0.80 per Class A Non-Voting share per year, or approximately \$0.20 per quarter, prior to any other dividends being paid. Earnings during the first

quarter exceeded the amount required to satisfy these dividends by 2.7 times. With Class B Non-Voting shareholders bearing a much greater proportion of the risk of income fluctuations, even if earnings had been only 38% of their actual figure, the company would still have been in a position to pay Class A shareholders their full, planned quarterly dividend. Given this margin, we anticipate that potential continued fluctuations in our comprehensive income as a result of the slower Alberta real estate market will not affect the payment of our Class A Non-Voting Share dividends.

### **Financing Costs**

Financing costs since inception total \$1.6 million, including professional fees for preparation of the IPO prospectus; offering, agent and brokerage fees and commissions; and other marketing and offering costs. In accordance with IFRS, these financing costs are not treated as expenses in the consolidated financial statements, but instead are shown as a reduction in the value of the equity of the company. These costs are, however, deductible for tax purposes over a five-year amortization period.

Our intent is to restrict the distributions to less than 100% of net income in order to utilize the tax deductibility of these expenditures. This distribution policy will, over time, have the result of retaining income equal to the offering costs within Builders Capital, which will increase the Net Asset Value of the company while ensuring that no corporate taxes are paid. Because of the two-tier share structure, and the priority on distributions that the Class A Non-Voting Shares hold over the Class B Non-Voting Shares, we expect the restriction in distributions to come primarily from the portion of income otherwise available for distribution to the Class B Non-Voting shareholders.

### **Balance Sheet**

At quarter-end, total assets were \$24.5 million (March 31, 2015 - \$27.5 million), consisting primarily of funded mortgages. Also included in total assets is the repossessed property discussed earlier, which is being held for resale. If there is a final write-down when this property is sold, it will be taken from our accumulated allowance for loan losses and will not affect our income statement as the write-down has already been recorded on our balance sheet.

Liabilities of \$1.6 million (March 31, 2015 - \$4.0 million) consisted of a \$1.2 million line of credit balance (March 31, 2015 - \$3.5 million); dividends relating to the fiscal quarter, which were paid on April 30, 2016; trade payables; and unearned lender fees.

## Quarterly Financial Information

	Quarter ended March 31 2016 \$	Quarter ended December 31 2015 \$	Quarter ended September 30 2015 \$	Quarter ended June 30 2015 \$	Quarter ended March 31 2015 \$	Quarter ended December 31 2014 \$	Quarter ended September 30 2014 \$	Quarter ended June 30 2014 \$	Quarter ended March 31 2014 \$
Revenues	898,301	879,036	967,231	964,761	964,912	967,975	899,007	882,831	786,410
Earnings and total comprehensive earnings	726,211	656,198	778,752	772,711	775,219	770,874	731,493	706,458	637,964
Total assets	24,485,930	24,328,786	26,578,841	26,669,379	27,553,847	27,191,077	24,226,077	24,404,039	24,542,111
Shareholders' equity	22,859,407	22,403,083	23,787,589	23,699,823	23,504,020	23,017,233	23,324,074	22,451,891	22,356,772
Basic and fully diluted earnings per share	0.31	0.27	0.32	0.32	0.32	0.32	0.30	0.30	0.27
Cash dividends declared	269,886	1,108,710	681,872	676,628	288,432	1,077,514	670,328	611,138	272,155
Cash dividends declared per Class A share	0.1973	0.2216	0.2016	0.1995	0.1973	0.2016	0.2016	0.1995	0.1973
Cash dividends declared per Class B share	0.3667	0.4234	0.4032	0.3989	0.3945	0.4134	0.3864	0.3456	0.3456

## **Distributions**

Class A Non-Voting shareholders are entitled to receive annual dividends of 8% in preference to all other shareholder distributions. Once these dividends have been paid, Class B Non-Voting shareholders are entitled to receive total annual dividends of up to 16%. At our fiscal year-end, any remaining income available for distribution after these dividends are paid is allocated pro-rata between the classes of shares, including the Voting Shares.

On March 21, 2016, based on income for the quarter, the company's Board of Directors declared a dividend of \$0.1973 per Class A Non-Voting Share to shareholders of record on March 31, 2016. This distribution was paid on April 30, 2016 and is recorded as payable in the accompanying condensed consolidated interim financial statements. The dividend amount was calculated to provide an annualized 8% return for the quarter on the \$10.00 initial Class A Non-Voting Share price.

Subsequent to the quarter-end, on April 25, 2016, again based on income for the first quarter of 2016, the Board declared a dividend of \$0.XXX per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on April 30, 2016.

## **Liquidity and Capital Resources**

Cash flow and liquidity were good during the quarter, although the somewhat slower Alberta real estate market has delayed some of our projected mortgage pay-downs. We will continue to monitor our cash flow on a daily basis as liquidity is critical to our success. Liquidity risk for the company comes primarily from the prospect of committing to a mortgage for which sufficient funds are not available to make draws as requested by the borrower. We have a number of tools to manage liquidity and to ensure that commitments can be met, which have been utilized to a greater extent in recent months than in the past. These include our \$3.5 million line of credit, detailed cash-flow planning procedures, and Builders Capital's well-established network of affiliates and mortgage industry contacts, through which mortgages can be sold or syndicated as required for cash flow purposes. In addition, our mortgage documents include language whereby a borrower cannot compel the company to advance funds. Our primary goal is to minimize unused cash balances, while ensuring that borrower needs and other commitments can always be met.

During the first quarter of the year, mortgages were purchased or funded in the amount of \$5.6 million and \$5.4 million was received as proceeds of sale, or as repayments on loans. As our mortgages are predominantly short-term in nature, the continual repayment by borrowers of existing mortgage investments creates liquidity for ongoing mortgage investments and funding commitments.

We have no plans or commitments for capital expenditures. Builders Capital is financed, and will continue to be financed, primarily by the issuance of common shares. We intend to issue additional common shares in the future to finance growth in our mortgage portfolio.

According to our share terms, Class A Non-voting shareholders have an annual right to redeem their shares on October 31 each year. Payment for the redemptions is to be made on November 30. In the final quarter of 2015, we received notice of redemption requests for a total of 101,500 shares. These shares were redeemed in accordance with our share terms for 95% of the Net Asset Value as calculated on October 31, 2015. The total redemption amount was \$932,300 and the payment reduced our share capital by \$1,015,000 for a net gain of \$82,700. This gain forms a part of the shareholders equity and has the effect of increasing the Net Asset Value per share of the remaining shares. While our intent in

general is to grow our mortgage portfolio and our capital base, we are nonetheless pleased that the share terms are functioning as intended to provide liquidity for our investors.

### **Related Party Transactions**

Our manager is a company controlled by certain Builders Capital directors. The manager receives a management fee calculated as 1% per annum of the book value of the share capital of the company. Management fees amounted to \$58,401 for the quarter. In addition to the management fee, the manager charges lender fees directly to borrowers, with 28.6% of these fees being paid to the company and the remaining 71.4% going to the manager.

During the quarter, we conducted a number of transactions with Builders Capital (2014) Ltd., a privately held corporation owned by certain directors of the company. We respectively purchased and sold \$1.4 million and \$1.1 million in mortgages. All transactions were completed at fair market values with the objectives of ensuring full cash utilization and creating liquidity as required.

### **Financial Instruments**

The company's significant financial instruments are our mortgages receivable. The risks associated with the mortgages are fairly typical for any lender and primarily revolve around the possibility of default on the part of the borrowers. The mortgages receivable are all written with fixed interest rates and no gains or losses are associated with these instruments. Virtually all of the company's revenue is derived from our mortgages, either as interest or as lender fees charged to borrowers at the inception and renewal of their loans.

### **Critical Accounting Estimates**

The determination of an impairment provision for the mortgage portfolio is a critical accounting estimate. Builders Capital considers evidence of impairment for mortgages receivable at both a specific and collective level. All individually significant mortgages are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but is not yet identifiable at an individual mortgage level. Mortgages that are not individually significant are grouped according to risk characteristics and each group is collectively assessed for impairment.

In assessing collective impairment, we review historical trends of probability of default, the timing of recoveries and the amount of loss incurred. This information is weighed against our judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a specific mortgage receivable is calculated as the difference between its carrying amount, including accrued interest, and the present value of the estimated future cash flows, discounted at the mortgage's original effective interest rate. Losses are recognized in the statement of comprehensive income and reflected in an allowance account against the mortgages receivable. When a subsequent event causes the amount of an impairment loss to decrease, the decrease in impairment loss is reversed through the statement of comprehensive income.

## **Responsibility of Management and the Board of Directors**

Management is responsible for the information disclosed in this MD&A and has in place the appropriate information systems, procedures and controls to ensure that the information used internally by management and disclosed externally is materially complete and reliable. In addition, our Audit Committee and Board of Directors provide an oversight role with respect to our public and financial disclosures. Both have reviewed and approved this MD&A and the accompanying consolidated financial statements for the quarter ended March 31, 2016.

## **Controls and Procedures**

Internal control over financial reporting encompasses controls and processes designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

As the management of Builders Capital, we are responsible for establishing and maintaining these controls. Under the supervision and with the participation of the CEO and the CFO, management carries out, on an ongoing basis, an assessment of the design of these internal controls. This assessment includes a risk evaluation of internal controls and documentation and testing of the key processes and controls. Due to the inherent limitations in any control system, an evaluation can only provide reasonable assurance over the effectiveness of the controls and internal controls are not expected to prevent and detect all misstatements due to error or fraud.

Based on our ongoing assessment, the CEO and the CFO have concluded that Builders Capital's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of condensed consolidated interim financial statements for external purposes as at May 6, 2016.

## **Outstanding Share Data**

The company's authorized share capital as at May 6, 2016 consists of 1,000 Voting Shares, of which 100 were outstanding at period-end; an unlimited number of Class A Non-Voting Shares, of which 1,367,895 were outstanding at period-end; and an unlimited number of Class B Non-Voting Shares, of which 974,576 were outstanding at period-end.

In addition, as part of the compensation for closing the IPO, the company granted 82,764 options to agents. Each of these options entitles the agent to purchase one Class A Non-Voting Share at the IPO price of \$10.00 at any time prior to their expiry on December 12, 2016. None of the options granted have been exercised.

## **Market Outlook**

The following discussion is qualified in its entirety by the Notice Regarding Forward-Looking Information at the beginning of this MD&A and by the section entitled Risks and Uncertainties that follows this Outlook section.

As Alberta is our primary market for construction mortgages, investors in Builders Capital may justifiably be concerned that a downturn in real estate values could put our existing portfolio in jeopardy, and negatively impact our ability to generate profits and pay dividends going forward. While the lower oil prices that have persisted since mid-2014 will likely continue to negatively impact the real estate market as 2016 proceeds, we believe that we are well positioned to continue to manage our mortgage portfolio and deliver attractive returns to shareholders, particularly given the signs of recovery seen in the oil market in recent weeks.

To sustain a profitable operation, Builders Capital requires a marketplace in which builders can be profitable. High real estate prices are not necessary; rather, profitability is dictated by the spread between raw land and construction costs and the final selling price. Construction costs have recently become inflated, particularly in Calgary. A reduction in real estate prices will result in a drop in raw land costs and, as we've begun to see in recent months, a concurrent drop in sub-trade costs as a result of decreased activity. Accordingly, we expect that margins on new construction will remain viable and we are optimistic that a smaller, but still profitable, construction marketplace in Alberta will allow us to keep our lending book in the province reasonably full. Our ideal borrower starts, completes and sells their projects quickly, and with a reasonable margin. We are confident that, even in the current challenging economic climate, there will still be a sufficient number of such borrowers.

Some construction lenders already appear to be pulling back from lending in Alberta. We believe that the tighter economic environment creates an opportunity for us to increase our market share, as our predecessor business has done under similar business conditions in the past. Canada Mortgage and Housing Corporation (CMHC), in its Fourth Quarter 2015 Housing Market Outlook, is forecasting Alberta single-detached housing starts of approximately 15,800 units in 2016, a slight increase over 15,600 in 2015, which should generate adequate demand for our services.

While Builders Capital is currently primarily invested in the Alberta market, with a concentration in Calgary, we have successfully taken the steps toward geographically diversifying our mortgage portfolio across Western Canada. In the past year, we reduced our Alberta holdings from 87% to 84% of the portfolio, and increased our mortgage holdings in British Columbia from 6% to 10% of our portfolio. In Alberta, our exposure to the wildfires that led to the evacuation of Fort McMurray in early May is limited as we currently have only one mortgage in the city.

We have a number of strategies in place to limit the risk that a down-turn in the economy poses to our mortgage portfolio. We maintain a prudent debt-to-equity ratio. Mortgage lending is generally restricted to 75% of what we believe to be the fair market value of a property at any given time, meaning that we have 25% of the value of the project in owners' equity ahead of us. We take a general allowance for doubtful accounts each quarter before paying dividends, allowing us to build a cushion of funds to further protect investors. We believe that our provision for loan losses is sufficient. However, should we deem it necessary, we can and will increase this allowance in future.

In addition, by investing only in short-term mortgages, we maintain the liquidity necessary to preserve capital. In the event that we believe a market has become too risky, we will work on converting our investments to cash, and will forego returns in order to protect the capital with which we've been entrusted.

Finally, safeguards built into our share structure give Builders Capital's public Class A Non-Voting shareholders priority on all capital and income distributions over our Class B Non-Voting shareholders. In the event of a serious decline in the earning potential or value of our portfolio, Class B shareholders would forego all distributions until the Class A shareholders have received both their 8% return and, in the case of a dissolution, their capital.

While we do anticipate having to take additional steps to collect on some of our mortgage assets over the coming months, we're confident in our ability to do so. Similarly, we believe that the necessary safeguards are in place to assure our ability to maintain the Class A Non-Voting Share dividend at 8% per annum.

While declining world oil prices are expected to reduce in-migration to Alberta, CMHC still forecasts a continued inflow of migrants, with net migration of 37,200 people in 2016. This will continue to drive a demand for housing, albeit at a somewhat subdued level. CMHC expects that housing starts in Alberta will also be impacted by oil pricing volatility in 2016, but to an extent that remains to be seen. It forecasts that total housing starts for the year will decline from 37,200 units in 2015 to 29,800 units in 2016, with a modest increase in 2017. In Saskatchewan, CHMC expects that total housing starts in 2016 will remain consistent with the 2015 level at 5,800 units, increasing modestly in 2017. In BC, total housing starts for the year are expected to decline slightly to 30,800 units from 31,300 units in 2015, with a further modest decline in 2017. Overall, we believe that the forecast levels of housing starts in our key markets are more than adequate to support the growth of our business.

Since our inception, we have had a sufficient number of quality lending opportunities to easily keep our capital fully utilized. Given the size of the marketplace, our current relatively small market share and the opportunities that exist to expand our geographic footprint, we expect to be able to continue to source sufficient quality lending opportunities to keep our capital fully utilized. We also have a continuing opportunity to purchase additional mortgages that meet our lending criteria from affiliates. While purchased mortgages do not generally provide a source of lender fee revenue, they do assist in keeping our capital fully utilized.

## **Risk and Uncertainties**

There are two primary areas of risk for us as a lender. The first is the risk that borrowers will fail to meet their obligations and repay mortgages as they come due. Secondly, there is a risk that sufficient quality investment opportunities will not be available to keep our capital fully deployed. As our primary goal is the preservation of our investors' capital, even at the expense of potential returns, we consider the risk of borrower default to be our primary concern.

A robust new-home construction market greatly reduces both of these risks, as it provides a strong marketplace into which builders can sell their completed projects, it maintains or increases the value of the security for our loans, and it provides an ongoing source of new projects and borrowers. A downturn in the market that substantially decreases security values could have a significant negative effect on our business. We cannot predict the performance of the housing market in the future with certainty.

In order to mitigate these risks, we restrict our loan amounts to a target of up to 75% of what we consider the fair market value of the security to be. The 25% equity component is a requirement for our borrowers and we believe it provides us with a sufficient margin for error in the event of a drop in



property values. The short-term nature of our loans also gives us the flexibility to convert our entire portfolio of mortgages to cash within a 12-month period, if economic conditions warrant. We also maintain sufficient construction expertise to allow us to economically complete any project on which we've loaned funds.

Our share terms provide that the Class A Non-Voting shareholders have a priority over other shareholders with respect to both the payment of dividends at an 8% rate, and any potential return of capital. This creates a significant reduction in the risk profile of the Class A Non-Voting Shares, as an impairment in the value of the mortgage portfolio, or a lack of funds available for distributions, will always be absorbed, to the full extent of their investment, by the Class B Non-Voting Shares before the Class A shareholders' rights are affected. We believe that this structure substantially reduces risk for the Class A shareholder.

Other risks and uncertainties exist for our business that are typical for business in general and for lenders in particular. These include changes in interest rates, potential environmental issues associated with the mortgage security, borrower solvency, any significant changes in competition, changes in tax legislation and other factors as described under Forward-Looking Information.

### **Additional Information**

Additional information about Builders Capital is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website at [www.builderscapital.com](http://www.builderscapital.com).