



## **Builders Capital Mortgage Corp.**

Management's Discussion and Analysis  
Quarter Ended June 30, 2017

## 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 August 28, 2017. It should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the 12 months ended December 31, 2016, available 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. These 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 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.

## **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.

## **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. All of our mortgages are tailored to the specific needs of residential builders, giving Builders Capital a competitive advantage in this sector of the construction market.

Our mortgage portfolio and operations are managed by Builders Capital Management Corp. (the manager) under a management agreement. The manager sources and services mortgage loans and directs the company's business operations. Under the terms of the management agreement, the manager provides staff, office space and equipment, and expertise required to operate the business of the company. The manager maintains extensive experience in all aspects of residential construction and in-depth, up-to-date residential real estate industry knowledge to ensure that it 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 such actions are conducted by the manager on behalf of the company.

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 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, though the manager, to complete and sell if necessary.

All of the loans we make to borrowers consist of promissory notes secured by collateral mortgages over real property. None of the mortgages are originally written for terms longer than one year. Subject to the satisfaction of Builders Capital's rigorous lending requirements, any or all of our mortgages may be, or may become, revolving in nature.

In some cases, the mortgage is intended to be repaid on or before the end of its original one-year term, which would typically coincide with the building project being completed and sold. In cases where the project has not been completed and/or sold by the end of the term, assuming that the manager is comfortable with the marketing efforts and security position, we will generally renew the mortgage to give additional time for completion and marketing. In these cases, no cash is usually received on the renewal, although we will sometimes require a payment or additional security on the loan.

In other cases, the intention is to continue financing the ongoing construction of projects for a borrower on a revolving basis. In these situations, each time a project is completed and sold, cash is received to pay-down the loan balance, in some cases to zero. As the loan balance is reduced, new projects can be added to the mortgage. At term-end, as builders will generally have a number of projects under construction at varying stages of completion, the mortgages are typically renewed and the builder draws down on the renewed mortgage to continue to fund their projects. In these cases, there is a revolving aspect to the loan but, again, no cash is expressly due upon the renewal.

Payments of principal, interest and fees are generally only required on the sale or refinancing of the property forming the security for our loan. However, our loan terms stipulate that we can expect payments after substantial completion of a project. Further, all of our mortgages are demand loans, which can be called at our discretion.

While our mortgages often revolve, and can continue to be renewed for multiple years, our goal is to keep the terms short on any one project and to have borrowers repay advances against each project on its completion, either through the sale of the property or by refinancing with another institution.

At inception, we target a loan to value ratio not exceeding 75%. However, calculating a loan to value ratio requires estimates of value, which are subject to uncertainty. For various reasons, including accruing interest, delays in completion of projects and changing market values, this target ratio is sometimes exceeded. We generally consider any loan that exceeds an estimated 85% loan to value to be impaired.

## **Q2 2017 Summary**

### **Performance Highlights**

- Consistent with our targeted distribution, dividends paid to Class A public shareholders in the quarter totaled \$0.1995 per share, or 8% of the original \$10.00 issue price.
- Quarterly mortgage revenue of \$0.87 million represented an annualized 14.2% of gross share capital, compared to \$0.86 million, or an annualized 14.7% of gross share capital, in Q2 2016.
- We improved our invested capital turnover rate to 29.6% from 28.6% in Q2 2016.
- 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 within expectations at 9.5% of revenues.
- At quarter-end, our debt-to-equity ratio was a conservative 16.7%.
- Earnings exceeded the amount required to pay planned Class A Non-Voting Share dividends by a healthy 1.9 times.

### **Business Environment**

- Real estate markets in our primary Southern Alberta marketplace showed initial signs of stabilizing in Q2 2017; however, the economic impacts of the province's two-year recession continued to be felt.
- 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 have pulled back from lending in Alberta, we believe that the tighter economic environment has created an opportunity for us to increase market share.
- Margins on new construction are expected to remain viable, benefitting from relatively low raw land and sub trade costs following the extended market downturn.

- Home sale prices are beginning to stabilize.
- Based on Canada Mortgage and Housing Corporation forecasts for 2017/2018, we believe housing starts in our western Canadian markets will be more than adequate to support the growth and continued geographic diversification of our business.

## Financial Overview

	Three months ended June 30, 2017 \$	Three months ended June 30, 2016 \$	Three months ended June 30, 2015 \$
Revenues	866,259	856,584	964,761
Earnings and total comprehensive earnings	625,909	677,932	772,711
Total assets	29,102,839	26,613,516	26,669,379
Shareholders' equity	24,941,461	22,907,067	23,699,823
Basic and fully diluted earnings per share	0.26	0.29	0.32
Cash dividends declared	627,214	630,272	676,628
Cash dividends declared per Class A share	0.1995	0.1995	0.1995
Cash dividends declared per Class B share	0.2346	0.3677	0.3989

## Investment Portfolio

At June 30, 2017

Property Type	Mortgage Portfolio (No.)	Outstanding Balance (\$)	Total Committed Mortgage Principal (\$)	%	AAM Allocation*
<b>Residential</b>					
Single family – Detached	21	20,598,351	24,290,000	77%	100%
Single family – Attached	4	6,036,911	7,475,000	23%	100%
<b>Total:</b>	<b>25</b>	<b>26,635,262</b>	<b>31,765,000</b>	<b>100%</b>	<b>N/A</b>
<b>Geographic Location of Property</b>					
Calgary and Area	12	16,373,062	20,655,000	61%	100%
Edmonton and Area	1	2,300,547	3,000,000	9%	100%
Other Alberta	8	4,317,052	4,360,000	16%	100%
British Columbia	3	2,684,131	2,800,000	10%	50%
Saskatchewan	1	960,470	950,000	4%	25%
<b>Total:</b>	<b>25</b>	<b>26,635,262</b>	<b>31,765,000</b>	<b>100%</b>	<b>N/A</b>
<b>Interest Rate (excluding fees)</b>					
Less than 11%	5	7,115,679	9,650,000	27%	N/A
11%-11.99%	2	3,325,069	7,875,000	12%	N/A
12%-12.99%	13	6,381,744	4,935,000	24%	N/A
Greater than 12.99%	5	9,812,770	9,305,000	37%	N/A
<b>Total:</b>	<b>25</b>	<b>26,635,262</b>	<b>31,765,000</b>	<b>100%</b>	<b>N/A</b>
<b>Original Funding Date **</b>					
Calendar 2017	6	5,273,909	8,360,000	24%	N/A
Calendar 2016	9	6,533,988	8,075,000	36%	N/A
Calendar 2015	4	5,047,369	4,305,000	16%	N/A
Calendar 2014 or earlier	6	9,779,996	11,025,000	24%	N/A
<b>Total:</b>	<b>25</b>	<b>26,635,262</b>	<b>31,765,000</b>	<b>100%</b>	<b>N/A</b>

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

\*\*Loans are originally written for terms of up to one year but are renewed in cases where a builder continues to roll new security onto the loan facility or if the project has not been sold but is still progressing or being actively marketed.

## Operating Results for the Three Months Ended June 30, 2017

Despite lingering economic challenges in our primary Southern Alberta marketplace, we maintained a full mortgage book through the second quarter of 2017. We remain comfortable with the value of our portfolio and our provision for mortgage losses, and confident in our ability to prosper in the current market conditions.

Cash advances and invoiced interest totaled \$11 million for the second quarter, up from \$6.3 million in Q2 2016 and \$6.9 million the previous quarter. These advances were offset by \$2.2 million in mortgage repayments. Based on an average of incoming and outgoing cash, we turned over 29.5% of our net invested capital during the quarter, which equates to an annualized turnover rate of one turn every 10.1 months. This was in line with our expectations and compares favourably to our fiscal 2016 cash turnover rate of one turn in 12 months. As market conditions improve, we expect to continue moving closer to the nine-month cash turnover rate that we target, which will assist in the generation of fee revenue and contribute to overall returns.

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 second quarter of 2017, we purchased no mortgages and sold \$5.1 million worth, which is consistent for the year-to-date as there were no purchase or sale transactions in the first quarter of the year. All of the sale transactions during the period were conducted with Builders Capital (2014) Ltd., a privately held corporation owned by certain directors of the company.

Our weighted average loan-to-value ratio remains higher than we would like, reflecting the extended period of weakness in the Alberta real estate market, which has lowered selling prices and lengthened marketing times. When investing in mortgages, we target a loan-to-value ratio not exceeding 75%. At quarter-end, our weighted average ratio was approximately 77.1%, with five loans exceeding our 85% threshold and thus deemed at risk of default. We are closely watching these projects and have earmarked funds from our allowance for doubtful loans to be applied as necessary. In three cases, we are currently pursuing foreclosure. In the remaining two cases, sales of the properties are imminent and, as a result of these transactions, we expect our weighted average loan-to-value ratio to return to our targeted level in the near future.

During the quarter, we unexpectedly had to push a mortgage covering two properties to foreclosure when we became aware of the borrower's deteriorating financial condition. The repossessed properties are for sale and are carried in our financial statements at their appraised values, totaling \$2.6 million. To protect our position, we paid out the first mortgage on the properties in the amount of \$988,000. Unfortunately, a write-down of \$195,000 was required on the original mortgage. This amount has been taken from our accumulated allowance for loan losses. To replenish the allowance, we added \$61,000 to our planned second quarter accrual for loan losses and will add a similar amount in each of the coming two quarters.

Builders Capital is committed to ensuring that our allowance for doubtful accounts remains sufficient to cover any further write-downs that occur as a result of actions undertaken on at-risk properties. 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 is our minimal use of leverage. Our debt-to-equity ratio at the end of the quarter was a modest 16.7%. The only debt that we employ is our line of credit, which is used primarily as a cash flow tool to facilitate making advances to borrowers. Keeping our debt to a minimum leaves us free from the influence of creditors and allows us the flexibility to manage our loan portfolio to our best advantage in different types of market conditions.

At quarter-end, the total value of our mortgage portfolio was \$26.6 million, which was consistent with the prior year, allowing for increases in our share capital over the past 12 months. The portfolio was made up of 25 mortgages with an average outstanding balance of \$1.1 million.

### **Revenue**

Mortgage revenue for the second quarter of 2017 was \$866,000, up by 1.1% from the \$856,000 reported for the second quarter of 2016. For the six months ended June 30, 2017, revenue was \$1.7 million, representing a 4.9% decrease from \$1.8 million in the same period of 2016.

At June 30, 2017, the weighted average interest rate on our mortgages was 11.66%, down from 12.87% at June 30, 2016. This change reflects our focus on building a higher-quality, lower-risk mortgage portfolio.

The three-month revenue consisted of \$794,000 in interest and \$72,000 in lender fees charged to borrowers, equating to annualized gross revenue of 14.2% of the weighted average gross share capital, compared to 14.7% for Q2 2016. The six-month revenue comprised \$1.5 million in interest and \$133,000 in lender fees, representing annualized gross revenue of 13.9% of the weighted average gross share capital, compared to 15.1% in 2016.

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 existing loans are renewed. Lender fees are maximized when turnover in the portfolio is highest. Lender fees in the second quarter were up by 17.8% over Q2 2016 and year-to-date lender fees were down slightly, decreasing by 3.6% from the 2016 amount. Lender fees in the quarter exceeded the management fee expense by 17.7%. Based on the increased turnover of our capital, we anticipate that lender fees will also increase going forward.

### **Expenses**

Excluding funds set aside to provide for loan losses and interest expense, second quarter operating expenses were within expectations at \$82,000, down from \$90,000 last year. The 2017 expenses represented 9.5% of revenue, down from 10.4% of revenue in 2016. Year-to-date operating expenses of \$162,000 were down by 4.4% from \$170,000 in 2016, representing 9.7% of revenue, the same percentage as last year. The company's operating expenses have remained reasonably consistent over time and we expect they will remain within expectations.

The second quarter provision for loan losses was \$125,000, an estimate based on an analysis of Builders Capital Management Corp, which manages the mortgage portfolio, as well as a current analysis of the

construction finance marketplace. The provision is collective, calculated by reference to the portfolio as a whole. As discussed above, the amount set aside in Q2 was increased following a draw-down in the allowance as a result of an unexpected foreclosure. To-date, we have accumulated a total of \$1.1 million to provide for loan losses, of which \$783,000 has been applied against specific foreclosed properties or discharged mortgages. Given the increased accruals planned for the next two quarters, we believe the remaining \$293,000 is sufficient to cover potential write-downs currently contained in the mortgage portfolio, and we will continue to set aside amounts that we consider prudent to cover future potential loan losses.

Management fees were \$61,000 for the second quarter and \$120,000 for the six-month period, 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 Alberta has picked up somewhat, we have been sourcing additional mortgage investments, and have drawn on our line of credit to fund these additional mortgage loans. At quarter-end, our line of credit stood very close to its limit of \$3.5 million and our funds were fully utilized. Use of the line of credit in the quarter generated interest expense of \$34,000, up from \$26,000 in Q2 2016. Year-to-date interest expense was \$49,000, down by 5% from the \$52,000 incurred in the first six months of 2016.

### **Comprehensive Income**

As expected, our strategy of charging slightly lower rates to borrowers in order to ensure a full mortgage book and higher quality lending opportunities had a negative impact on second quarter comprehensive income. Our results were also impacted by the increase in our Q2 provision for mortgage losses. Due to the combined impact of these factors, second quarter comprehensive income decreased by 7.7% to \$626,000, or \$0.26 per share, from \$678,000, or \$0.29 per share, in Q2 2016.

For the six-month period, comprehensive income of \$1.3 million (\$0.52 per share) was down by 10.8% from \$1.4 million (\$0.60 per share) in 2016.

The decrease in comprehensive income did not affect dividends to our Class A Non-Voting shareholders in the second quarter. 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 in the quarter were \$0.26 per share overall, but were \$0.42 per Class A Non-Voting Share. These earnings exceeded the amount required to satisfy the 8% dividend committed to the Class A Non-Voting shareholders by 2.1 times. With Class B Non-Voting shareholders bearing a much greater proportion of the risk of income fluctuations, even if earnings had been only 47% 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 will not affect the payment of our Class A Non-Voting Share dividends.

In order to maintain distributions on the Class B Non-Voting Shares, we have been actively working to raise capital from the sale of additional Class A Non-Voting Shares. Increasing the number of Class A

Non-Voting Shares will change the ratio between our share classes. As the ratio of Class A to Class B shares rises, the Class B Non-Voting Share returns should also begin to rise.

### **Share Issuance and Financing Costs**

On May 31, 2017, we closed a public offering for 219,975 Class A Non-Voting shares at \$10.00 per share for gross proceeds of \$2,199,750. The net proceeds of this offering were almost immediately required in general operations and were quite quickly invested in new mortgage loans.

Subsequent to the quarter-end, on July 25, 2017, we closed a private placement for an additional 50,000 Class A Non-Voting shares at \$10.00 per share for gross proceeds of \$500,000. The net proceeds of this offering have also been invested in mortgage loans.

Financing costs since inception total \$2.1 million, including professional fees for prospectus preparation; 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 shareholder distributions to less than 100% of net income in order to utilize the tax deductibility of these payments. 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 June 30, 2017, total assets were \$29.1 million (Q2 2016 – \$26.6 million), consisting primarily of funded mortgages. The increase in total assets since June 30, 2016 was due to the new mortgage advances funded with proceeds from share sales in the quarter. Also included in total assets is a single building lot located in Fort McMurray, Alberta that was repossessed in 2016 and two building lots in Richmond, British Columbia that were repossessed during the quarter. All three properties are being carried at their estimated fair market values.

Liabilities at quarter-end totaled \$4.2 million (Q2 2016 – \$3.7 million), comprising the line of credit balance; dividends relating to the fiscal quarter, which were paid on July 31, 2017; trade payables; balance due to Builders Capital Management Corp.; and deferred lender fees.

## Quarterly Financial Information

	Quarter ended June 30 2017 \$	Quarter ended March 31 2017 \$	Quarter ended December 31 2016 \$	Quarter ended September 30 2016 \$	Quarter ended June 30 2016 \$	Quarter ended March 31 2016 \$	Quarter ended December 31 2015 \$	Quarter ended September 30 2015 \$
Revenues	866,259	801,765	835,278	807,359	856,584	898,301	879,036	967,321
Earnings and total comprehensive earnings	625,909	626,712	669,068	646,032	677,932	726,211	656,198	778,722
Total assets	29,102,839	24,503,762	23,678,390	24,610,504	26,613,516	24,485,930	24,256,975	26,578,841
Shareholders' equity	24,941,461	23,017,258	23,128,607	23,181,001	22,907,067	22,859,407	22,403,083	23,787,589
Basic and fully diluted earnings per share	0.26	0.26	0.28	0.28	0.29	0.31	0.27	0.32
Cash dividends declared	627,214	638,626	644,549	640,651	630,272	269,886	1,108,710	681,872
Cash dividends declared per Class A share	0.1995	0.1973	0.2016	0.2016	0.1995	0.1973	0.2216	0.2016
Cash dividends declared per Class B share	0.2346	0.3119	0.3717	0.3677	0.3677	0.3667	0.4234	0.4032

## **Distributions**

Under our two-tiered share structure, 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 June 20, 2017, based on income for the second quarter, the company's Board of Directors declared a dividend of \$0.1995 per Class A Non-Voting Share to shareholders of record on June 30, 2017. This distribution was paid on July 31, 2017 and is recorded as payable in the accompanying financial statements. The dividend amount was calculated to provide an annualized 8% on the \$10.00 initial Class A Non-Voting Share price.

Subsequent to quarter-end, on July 25, 2017, again based on income for the second quarter of 2017, the Board declared a dividend of \$0.2346 per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on July 31, 2017. This dividend is not recorded in these financial statements, but is noted in the last line of the table above as it was calculated based on Q2 earnings.

## **Liquidity and Capital Resources**

Cash flow and liquidity are critical to our success. We monitor both daily to ensure we can meet the expectations of our borrowers.

In the second quarter, liquidity was good and cash inflows were sufficient to fund our committed cash outflows, despite delays to some of our projected mortgage pay-downs as a result of the slower Alberta real estate market.

During the three months, mortgages were funded in the amount of \$10.2 million and \$2.2 million was received 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.

Our mortgage portfolio turns over approximately annually. We expect that borrower repayments will remain at a reasonably consistent level throughout 2017 and plan to again fund mortgages in amounts approximately equal to the mortgage repayments received. It is likely that a number of our mortgages will be renewed as they come due, as discussed earlier under Operations.

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. As noted in the table titled Investment Portfolio above, we have mortgage commitments to borrowers totaling \$31.8 million, which exceed the current amounts funded by \$5.1 million. We anticipate funding these commitments through the repayment of existing mortgages. Should mortgage repayments fall short of our commitments, we have a number of tools to manage liquidity and to ensure that commitments can be met. Included are 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.

Since inception, almost all of the sales and purchases of mortgages, which have both helped keep the mortgage book full and been a source of liquidity as required, have been to and from related parties, in particular Builders Capital (2014) Ltd. ("BCL"). BCL is a privately held corporation, of which Builders Capital directors Sandy Loutitt and John Strangway are also both directors. The company has often been reliant on BCL as a vendor and purchaser of mortgages and as a source for liquidity, including at certain times of low cash flow, for payment of dividends. This reliance means that if BCL was unwilling, or unable, to act as a purchaser or vendor of mortgages, the company would have to leave a substantially larger margin for error in our cash management practices, which would reduce profitability. The company expects to continue to be able to rely on BCL as a source of liquidity in the future. It is unlikely we could find another party that could provide liquidity as quickly or as efficiently.

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. In the fourth quarter of 2016, we filed a preliminary prospectus and commenced marketing to close an additional capital raise. On May 26, 2017, we received a receipt for the final prospectus and, as earlier noted, we closed our public offering on May 31, 2017. In total, 219,975 Class A non-voting shares were issued at \$10.00 per share for gross proceeds of \$2,199,750. Financing costs associated with this offering were approximately \$560,000.

According to our share terms, Class A Non-voting shareholders have an annual right to redeem their shares on October 31 each year at 95% of Net Asset Value. Payment for the redemptions is to be made on November 30.

## **Related Party Transactions**

Our manager is a company controlled by Sandy Loutitt and John Strangway, who are both also directors of Builders Capital. 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 \$61,000 for the quarter (Q2 2016 - \$58,000).

In addition to the management fee, the manager charges lender fees directly to borrowers both on loan originations and on loan renewals, with 28.6% of these fees being paid to the company and the remaining 71.4% going to the manager. The company collects these fees from the borrower, both on our own behalf and on behalf of the manager, by adding them to the principal amount of the mortgage, generally on the first advance to the borrower. The company then pays the manager's share of the fees to the manager, regardless of whether or not any payments have been received on the mortgage. Such payments to the manager are generally made within 30 days of having been charged to the borrower. Renewal fees are also charged to the borrower and paid to the manager during the term of the mortgage. During the quarter, the amount of these fees collected on behalf of the manager totaled \$112,000 (Q2 2016 - \$157,000).

In general, mortgages are purchased when the company has excess cash on hand, quality mortgages are available to purchase, and opportunities to immediately fund additional mortgages are not available.

The acquisition of mortgages helps us to minimize excess balances and maximize interest revenue. Mortgages are sold when, despite the line of credit being fully drawn, additional cash is required, or is forecast to be required, to fund mortgage draws and commitments. Often, mortgages purchased are subsequently sold back and vice versa. The purchase and sale of mortgages sometimes results in balances due to or from related parties being outstanding for short periods of time. These balances are unsecured and are non-interest bearing. During the quarter ended June 30, 2017, \$5.1 million in mortgages were sold and none were purchased.

## **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 Board of Directors and Audit Committee provide an oversight role with respect to our public and financial disclosures. Both have reviewed and approved this MD&A and the accompanying condensed consolidated financial statements for the quarter ended June 30, 2017.

## Outstanding Share Data

The company's authorized share capital as at August 28, 2017 consists of 1,000 Voting Shares, of which 100 were outstanding at year-end; an unlimited number of Class A Non-Voting Shares, of which 1,670,270 were outstanding at quarter-end; and an unlimited number of Class B Non-Voting Shares, of which 974,576 were outstanding at quarter-end.

## 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.

In each of our three key provincial markets, the outlook is largely favourable.

We continue to see signs that the worst of the downturn in Alberta's housing market may have passed. Recent data from the Canadian Real Estate Board (CREA) showed a 9.8% increase in Alberta residential sales activity in the first seven months of 2017 and a 3% increase for the month of July 2017, compared to the same periods in 2016. Also according to CREA, the provincial average price for homes sold in the first seven months of 2017 was 2% higher than a year earlier, although the July 2017 average price was 1.8% lower than it was in July 2016.

While we believe it will take time for a market recovery to fully materialize in Alberta, the longer-term outlook for the province has become more positive. Slightly higher oil prices forecast for later in 2017 are expected to stabilize investment in the province, contributing to economic and employment growth that will gain momentum in 2018, in turn driving up housing starts. Canada Mortgage and Housing Corporation (CMHC) forecasts that total housing starts in Alberta for 2017 will be between 21,800 and 23,800 units with starts expected to increase to between 22,900 and 25,900 units in 2018.

In BC, the economy is expected to expand through 2018, benefiting from growth in domestic and internal demand for goods and services, which should keep housing starts above long-term averages. According to CMHC, total starts in 2017 are expected to moderate somewhat from the level of activity in 2016, but still be between 32,000 and 34,300 units, with a similar outlook for 2018 at 29,700 to 32,000 units.

Finally, in Saskatchewan, CMHC forecasts that economic expansion in 2017 and 2018 will drive an upward trend in home construction. Housing starts for 2017 are forecast to range from 4,600 to 5,200 units, increasing to between 4,900 and 5,500 units in 2018.

Overall, we believe that the projected levels of housing starts in our key markets are more than adequate to support the growth of our business in the near term. We also expect that margins on new construction will remain viable, particularly in Alberta, where building costs have generally decreased and selling prices appear to be stabilizing.

While our market outlook is improving, we caution that the extended downturn in Alberta has taken its toll on builders. Over the past 12 months, we have foreclosed on seven properties and sold four of them. It remains entirely possible that we will need to take additional steps to collect on some of our



mortgage assets over the coming months. That said, we are optimistic that the foreclosures have weeded out the most significant vulnerabilities in the portfolio. 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.

These safeguards include maintaining a prudent debt-to-equity ratio. Our 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 plan to 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. Should we deem it necessary, as was the case this quarter, we can increase this allowance to ensure that our provision for loan losses remains sufficient.

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. As demonstrated during the second quarter, with the impact of our increased allocation of funds against potential loan losses borne entirely by Class B Non-Voting shareholders, this structure is functioning as intended.

Going forward, we are confident of our ability to keep our capital fully utilized and to continue to grow our business. Given the size of the marketplace, our current relatively small market share, the opportunities that exist to expand our geographic footprint, we are well positioned to continue sourcing high-quality lending opportunities. 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 employed.

## **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).