Builders Capital Mortgage Corp.

Management's Discussion and Analysis
Year Ended December 31, 2018

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 April 29, 2019. It should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2018, available on SEDAR at www.sedar.com and on our website at www.builderscapital.ca. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). 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 an 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 31st 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, as well as the 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 in order 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, through 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 become concerned about collectability when any loan exceeds an estimated 85% loan to value.

Fiscal Year Summary

Performance Highlights

- Consistent with our targeted distribution, dividends paid to Class A public shareholders in 2018 were $0.80 per share, representing an 8% annual return on the original $10.00 issue price.
- Annual mortgage revenue of $3.4 million represented an annualized 12.4% of gross share capital calculated on the weighted average shares outstanding, compared to 3.4 million, or 13.3% of gross share capital in 2017.
- At year-end, our debt-to-equity ratio was a conservative 10.2%.
- Earnings exceeded the amount required to pay planned Class A Non-Voting Share dividends by a healthy 1.3 times.

Business Environment

- Conditions in the Alberta real estate market remained slow throughout 2018 with the number of residential sales in the province declining by 4,135 units, or 7.2% and the average MLS sales price down 2.6% year-over-year according to the Alberta Real Estate Association.
- The Canadian Mortgage and Housing Corporation (CMHC) anticipates that Alberta's housing markets will gradually transition to more balanced conditions in 2019 and 2020, supported by gradual improvement in employment and demographic fundamentals.
- Margins on new construction continue to be viable, benefitting from relatively low raw land and sub trade costs in the Alberta market.
- Overall, we believe housing starts in our western Canadian markets will be adequate to support the long-term growth and continued geographic diversification of our business.

Financial Overview

	Year ended December 31, 2018 $	Year ended December 31, 2017 $	Year ended December 31, 2016 $
Revenues	3,429,265	3,364,860	3,397,522
Total comprehensive income	1,924,711	2,382,194	2,719,244
Total assets	28,918,136	31,418,419	23,678,390
Shareholders' equity	26,250,889	25,683,552	23,128,607
Basic and diluted earnings per share	0.70	0.94	1.15
Cash dividends declared	2,171,973	2,376,866	2,185,358
Cash dividends declared per Class A share	0.80	0.80	0.80
Cash dividends declared per Class B share	0.74	1.12	1.11

Investment Portfolio

At December 31, 2018

Property Type	Mortgage Portfolio (No.)	Outstanding Balance ($)	Total Committed Mortgage Principal ($)	%	AAM Allocation*
Residential					
Single family – Detached	19	15,460,246	22,520,000	56%	100%
Single family – Attached	10	12,218,077	14,435,550	44%	100%
Total:	**29**	**27,678,323**	**36,955,550**	**100%**	**N/A**
Geographic Location of Property					
Calgary and Area	19	20,480,712	26,075,550	74%	100%
Edmonton and Area	4	4,111,457	5,750,000	15%	100%
Other Alberta	3	1,545,640	1,540,000	5%	100%
British Columbia	3	1,540,514	3,590,000	6%	50%
Total:	**29**	**27,678,323**	**36,955,550**	**100%**	**N/A**
Interest Rate (excluding fees)					
Less than 11%	7	9,111,677	12,410,550	33%	N/A
11%-11.99%	5	4,521,314	4,880,000	16%	N/A
12%-12.99%	16	12,329,513	17,865,000	45%	N/A
Greater than 12.99%	1	1,715,819	1,800,000	6%	N/A
Total:	**29**	**27,678,323**	**36,955,550**	**100%**	**N/A**
Original Funding Date **					
Calendar 2018	16	13,383,627	15,175,550	48%	N/A
Calendar 2017	5	6,535,659	9,200,000	24%	N/A
Calendar 2016	2	770,809	3,350,000	3%	N/A
Calendar 2015	3	3,174,188	3,105,000	11%	N/A
Calendar 2014 or earlier	3	3,814,040	6,125,000	14%	N/A
Total:	**29**	**27,678,323**	**36,955,550**	**100%**	**N/A**

*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 and Twelve Months Ended December 31, 2018

Our mortgage portfolio remained reasonably consistent throughout 2018, including through the final quarter of the year, varying by only 3.2% over the 12 months. Assets held for sale and share capital remained consistent throughout the fourth quarter of 2018 with activity levels slowed due to ongoing economic challenges in our primary Southern Alberta marketplace.

Cash advances and invoiced interest totaled $5.3 million for the fourth quarter, up 7% from the $4.9 million achieved in the same period last year, but still substantially lower than our most productive quarters. For the current fiscal year, cash advances and invoiced interest were $24.8 million, down 9.5% from $27.4 million in 2017.

The Q4 2018 and the annual 2018 advances were offset by $5.5 million and $28.2 million in mortgage repayments respectively. Based on an average of incoming and outgoing cash, we turned over 21.1% of our weighted average net invested capital during the quarter and 105% of our net capital in the year. The annual figure equates to one full cycling of net invested capital every 11.5 months. While this was still below our targeted capital turnover rate, it is an improvement on the 90.4% of net capital turned over in 2017. As market conditions improve, we hope to be able to liquidate our property inventory positions and to be able to source additional profitable loans in order to move closer to our targeted nine-month capital turnover rate. At the end of the year, we remain comfortable with the value of our portfolio and our provision for mortgage losses, and we are confident in our ability to prosper as the market gradually returns to more balanced conditions.

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 2018 fiscal year, we respectively purchased and sold $4.9 million and $0.7 million in mortgages. All of the purchase and sale transactions 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 slightly 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 ("LTV") ratio not exceeding 75%. At quarter-end, our weighted average ratio was approximately 79%, in line with the 79% we reported at the end of Q3 and slightly higher than the 78% achieved at the end of 2017. Loans which exceed our 85% threshold are deemed at risk of default and we closely watch these projects and generally earmark funds from our allowance for doubtful loans to be applied as necessary.

During 2018, we reduced our portfolio of foreclosed properties from three properties with a combined carrying value of $3.5 million, to two properties with a combined carrying value of $1.9 million. Subsequent to the year-end, we foreclosed on two additional mortgages, which combined, represent eight properties. The first of these mortgages was for three homes under construction in Edmonton. Of these three properties, two are now under firm contracts for sale and the third is listed for sale with an asking price of $1.1 million. The second foreclosure was on a mortgage for a partially finished multi-family townhouse project in Calgary. We have taken back four incomplete units on which finishing is currently underway, and one complete unit which is listed for sale. These two mortgages have been assessed as impaired at the year-end and the estimated credit losses have been allowed for in the consolidated financial statements.

We note that the reduction in profitability related to unproductive inventory and to the additional provisions required for mortgage losses has had no impact on dividends paid to owners of our Class A Non-Voting Shares. The 8% return paid on the Class A Shareholders' original $10 share price is always declared and paid prior to any dividends being declared on the Class B Non-Voting Shares. Our quarterly earnings would have had to drop an additional 36% before the Class A Non-voting share dividends would have been affected. We are pleased that the share structure created to safeguard the capital and dividends of the public Class A shareholders is functioning as designed.

Further reducing shareholder risk is our minimal use of leverage. Generally, 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. In the final quarter of 2017 we borrowed an additional $1.3 million, secured by our assets held for sale, to mitigate the impact of unproductive assets. We repaid one half of this loan in August of 2018 and will repay the remainder as inventory is sold. As difficult market conditions have persisted, we have become more conservative in our lending, and have been reducing our line of credit balance. Accordingly, our debt-to-equity ratio stood at 10.2% at year-end, down from 22.3% at December 31, 2017 and 11.7% at September 30, 2018. Keeping our debt to a minimum is a priority for us as it leaves us free from undue influence of creditors and allows us the flexibility to manage our loan portfolio to our best advantage in different types of market conditions.

At the end of 2018, the total value of our mortgage portfolio, before taking into account our $712,849 allowance for mortgage losses, was $27.7 million, which was 1.6% less than at the end of fiscal 2017. This small decrease is consistent with our more conservative approach to lending and to the use of debt. As at December 31, 2018, our loan portfolio was made up of 29 mortgages with an average outstanding balance of $954,000.

Revenue

For the three months ended December 31, 2018, mortgage revenue increased 5% to $884,000, from $842,000 in the fourth quarter of 2017. For the year ended December 31, 2018, revenue increased to $3.4 million, 1.9% higher than in fiscal 2017.

At December 31, 2018, the weighted average interest rate on our mortgages was 11.67%, up from 11.31% at December 31, 2017. Our goal going forward is to maintain our interest rates at or near this level.

Fourth quarter 2017 revenue consisted of $817,000 in interest and $67,000 in lender fees charged to borrowers, equating to annualized gross revenue of 12.7% of the weighted average gross share capital. This compares to 12.5% for Q4 2017. The 12-month revenue was comprised of $3.2 million in interest and $249,000 in lender fees, representing annualized gross revenue of 12.4% of the weighted average gross share capital. This compares to 13.3% in 2017.

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 fourth quarter increased by 2.7% compared to Q4 2017, however fiscal 2018 lender fees were 6.5% lower as compared to fiscal 2017. Lender fees as a proportion of management fees were 95.3% in the fourth quarter and 90.1% on a full year basis. Our goal is to keep lender fee revenue consistently above

management fee expense and we expect to make further progress towards this goal as market conditions improve.

Expenses

Excluding funds set aside to provide for loan losses and interest expense, fourth quarter operating expenses decreased by 4.4%, or $5,000, to $102,000, compared to Q4 2017. This represented 11.6% of revenue as compared to 12.7% last year. Annual operating expenses of $389,000 were up 3.2% from $377,000 in 2017 and represented 11.3% of revenues as compared to 11.2% during the same period last year. Our goal is to keep operating expenses within 10% of revenues and we will continue to closely monitor our expenses as we work toward this target.

In the fourth quarter, we recorded a provision for mortgage losses of $449,000, up three times over the provision taken in the fourth quarter of 2017. The substantial increase in the provision was a result of a number of issues including the two foreclosures mentioned above, our continuing efforts to sell a vacant lot in Richmond, B.C. and ongoing weakness in real estate markets in Western Canada in general. For the fiscal year, our total provision for mortgage losses was $872,000, up almost twice from the prior year. These larger provisions are intended to ensure that the carrying value of both our mortgages receivable and our assets held for sale reflect true fair values. Our expectation is that this level of write-down will not be required again in the foreseeable future and that we will return to amounts similar to the average of $109,000 per quarter that we have recorded since the beginning of 2014.

Management fees were $71,000 for the fourth quarter and $276,000 for the year, calculated on the total gross amount of Class A and Class B Non-Voting Shares outstanding. As we continue to grow our capital base, these fees will continue to increase, but our expectation is that they will be more than offset by increasing revenues.

Interest expense applies to our operating line of credit, which we use as a cash flow tool to fund mortgage draws. Interest expense also applies to the loan drawn in the fourth quarter of 2017, which is secured by assets held for sale and half of which was repaid in 2018. 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. A short-term reduction in new mortgage investments resulting from our disciplined mortgage selection process, combined with the reduction in assets held for sale, enabled us to reduce our line of credit in the fourth quarter of 2018. As at December 31, 2018, our line of credit balance was $1.4 million as compared to $3.8 million at the end of 2017. Accordingly, fourth quarter interest expense was also lower at $41,000, as compared to $58,000 in Q3 2018 and $64,000 in Q4 2017. For the fiscal year, interest expense was higher at $243,000 as compared to $161,000 in 2017.

Total Comprehensive Income

Our fourth quarter comprehensive income results were negatively influenced by foreclosures which occurred subsequent to the quarter end, but which required provisions for loan losses to be set aside in Q4 2018. Generally slow market conditions have also reduced the turnover in our loan book and required us to be more conservative in our lending. As a result of these factors, fourth quarter comprehensive income decreased by 45.2% to $292,000, or $0.10 per share, from $533,000, or $0.20 per share, in Q4 2017. For the full year, comprehensive income of $1.9 million ($0.70 per share) declined by 19.2% from $2.4 million ($0.94 per share) in 2017.

The decrease in comprehensive income did not affect dividends paid to our Class A Non-Voting shareholders in the year. 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 year were $0.70 per share overall, but were $1.06 per Class A Non-Voting Share. These earnings exceeded the amount required to satisfy the 8% ($0.80 per share) dividend committed to the Class A Non-Voting shareholders by 1.3 times. With Class B Non-Voting shareholders bearing a much greater proportion of the risk of income fluctuations, even if earnings had been only 75% 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 in relation to the Class B Non-Voting Shares will improve the Class B Non-Voting share returns in any period during which our net earnings exceed an 8% overall return on capital. On June 30, we exchanged 50,000 Class B Non-Voting Shares for 50,000 Class A Non-Voting Shares further improving our ratio which now stands at 2:1, up from 1.4:1 after our initial public offering. Our share terms limit the ratio to no greater than 3:1.

Share Issuance Costs
Share issue costs since inception total $2.3 million, including professional fees for offering document preparation; offering, agent and brokerage fees and commissions; and other marketing and offering costs. In accordance with IFRS, these share issue costs are accounted for 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.

Statement of Financial Position
At December 31, 2018, total assets were $28.9 million (2017 – $31.4 million), $1.9 million (6.7%) of which was tied up in assets held for sale. This compares favourably to December 31, 2017 when 11.3% of total assets were tied up in assets held for sale. The balance of total assets is primarily funded mortgages.

The $2.5 million change in total assets since December 31, 2017 reflects approximately $3.1 million in resources having gone towards reducing debt, offset by an additional $1.1 million in share capital. In addition, retained earnings are $493,000 less than they were at the end of the prior year. In 2018, dividends declared exceeded total comprehensive income by $246,000 due primarily to the larger provisions for mortgage losses which were necessary as a result of both current and future foreclosures. As well, a change in accounting policy as required by new International Financial Reporting Standard

IFRS9, *Financial Instruments*, resulted in a one-time charge to retained earnings of $247,000. This charge is discussed further in the consolidated financial statements.

Assets held for sale include one building lot in Richmond, British Columbia that was repossessed during Q2 2017, and one completed home in Saskatoon, Saskatchewan. Both properties are being carried at their estimated fair market value.

Liabilities at year-end totaled $2.7 million (2017 – $5.7 million) and were comprised of: the balance on our line of credit; dividends relating to the fiscal quarter paid on January 31, 2019; our trade payables; the balance due to Builders Capital Management Corp.; deferred lender fees and a loan payable which was first drawn in the fourth quarter of 2017.

The company was in compliance with all bank covenants relating to the line of credit and the loan payable and had no off-balance sheet arrangements during the year.

Quarterly Financial Information

	Quarter ended December 31 2018 $	Quarter ended September 30 2018 $	Quarter ended June 30 2018 $	Quarter ended March 31 2018 $	Quarter ended December 31 2017 $	Quarter ended September 30 2017 $	Quarter ended June 30 2017 $	Quarter ended March 31 2017 $
Revenues	884,185	870,441	845,660	828,979	842,234	854,603	866,259	801,765
Earnings and total comprehensive earnings	292,116	563,880	492,823	575,892	533,613	595,960	625,909	626,712
Total assets	28,918,136	29,898,420	33,234,463	30,060,233	31,418,419	30,005,779	29,102,705	24,503,762
Shareholders' equity	26,250,889	26,768,731	26,522,452	25,679,439	25,683,552	25,296,956	24,941,461	23,017,258
Basic and fully diluted earnings per share	0.10	0.20	0.18	0.21	0.20	0.23	0.26	0.27
Cash dividends declared	552,658	493,450	542,343	583,522	545,664	565,362	627,214	638,626
Cash dividends declared per Class A share	0.2016	0.2016	0.1995	0.1973	0.2016	0.2016	0.1995	0.1973
Cash dividends declared per Class B share	0.1890	0.1247	0.1763	0.1763	0.2521	0.2057	0.2346	0.3119

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 December 18, 2018, based on income for the fourth quarter of 2018, our Board of Directors declared a dividend of $0.2016 per Class A Non-Voting Share to shareholders of record on December 31, 2018. This distribution was paid on January 31, 2019 and is recorded as payable in the accompanying consolidated financial statements. The dividend amount was calculated to provide an annualized 8% return on the $10.00 initial Class A Non-Voting Share price.

Subsequent to the quarter-end, on January 28, 2019, again based on income for the fourth quarter of 2018, the Board declared a dividend of $0.1247 per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on January 31, 2019. This dividend is not recorded in these consolidated financial statements as it was declared subsequent to the year end.

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 final quarter of 2018, 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 slow Alberta real estate market.

During the three months ended December 31, 2018, mortgages were funded in the amount of $4.4 million, and $5.5 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 through 2019 and plan to continue funding mortgages in amounts approximately equal to 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 arises 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 $37.0 million, which exceed the current amounts funded by $9.3 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 $4.5 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 are prepared to increase our issued capital and regularly make solicitations for investments in Class A Common non-voting shares. Should such shares be issued, the proceeds will be used for general cash flow and for expansion of our mortgage portfolio. Builders Capital is financed, and will continue to be financed, primarily by the issuance of common shares. In 2018, we issued an additional 113,500 shares at a price of $10.00 each; after offering costs of $63,000 this contributed $1,072,000 to our capital base.

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 each year. During 2018 we received a redemption request for 1,200 shares, which were redeemed on November 30, 2018 for $10,920.

Related-Party Transactions

Our manager is a company controlled by Sandy Loutitt and John Strangway, both of whom are 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 $71,000 for the fourth quarter (Q4 2017 - $67,000) and $276,000 for the year (2017 - $253,000).

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 fourth quarter and fiscal year, the amount of these fees collected on behalf of the manager totaled $175,000 (Q4 2017 – $289,000) and $558,000 (2017 – $672,000) respectively.

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 December 31, 2018, no mortgages were purchased or sold. During the fiscal year, $4.9 million in mortgages were purchased and $0.7 million were sold.

Changes in accounting policies

We have adopted IFRS 9-*Financial Instruments* (IFRS9) and IFRS 15-*Revenue from contracts with customers* (IFRS 15) effective January 1, 2018 without restatement of comparative figures.

IFRS 9 Financial Instruments

The requirements of IFRS 9 represent a significant change from IAS 39-*Financial Instruments: Recognition and Measurement*. The key changes to our accounting policies resulting from this change are as follows:

IFRS 9 contains three principal classification categories for financial assets: measured at, amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale.

The adoption of IFRS 9 has not had a significant effect on our accounting policies for financial liabilities.

IFRS 9 replaced the incurred loss model in IAS 39 with an 'expected credit loss' (ECL) model. The new impairment model applies to financial assets measured at amortized cost (including mortgages receivable), contract assets and debt investments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognized earlier and are generally expected to be larger than those recognized under IAS 39 as an allowance for credit losses will be recorded regardless of whether or not there has been an actual loss event.

In accordance with the transition provisions contained in IFRS 9, the new standard has been adopted retrospectively without restatement. Adoption of IFRS 9 has had no effect on our financial assets and financial liabilities, which continue to be measured at amortized cost subsequent to their initial recognition. The effect on the allowance for credit losses on January 1, 2018 has been recognized as an adjustment to opening retained earnings in the consolidated statements of changes in shareholders equity.

IFRS 15 Revenue from contracts with customers

The implementation of IFRS 15 did not have a significant impact on our revenue streams.

Financial Instruments

Accounting Policies

As part of our operations, we carry financial instruments consisting of cash, mortgages receivable, line of credit, accounts payable and accrued liabilities and amounts due to a related party. The following are our accounting policies for financial instruments:

i) Recognition and initial measurement – Accounting policy applicable effective January 1, 2018

All financial assets and financial liabilities are initially recognized when the Company becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is initially measured at fair value plus, for an item not at fair value through profit or loss (FVTPL), transaction costs that are directly attributable to its acquisition or issue.

ii) Financial assets - classification and subsequent measurement – Accounting policy applicable effective January 1, 2018

On initial recognition, a financial asset is classified as measured at: amortized cost; fair value through other comprehensive income (FVOCI) – debt investment; or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets, in which case all affected financial assets would be reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows;
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding: and
- The Company classifies its mortgages receivable as at amortized cost.

A debt investment is measured at FVOCI if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Company has no debt investments measured at FVOCI.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL. This includes all derivative financial assets.

iii) Financial assets - business model assessment – Accounting policy applicable effective January 1, 2018

The Company makes an assessment of the objective of the business model in which a financial asset is held at the portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Company's management;

- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectation about future sales activity.

Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL.

iv) Financial assets - Assessment whether contractual cash flows are solely payments of principal and interest – Accounting policy applicable effective January 1, 2018

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Company considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the company considers:

- Contingent events that would change the amount or timing of cash flows;
- Terms that may adjust the contractual coupon rate, including variable rate features;
- Prepayment and extension features; and
- Terms that limit the Company's claim to cash flows from specified assets (e.g. non-recourse features).

A prepayment feature is consistent with the solely payments of principal and interest criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for early termination of the contract.

v) Financial assets - Subsequent measurement and gains or losses – Accounting policy applicable effective January 1, 2018

- Financial Assets at FVTPL – These assets are subsequently measured at fair value. Net gains or losses, including interest or dividend income, are recognized in profit or loss.
- Financial Assets at amortized cost – These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains or losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss.
- Debt investments at FVOCI – These assets are subsequently measured at fair value. Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment are recognized in profit or loss. Other net gains and losses are recognized in Other comprehensive income (OCI). On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss

vi) Financial assets: Subsequent measurement and gains and losses – Accounting policy applicable before January 1, 2018

- **Loans and receivables** – Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivable instruments are comprised of mortgages receivable. Loans and receivables are initially recognized at the amount expected to be received less, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.
- **Financial Assets at FVTPL** – Financial assets or financial liabilities are classified as FVTPL when the financial asset or liability is either held for trading or it is designated as such by management on initial recognition. These assets or liabilities are stated at fair value, with any gains or losses arising on re-measurement recognized immediately in the consolidated statement of comprehensive income. The net gain or loss recognized in the consolidated statement of comprehensive income incorporates any dividend or interest earned. The Company has classified cash as FVTPL.
- **Other financial liabilities –** These liabilities are recognized initially at fair value, net of transaction costs, and are subsequently stated at amortized cost each year. The Company has classified accounts payable and accrued liabilities, line of credit, loan payable and due to related party as other financial liabilities

vii) Financial liabilities - Classification, subsequent measurement and gains or losses

Financial liabilities are classified as measured at amortized cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognized in profit or loss. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in profit or loss. Any gain or loss on derecognition is also recognized in profit or loss.

viii) Impairment – Accounting policy applicable effective January 1, 2018

The Company recognizes allowances for expected credit losses (ECLs) on financial assets measured at amortized cost.

The Company measures ECLs for financial assets based on a three-stage approach. Stage 1 includes performing loans for which the credit risk at the reporting date has not increased significantly since initial recognition; Stage 2 includes performing loans which have experienced a significant increase in credit risk since initial recognition; and Stage 3 are loans which are considered credit impaired. The Company measures loss allowance at an amount equal to 12 months of expected losses for Stage 1 assets, and at an amount equal to lifetime expected losses for stage 2 and stage 3 assets.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECL, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Company's historical experience and informed credit assessment and includes forward-looking information.

In assessing credit risk and in calculating the amount of expected credit losses, the Company relies on estimates and exercises judgement regarding matters for which the ultimate outcome is unknown.

These judgements include changes in circumstances that may cause future assessments of credit risk or credit losses to be materially different from current assessments, which could require an increase or decrease in the allowance for credit losses.

The Company considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Company in full, without recourse by the Company to actions such as realizing security.

Measurement of ECLs:

- ECLs are estimates of credit losses weighted by their likelihood of occurrence. They are measured by calculating the present value of the difference between the expected cash flows from a contract and the cash flows due to the Company in accordance with the contract. 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.
- The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk.
- Allowances for credit-impaired financial assets (Stage 3) are recorded for individually identified loans in amounts calculated to reduce their carrying value to the expected recoverable amount. The Company reviews its loans at least quarterly and assesses the ultimate collectability and estimated recoveries for any loans considered to be credit-impaired.

Mortgages receivable are shown on the consolidated statement of financial position net of the calculated ECL allowance.

ix) Impairment – Accounting policy applicable before January 1, 2018

Financial assets not classified as at FVTPL were assessed on each reporting date to determine whether there was objective evidence of impairment. A financial asset was considered to be impaired only if evidence indicated that one or more events had occurred after its initial recognition that had had a negative effect on the estimated future cash flows of that asset.

The Company considered evidence of impairment for financial assets not classified as at FVTPL at both a specific and collective level. All individually significant mortgages were assessed for specific impairment. Those found not to be specifically impaired were then collectively assessed for any impairment that has been incurred but not yet identifiable at an individual mortgage level. Mortgages that are not individually significant are collectively assessed for impairment by grouping together mortgages with similar risk characteristics.

In assessing collective impairment, the Company reviews historical trends of probability of default, the timing of recoveries and the amount of loss incurred, adjusted for management's judgments 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 receivable's original effective interest rate. Losses are recognized in the consolidated 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 consolidated statement of comprehensive income.

x) Financial Instruments – Derecognition

- **Financial Assets**

The Company derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Company neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

- **Financial liabilities**

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognized in profit or loss.

Credit Risk

Credit risk is the risk of loss associated with the counterparty's inability to fulfill its payment obligations. Credit risk arises principally from the company's lending activities. Any instability in the real estate sector and an adverse change in economic conditions in Canada could result in declines in the value of real property securing the Company's mortgages. The Company mitigates this risk by adhering to the investment and operating policies of the Company.

All mortgages to which the Company commits are individually evaluated by the Company's underwriters using credit risk assessment tools and are assigned risk ratings in accordance with the level of credit risk attributed to each loan. Each new mortgage is approved independently and in accordance with the authorization structure set out in the Company's policies. Our underwriting approach places a strong emphasis on the value of the mortgage security and an assessment of the financial viability of the construction project being financed.

We have clearly defined underwriting policies and procedures that we adhere to in our mortgage approval process. These include a maximum projected loan to value ratio, standards with regard to the asset quality and marketability, geographic market restrictions and requirements regarding the overall credit quality and integrity of borrowers. We also actively analyze external market conditions including prevailing real estate values and employment conditions in the markets in which we lend. In all cases, the Company's mortgages receivable are secured by registered charges over real property.

The Company utilizes an internal risk rating system to categorize each mortgage in the portfolio on the basis of the perceived risk of a potential credit loss. The risk assessment of each mortgage assigned at the underwriting stage is subsequently revised based on changes in market conditions and on factors specific to the mortgage and the borrower. One of the main factors in considering whether the credit risk of a mortgage has increased significantly is the estimated loan to value ratio. Loan to value ratios can change due to declining property values, as well as other factors such as the inability of the borrower to continue to inject equity into the project. Mortgages are considered to be impaired when the expectation is that full collection of principal and interest is no longer likely.

The Company's lending is for construction purposes, and all loans are made only on the strength of mortgage security over real property. The value of the underlying security is subject to change for a variety of factors, including the degree of completion of the construction, possible deterioration in structures left incomplete and market forces which can cause values to both increase or decrease.

In the case of mortgage impairment, probable recovery is determined using a combination of updated property-specific information, historical loss experience and management judgement to determine the impairment provision that may be required. The primary factor in assessing a mortgage as low risk would be a loan to value ratio which is low enough to make a potential credit loss extremely unlikely.

Although the Company writes mortgages for periods of one year or less, the mortgages are often renewed based either on the borrower's ongoing requirement for capital for additional projects, or because the project which was originally financed has not been completed and sold. In each case, prior to renewal, the Company assesses the mortgage for impairment.

Mortgages which were funded prior to the end of the previous fiscal year, and which have been renewed due to delays in completing the construction or the sale of the underlying security rather than due to a revolving arrangement for ongoing construction having been made, and for which no specific allowance has been recognized, can be considered to be past due, but not impaired as management considers collection to be reasonably assured due largely to the estimated value of the mortgage security held.

Management believes the credit risk with respect to cash that is held at a Schedule 1 Canadian bank to be minimal.

Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates.

i) Interest Rate Risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will vary as a result of changes in market interest rates. We manage our financial instruments with the objective of mitigating any potential interest rate risks. The interest rates on the company's mortgages receivable are fixed for the term. Therefore, we are not exposed to significant cash flow interest rate risk. As at September 30, 2018, our mortgages receivable are subject to fair value interest rate risk as a decrease or increase in market interest rates will decrease or increase the fair value of the fixed rate financial asset. Any change in market interest rates will, however, have no impact on our cash flows or comprehensive income for the year as mortgages receivable carry a fixed rate of interest.

We are exposed to interest rate risk on our line of credit and loan payable as they carry a variable rate of interest. The impact on total comprehensive income if interest rates had been 1% higher or lower for the quarter ended September 30, 2018 would be approximately $8,981.

ii) Foreign Currency Risk

We do not have assets or liabilities in foreign currency.

Liquidity Risk

Liquidity risk arises from the possibility of not having sufficient ability to obtain debt financing or equity capital to fund future growth or meet our obligations as they arise and become due. Furthermore, liquidity risk also arises if we are not able to obtain financing on favorable terms.

The company's main liquidity requirements will arise from mortgage acquisitions, manager fees and distributions to shareholders. All of the aforementioned liquidity requirements, except for mortgage acquisitions, are generally funded from cash flows earned on mortgage interest and fees. Mortgage acquisitions are generally funded through equity issuances. The company's financial condition and results of operations would be adversely affected if it were unable to obtain additional funds through equity issuances or financing, or if we were unable to meet our other liquidity requirements from ongoing operating activities.

Our approach to managing liquidity is to ensure that we will have sufficient financial resources available to meet our liabilities as they become due. This includes monitoring of cash, line of credit, loan payable and accounts payables and accrued liabilities. We intend to mitigate our liquidity risk by not entering into property acquisitions unless we have secured or are confident that we can secure the appropriate capital (debt and/or equity) to fund the particular acquisition. Liquidity risk is also mitigated by the terms offered to investors, which state that all redemptions are at the discretion of management and are dependent on the circumstances, and to borrowers, which state that the company is never obligated to advance additional mortgages or funding.

Critical Accounting Estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting year. Estimates, assumptions and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual outcomes can differ from these estimates. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the amounts recognized in the consolidated financial statements are:

Measurement of fair values

Our accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities.

Fair value represents the price at which a financial instrument could be exchanged in an orderly market, in an arm's length transaction between knowledgeable and willing parties who are under no compulsion to act. We classify the fair value of the financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1: Fair value measurements are those derived from quoted prices (unadjusted) in the active market for identical assets or liabilities.
- Level 2: Fair value measurements are those derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (derived from

prices).

- Level 3: Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

We review significant unobservable inputs and valuation adjustments. If third party information is used to measure fair values, we will assess the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Measurement of expected credit loss

We are required to make estimates and assumptions that relate to the expected credit losses. These judgements include changes in circumstances that may cause future assessments of credit risk to be materially different from current assessments which would require an increase or decrease in the allowance for credit losses.

Classification of non-voting shares with redemption feature

Under IFRS, IAS 32 requires that shares of an entity which include a contractual obligation for the issuer to repurchase or redeem them for cash or another financial asset be classified as financial liabilities. Our Class A and Class B non-voting shares contain a redemption feature whereby the holders can request redemption of the shares during a specified period during the year. The redemption feature is subject to certain restrictions which give Management the ability to effectively defer redemption indefinitely. Accordingly, management has applied judgment in assessing whether the redemption feature would create a contractual obligation to repurchase or redeem shares for cash or another financial asset and has determined that it would not and that the shares should be classified as equity.

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 consolidated financial statements for the year ended December 31, 2018.

Outstanding Share Data

The company's authorized share capital as at April 29, 2019, 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 1,979,570 are outstanding; and an unlimited number of Class B Non-Voting Shares, of which 924,576 are outstanding.

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.

While real estate market conditions remains slow in Western Canada, the Canada Mortgage and Housing Corporation (CMHC) expects that buyers' market conditions in both Alberta and Saskatchewan should gradually shift to a balanced market with gradual improvement in economic and demographic fundamentals. We believe that the projected levels of housing starts are more than adequate to support the growth of our business. We also expect that margins on new construction will remain viable, particularly in Alberta, where building costs have generally decreased and selling prices are expected to gradually strengthen.

We continue to caution that the extended downturn in Alberta has taken its toll on builders. Over the past 18 months, we have foreclosed on seven properties and sold five of them. We have also had to foreclose on additional properties subsequent to the year-end. 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 third 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, and 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 have 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. The company has also recently been named in a lawsuit brought by a potential purchaser of a property under construction on which we held a mortgage. We foreclosed on the property in 2017 and, as a result, the potential purchaser's interest was foreclosed off the title. Their claim is for $50,000. Based on advice from legal counsel, management considers this claim to have no merit and the possibility of having to pay anything under this litigation remote. Accordingly, no provision for this claim has been recorded in the consolidated financial statements. Should any payment be required in the future, amounts to settle the liability would be considered a loan loss and be drawn from our accumulated allowance for such losses.

Additional Information

Additional information about Builders Capital is available on SEDAR at www.sedar.com and on our website at www.builderscapital.com.