



## **Builders Capital Mortgage Corp.**

Management's Discussion and Analysis  
Year Ended December 31, 2022

## 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 17, 2023. It should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2022, available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website at [www.builderscapital.ca](http://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 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 and Nova Scotia.

## **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 and Nova Scotia. We believe that staying focused on this niche market reduces overall risk and increases the potential return on our mortgage portfolio. 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 lend on projects that we believe are economically sound and for which we have the capability, through the manager, to complete and sell if necessary.

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 often 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.

## **Fiscal Year Summary**

### **Performance Highlights**

- Consistent with our targeted distribution, we paid dividends of \$0.80 per share to our Class A public shareholders in 2022. This represents an 8% annual return on the original \$10.00 issue price for the ninth consecutive year since inception.
- Total comprehensive income grew to \$2.7 million, up 16.2% year-over-year.
- Earnings per share increased to \$0.92, up 15% from \$0.80 in 2021.
- Assets held for sale were successfully reduced by 32% year-over-year. By year-end, assets held for sale represented just 4.1% of shareholders' equity.
- We further enhanced the geographic diversity of our portfolio with continued growth in the BC market, expansion into Nova Scotia, and an 11% decrease in the proportion of mortgage funds deployed in Alberta.
- We achieved an approximate weighted average loan-to-value ratio of 73.3% on our mortgage portfolio, slightly exceeding our 75% target level.

### **Business Environment**

- We continue to benefit from higher market interest rates, which in turn, are driving improved profitability from our mortgage portfolio.
- Housing markets have begun to stabilize in our core markets and forecasters anticipate conditions will strengthen over the medium-term, with demand for housing significantly outstripping supply.
- We are moving forward with a healthy weighted average loan-to-value ratio on our portfolio, which provides significant stability.

## Financial Overview

	Year ended December 31, 2022 \$	Year ended December 31, 2021 \$	Year ended December 31, 2020 \$
Revenues	3,758,973	3,061,163	3,230,735
Total comprehensive earnings	2,708,179	2,330,023	2,124,919
Net mortgages receivable, end of period	34,134,123	28,405,141	24,274,040
Total assets	35,720,048	30,518,304	27,352,266
Shareholders' equity	29,269,826	26,887,779	26,816,558
Basic and Diluted Earnings per share	0.92	0.80	0.72
Cash dividends declared	2,632,467	2,258,802	2,047,833
Cash dividends declared per Class A share	0.80	0.80	0.80
Cash dividends declared per Class B share	1.07	0.72	0.48

## Investment Portfolio

At December 31, 2022

Property Type	Mortgage Portfolio (No.)	Outstanding Balance (\$)	Total Committed Mortgage Principal (\$)	%
Single family – Detached	25	31,205,241	43,705,000	90%
Single family – Attached	6	3,328,968	5,980,000	10%
<b>Total:</b>	<b>31</b>	<b>34,534,209</b>	<b>49,685,000</b>	<b>100%</b>
<b>Geographic Location of Property</b>				
Calgary and Area	14	13,891,576	20,565,000	40%
Edmonton and Area	1	829,581	825,000	2%
Other Alberta	3	3,002,198	4,100,000	9%
British Columbia	12	16,538,894	23,875,000	48%
Nova Scotia	1	271,960	320,000	1%
<b>Total:</b>	<b>31</b>	<b>34,534,209</b>	<b>49,685,000</b>	<b>100%</b>
<b>Interest Rate (excluding fees)</b>				
Less than 10%	2	1,407,715	3,965,000	4%
10%-10.99%	24	27,467,810	39,270,000	80%
11%-11.99%	4	5,272,199	5,725,000	15%
Greater than 12%	1	386,485	725,000	1%
<b>Total:</b>	<b>31</b>	<b>34,534,209</b>	<b>49,685,000</b>	<b>100%</b>
<b>Original Funding Date *</b>				
Calendar 2022	13	11,515,643	18,070,000	32%
Calendar 2021	12	14,344,415	19,290,000	42%
Calendar 2020	4	6,697,149	7,600,000	20%
Calendar 2019 or earlier	2	1,977,002	4,725,000	6%
<b>Total:</b>	<b>31</b>	<b>34,534,209</b>	<b>49,685,000</b>	<b>100%</b>

\*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.

## Introduction

We achieved stronger top and bottom-line results in fiscal 2022 on a combination of growth in our mortgage book, higher interest rates on new and renewing mortgages, and a reduction in assets held for sale. Our improved results reflect the continued positive outlook among builders in the categories we target, even as some of them experienced weaker housing markets in 2022. With demand for housing expected to outstrip supply by a significant margin in the near future, builders in our core markets have continued to progress projects already underway, while also starting new ones with a view to selling into healthy real estate markets going forward.

Lower costs of construction have provided added support for building activity. Most notably the price of building lots, which generally makes up a substantial portion of the cost of a new home, trended downward in most markets in 2022. In addition, the average price of lumber, also a major cost driver, fell significantly from a peak of \$1,645 US per thousand board feet in May 2021 to \$384 US by December 2022, a decline of 77%. Capable builders with good cost controls are typically able to operate profitably even in weaker housing markets so long as selling prices exceed costs. We believe that even if a recession occurs, the current market dynamics will generally continue to exist, supported by continuing demand and by a general easing of costs.

While the overall favourable market dynamics led to growth in our mortgage book in 2022, we continued to carefully monitor our portfolio risk. A key metric of the stability of our portfolio is the average loan-to-value (LTV) ratio of our mortgages as this is a key predictor of how likely we are to experience a loss on any given loan if future real estate markets weaken. While the LTV calculation can be subject to uncertainties, particularly given fluctuating values, our estimated weighted average LTV was a conservative 73.3% at December 31, 2022, beating our target of 75%. We also maintained our geographic diversification in 2022 with 51% of our mortgage portfolio located in the province of Alberta, 48% in BC and 1% in Nova Scotia as at year-end.

Additionally, we continued to increase the turnover rate in our mortgage portfolio, which we calculate by averaging total funds advanced to borrowers and total repayments received from borrowers during the period. This improving trend saw us turn 138% of our net invested capital in 2022, up from 130% a year earlier. For the 2022 year, this translated to one complete turn of capital every 8.8 months, which slightly exceeds our targeted goal of a nine-month turn-over period. Higher turnover rates contribute to higher lender fee earnings while also helping to reduce risk by ensuring a more current portfolio of mortgages.



## **Operating Results for the Three and Twelve Months Ended December 31, 2022**

We significantly improved our utilization of capital in fiscal 2022 with a major reduction in assets held for sale. We completed and sold all of the inventory we were holding at the beginning of the year and carried out only a single additional foreclosure during fiscal 2022. Subsequent to the year-end, we entered into a contract to sell the one remaining property and expect to have all of our assets invested in mortgages by the end of Q2 2023.

Increased optimism in the construction industry also contributed to our success in sourcing additional new mortgages, which further strengthened our capital utilization ratio. Our utilization ratio, as measured by net mortgages receivable as a percentage of our shareholders' equity balance, rose to 116.6% by the end of 2022, up from 105.6% at the end of 2021 and 90.5% at the end of 2020. With generally good confidence among builders and a growing presence in the market, we believe we can maintain our utilization rate at approximately this ratio in 2023.

The better utilization of capital paired with higher interest rates resulted in earnings per share increasing 15% to \$0.92 in 2022, from \$0.80 in 2021. This increase enabled us to comfortably maintain our \$0.80 annual distribution on the Class A shares and to increase the annual distribution on the Class B shares from \$0.48 in 2020 to \$1.07 in 2022.

For the three months ended December 31, 2022, cash advances and invoiced interest also improved, climbing 9.7% year-over-year to \$11.2 million. This increase reflects better turnover on our loans, additional use of our line of credit, and reduced capital tied up in non-productive assets held for sale. Fourth quarter loan repayments of \$6.6 million were 16.5% less than the same quarter in 2021, and annual loan repayments of \$32.4 million were 6% higher than the previous year. Having achieved our goal of turning over our capital approximately every nine months, we anticipate these advance and repayment figures will remain consistent at least through 2023.

We are pleased that the 73.3% approximate weighted average loan-to-value ratio ("LTV") of our mortgage portfolio exceeded our target rate of 75%. Our success in improving and maintaining our weighted average loan-to-value ratio provides important stability as we continue to grow the company.

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. As 2022 progressed, we expanded the use of the facility to pursue additional mortgage opportunities resulting in our line of credit being 87.6% utilized at year-end. As we work to further expand the portfolio, we expect to continue utilizing our credit facility in this way.

As at the end of the year, the total value of our mortgage portfolio, before considering our \$400,000 allowance for mortgage losses, had grown to \$34.5 million. This was a 20.5% increase from \$28.7 million in 2021. As at December 31, 2021, our loan portfolio was made up of 31 mortgages with an average outstanding balance of \$1.1 million. This compares to 37 mortgages averaging \$775,000 as at December 31, 2021.

## Revenue

For the three months ended December 31, 2022, we grew revenues to \$1.1 million, up 20% from \$884,000 in 2021. This increase primarily reflects better utilization of our capital with fewer of our assets tied up in unproductive inventory. We also benefited from a larger capital base and higher turnover rates on our mortgages. Our net mortgages receivable figure represented 117% of our shareholders equity at year-end, as compared to 106% in 2021.

Our Q4 2022 revenue was comprised of \$946,000 (2021 - \$782,000) in interest and \$115,000 (2021 - \$102,000) in lender fees. Higher turnover in the quarter resulted in lender fees increasing by 12% year-over-year.

For the year ended December 31, 2022, total revenues grew 22.8% to \$3.8 million, from \$3.1 million in 2021, with interest of \$3.3 million increasing by 23.4% and fee revenue of \$430,000 up 18%.

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 earned in 2022 exceeded management fees paid by a healthy margin of 47%, consistent with our goal of maintaining lender fee revenues at amounts exceeding management fee expense.

## Expenses

Operating expenses, excluding funds set aside to provide for loan losses and interest expense, were \$104,000 in the fourth quarter and \$409,000 for the fiscal year. This was in line with operating expenses of \$104,000 and \$399,000, respectively, in the same periods of 2021.

The most significant variation in our expenses over the last several years has come in the provision required to allow for potential mortgage losses. Calculating this provision requires applying judgement and assumptions relating to potential future losses. In 2018 and 2019, we sustained considerably higher loan losses than anticipated as we had to foreclose on a number of mortgages due to a weak housing market in Alberta where, at the time, the bulk of our loans were located. We brought a disciplined approach to managing these problem loans and in the over the last three years have focused on completing and selling the homes we acquired through foreclosures which was largely accomplished by year-end. At the same time, we worked to achieve more geographic diversity to better insulate against similar shocks in the future. Our fourth quarter 2022 provision for mortgage losses was \$195,000 (2021 - \$97,005) and for 2022, the annual required provision was \$353,000. While this annual provision was somewhat larger than the \$275,000 required in 2021, the 28% increase was reasonably consistent with the 23% increase in revenues, such that the provision still represented 9.4% of total revenue. This is a substantial reduction from the amounts required just three years ago and brings us close to our target rate of 8% of total revenue. Provisions for mortgage losses are determined based on our ongoing assessment of our mortgage portfolio and current market conditions. We are optimistic that we can maintain our provisions at these lower levels going forward given the stabilization in local market conditions and our more current and diverse portfolio of mortgages.

Management fees were \$75,000 in the fourth quarter and \$293,000 for the year, calculated on the total gross amount of Class A and Class B Non-Voting Shares outstanding. Our intention is to continue to grow our capital base, resulting in these fees increasing, but our expectation is that this impact will be more than offset by higher revenues.

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 available 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. During the fourth quarter of 2022 we took advantage of investment opportunities which caused our line of credit balance to grow by \$1.3 million, resulting in interest expense for the quarter increasing to \$114,000 as compared to \$39,997 in Q4 2021 and \$79,000 in Q3 2022. Interest expense for the full 2022 year increased to \$288,000 (2021 - \$57,000) due to higher rates of cash utilization.

### **Total Comprehensive Income**

We grew total comprehensive income to \$648,000 in the fourth quarter of 2022, a slight increase from \$643,000 in the same period of 2021. For the full-year period, comprehensive income increased to \$2.7 million (2021 – \$2.3 million) and earnings per share climbed to \$0.92 (2021 - \$0.80), a 16.2% and 15% year-over-year increase, respectively. Aside from some expected variability, our provision for mortgage losses has been trending downwards for four consecutive years, reflecting the success of our strategies for strengthening our mortgage portfolio, as well as stabilization in the Alberta real estate market. This improving trend has contributed substantially to our bottom line and going forward, maintaining our provision at these levels will remain a priority. Despite the recent slowdown in real estate sales and prices in some Canadian markets, building activity in our core markets remains strong, particularly in Alberta where housing starts are substantially higher as compared to the past several years. In assessing potential borrowers, we are assuming that some future declines in house values will occur. We believe we are sufficiently compensating for this possibility and that this should help to keep our provisions close to the current lower levels.

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 \$0.92 per share overall and \$1.34 per Class A Non-Voting Share. These earnings exceeded the amount required to satisfy the dividend committed to the Class A Non-Voting shareholders by 1.7 times. With Class B Non-Voting shareholders bearing a much greater proportion of the risk of income fluctuations, even if earnings had been only 60% of their actual figure the company would still have been able to pay Class A shareholders their full planned annual dividends. 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. Our policies limit the ratio to no greater than 3:1.

### **Statement of Financial Position**

At December 31, 2022, total assets were \$35.7 million (December 31, 2021 – \$30.5 million), \$1.2 million of which was assets held for sale, and the balance of which was virtually all funded mortgages.

Our mortgage portfolio continued to grow during the year with net mortgages of \$34.1 million at year-end representing 117% of our shareholders' equity balance. This compares favourably to 106% a year

earlier and was achieved through a 32.2% reduction in non-productive assets held for sale, together with the success of our strategy for achieving greater utilization of our available line of credit while sourcing additional mortgage opportunities to fully utilize available funds.

Assets held for sale are comprised of properties which we have obtained in foreclosure actions. In most cases, these properties are unfinished at the time of foreclosure and we typically expend resources to complete and prepare them for sale. During the year we disposed of all three of the properties we were holding at December 31, 2021. We obtained one additional property through foreclosure action in Q1 2022, a vacant building lot in Cochrane, Alberta and continued to hold it as at December 31, 2022. Subsequent to the year-end, we entered into a conditional sales contract to sell this property and are optimistic that we will soon have no real estate assets for sale.

Liabilities at year-end, excluding our line of credit, totaled \$733,000 (December 31, 2021 – \$611,000) and were comprised of dividends relating to the fiscal quarter paid on January 31, 2023, our trade payables, amounts due to related parties, and deferred lender fees. Throughout the quarter we were in compliance with all bank covenants relating to the line of credit, and we had no off-balance sheet arrangements.

Our line of credit balance stood at \$5.7 million, as compared to \$3.0 million at December 31, 2021. Use of the line of credit is an indication that our capital is fully utilized and we are pleased that our mortgage portfolio has grown to where this is again necessary.

Shareholders' Equity consists of net share capital and retained earnings. During Q4, 2022 we actively raised capital through a rights offering by which shareholders of record on October 28, 2022 were able to purchase additional Class A Non-voting common share in the capital of the company for a price of \$9.30 each. The rights offering resulted in the issuance of 247,501 shares for gross proceeds of \$2,301,759. There were no other share issuances or redemptions during 2022.

Total share issue costs relating to the rights offering came to \$51,204 and total share issue costs since inception now stand at \$2.4 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.

## Quarterly Financial Information

	Quarter ended December 31, 2022 \$	Quarter ended September 30, 2022 \$	Quarter ended June 30, 2022 \$	Quarter ended March 31, 2022 \$	Quarter ended December 31, 2021 \$	Quarter ended September 30, 2021 \$	Quarter ended June 30, 2021 \$	Quarter ended March 31, 2021 \$	Quarter ended December 31, 2020 \$
Revenues	1,061,004	938,523	914,929	844,516	884,194	780,972	691,848	704,149	830,155
Total comprehensive earnings	647,964	700,808	694,575	664,861	642,857	575,009	548,076	564,021	523,277
Total assets	35,720,048	32,117,611	32,055,029	30,682,037	30,518,304	29,778,385	28,669,052	27,454,925	27,352,266
Assets held for sale	1,187,064	1,175,338	1,243,197	1,240,113	1,752,075	2,474,098	2,542,042	3,150,165	2,089,016
Shareholders' equity	29,269,826	27,075,517	27,031,412	26,951,410	26,887,779	26,854,608	26,864,364	26,894,699	26,816,558
Earnings per share	0.22	0.24	0.24	.23	.22	.20	0.19	0.19	0.18
Cash dividends declared	706,804	654,078	647,134	624,450	609,686	584,765	578,472	485,880	589,049
Cash dividends declared per Class A share	0.2016	0.2016	0.1995	0.1972	0.2016	0.2016	0.1995	0.1972	0.2016
Cash dividends declared per Class B share	0.2773	0.2742	0.2712	0.2521	0.2268	0.1995	0.1972	0.1008	0.2016

## 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 intended for distribution after these dividends are paid is allocated pro-rata between the classes of shares, including the Voting Shares.

On December 19, 2022, based on income for the fourth quarter of 2022, our Board of Directors declared a dividend of \$0.2016 per Class A Non-Voting Share to shareholders of record on December 31, 2021. This distribution was paid on January 31, 2023 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 31, 2023, again based on income for the fourth quarter of 2022, the Board declared a dividend of \$0.2898 per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on January 31, 2023. This dividend is not recorded in these consolidated financial statements as it was declared after 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.

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 the coming year 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 Investment Portfolio table above, we have mortgage commitments to borrowers totaling \$49.7 million, which exceed the current amounts funded by \$15 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. These tools include our \$780,000 in available 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 our sales and purchases of mortgages have been to and from related parties, in particular Builders Capital (2014) Ltd. ("BCL"). BCL is a privately held corporation, of which

Builders Capital director Sandy Loutitt is a director. 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 larger margin for error in our cash management practices, which could reduce profitability.

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.

According to our share terms, Class A Non-voting shareholders have an annual right to redeem their shares on October 31st each year at 95% of Net Asset Value. Payment for the redemptions is to be made on November 30th each year. We received no request for redemption in 2022.

### **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 \$75,000 for the quarter (Q4 2021 - \$74,000) and \$293,000 for the year (2021 - \$291,000).

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 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 of 2022, fees collected on behalf of the manager totaled \$318,000 (Q4 2021 - \$374,000). For the year ended December 31, 2021, fees collected were \$1.1 million compared to \$1.1 million in the prior year.

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 minimize excess cash 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 non-interest bearing. During the fourth quarter of 2022, two mortgages were sold for a total of \$1.2 million and no mortgages were purchased. During the 2022 year, six mortgages were sold totaling \$2.3 million and one mortgage purchased for \$200,000. In 2021, a single mortgage was sold in Q4 for \$1.2 million and none were purchased during the year.

## 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.

The series of interest rate increases initiated by the Bank of Canada through 2022 and into early 2023 in response to inflation appears to be nearing its end and forecasters anticipate that the related correction affecting housing markets will begin to let up. In its March 6, 2023 Canadian Housing Market Outlook report, RBC Economics noted that the slowdown has significantly moderated since the fall and noted a continuation of solid market fundamentals with inventories still historically low, no signs of overbuilding virtually anywhere in the country, and booming immigration expected to continue over the medium term.

While the interest rate increases of the past five quarters have contributed to a cooling of housing markets in many parts of Canada, it has also presented opportunities for us to both increase our own rates and to gain additional market share as competitors increase theirs. We are also seeing competitors becoming more conservative in their lending to the construction markets we serve, in turn enabling us to be more conservative in our own lending while still maintaining or growing our market share. Further, we believe that despite a hangover after the market excesses of recent years, demand for housing remains strong. RBC Economics noted, "While homebuilding has picked up in Canada over the past three years—housing completions rose from less than 190,000 units in 2019 to roughly 220,000 units in 2021 and 2022—it was nowhere near enough to meet supercharged demand. We estimate that our housing stock must expand by at least 270,000 units per year by 2025 just to accommodate the growth in households."

In recent years, we have focused on achieving greater geographic diversity in our mortgage portfolio, with our capital now broadly split between Alberta and British Columbia. This strategy is paying dividends as weakness in B.C. is being partially offset by the more minimal declines in Alberta prices and volumes. We will continue to closely monitor the markets we serve and focus our resources on those areas and builders that we are most confident will result in maximizing revenues, while reducing risks.

Minimizing unproductive assets is a key driver of our profitability and we will continue to focus on keeping future foreclosures to a minimum. To this end, we have reduced the approximate weighted average loan-to-value ratio on our portfolio to below 75% and will focus on keeping it at that level. Given the historic run-up in prices which has occurred across much of the country, we are also ensuring that we build in a somewhat larger margin-for-error when assessing the finished value of homes under construction. We continue to believe there is sufficient equity in the majority of loans in our portfolio to minimize the risk of loan losses. Even if foreclosure activity should need to increase, we believe the necessary safeguards are in place to assure our ability to maintain the Class A Non-Voting Share dividend at approximately \$0.80 per annum.

These safeguards include maintaining a prudent debt-to-equity ratio, generally restricting our lending to 75% of what we believe to be the fair market value of a property at any given time and taking adequate allowances for expected credit losses allowing us to build a cushion of funds to further protect investors. 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 historically, with the impact of increased allocation of funds against potential loan losses and unproductive assets borne entirely by Class B Non-Voting shareholders, this structure functions as intended.

In the near-term, we expect to benefit from the ability to charge higher rates to our borrowers while a sufficiently robust demand for housing contributes to our borrower's profitability and enables us to keep our lending book full with profitable and relatively low-risk mortgages.

## **Financial Instruments**

Our primary business purpose is to invest in mortgages, which are the only significant financial instrument that we carry and are the source of virtually all of our revenues. These financial instruments expose us to risks which are managed as follows:

### **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 our 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 our mortgages. We mitigate this risk by adhering to the investment and operating policies of the company.

All mortgages to which we commit are individually evaluated by our 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 our 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, our mortgages receivable are secured by registered charges over real property.

We utilize 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.

### **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. 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.

#### **ii) Foreign Currency Risk**

We do not have assets or liabilities denominated 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 favourable terms.

Our main liquidity requirements will arise from mortgage advances, manager fees and distributions to shareholders. All of the aforementioned liquidity requirements are generally funded from cash flows earned on mortgage interest and fees. Our 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 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.

## **Capital Management**

Our capital consists of shareholders' equity. Our objectives when managing capital are, with a focus on capital preservation, to acquire, originate and maintain a portfolio consisting primarily of construction mortgages that generates attractive returns relative to risk in order to permit us to pay quarterly distributions to our shareholders.

We set the amount of capital in relation to risk and manage the capital structure and make adjustments to it in light of changes to economic conditions and the risk characteristics of the underlying assets.

Our objectives when managing capital are:

- i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and,
- ii) to maintain investor, creditor, and market confidence in order to sustain the future development of the business.

Our company is subject to externally imposed capital requirements. The credit facility contains certain financial covenants that must be maintained. During the period, we were in compliance with all financial covenants.

## **Use of Estimates and Judgements**

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 amounts 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 us the ability to effectively defer redemption indefinitely. Accordingly, we have 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 have 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, 2022.

#### **Outstanding Share Data**

The company's authorized share capital as at April 17, 2023 consists of 1,000 Voting Shares, of which 100 were outstanding at period-end; an unlimited number of Class A Non-Voting Shares, of which 2,261,124 are outstanding; and an unlimited number of Class B Non-Voting Shares, of which 912,836 are outstanding.

#### **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 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 reasonable time 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.

### **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).