



## **Builders Capital Mortgage Corp.**

Management's Discussion and Analysis  
Quarter Ended September 30, 2023

## 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 November 29, 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, and the Condensed Consolidated Interim Financial Statements (unaudited) for the three months ended September 30, 2023 and 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 primarily 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 primarily in Western Canada. 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.

## **Q3 2023 Summary**

### **Performance Highlights**

- We distributed \$0.20 per share to our Class A public shareholders in the third quarter of 2023, again meeting our distribution target as we have every quarter since our inception 10 years ago.
- Subsequent to the quarter-end, we distributed \$0.40 per share to our Class B shareholders based on Q3 2023 earnings. This provided an annualized 16% return on the original \$10.00 share issue price.
- We achieved the highest quarterly revenue result in our history, with third quarter revenues growing 28% to \$1.2 million, from \$0.9 million Q3 2022.
- Total comprehensive income grew 20.4% year-over-year to \$817,000, from \$701,000.
- Earnings per share increased to \$0.26, from \$0.24 year-over-year.
- Assets held for sale were successfully reduced by 45% as compared to a year ago. By quarter-end, assets held for sale represented just 2.2% of shareholders' equity.
- We achieved an approximate weighted average loan-to-value ratio on our mortgage portfolio of slightly better than our 75% target level.

## Business Environment

- Despite our strong current quarter results, we anticipate the Western Canadian housing market incurring tightening with higher interest rates affecting demand for new home construction.
- Our strategy will be to maintain the increased geographic diversity in our portfolio, while also emphasizing market segments we consider to be strongest, with consistent turnover.
- On top of maintaining a healthy weighted average loan-to-value ratio in our portfolio, we see opportunity in our market sector for growth to service an under appreciated market segment.

## Financial Overview

	Three months ended September 30, 2023 \$	Three months ended September 30, 2022 \$	Nine months ended September 30, 2023 \$	Nine months ended September 30, 2022 \$
Revenues	1,201,781	938,523	3,415,536	2,697,969
Total comprehensive earnings	817,368	700,808	2,480,022	2,060,245
Net mortgages receivable, end of period	36,327,104	30,392,071	36,327,104	30,392,071
Total assets	37,189,078	32,117,611	37,189,078	32,117,611
Shareholders' equity	29,503,926	27,075,517	29,503,926	27,075,517
Basic and Diluted Earnings per share	0.26	0.24	0.78	0.71
Cash dividends declared	817,359	654,078	2,340,131	1,925,662
Cash dividends declared per Class A share	0.20	0.2016	0.5972	0.5983
Cash dividends declared per Class B share	0.40	0.2742	0.1972	0.7975

## Investment Portfolio

At September 30, 2023

Property Type	Mortgage Portfolio (No.)	Outstanding Balance (\$)	Total Committed Mortgage Principal (\$)	%
Single family – Detached	18	18,975,671	24,632,200	51%
Single family – Attached	9	17,924,335	22,475,000	49%
<b>Total:</b>	<b>27</b>	<b>36,900,006</b>	<b>47,107,200</b>	<b>100%</b>
<b>Geographic Location of Property</b>				
Calgary and Area	9	12,349,190	19,315,000	33%
Edmonton and Area	1	897,808	825,000	2%
Other Alberta	3	2,453,377	3,900,000	7%
British Columbia	13	20,755,088	22,647,200	56%
Nova Scotia	1	444,543	420,000	1%
<b>Total:</b>	<b>27</b>	<b>36,900,006</b>	<b>47,107,200</b>	<b>100%</b>
<b>Interest Rate (excluding fees)</b>				
Less than 10%	1	399,393	590,000	1%
10%-10.99%	8	12,170,787	14,620,000	33%
11%-11.99%	2	2,429,247	2,950,000	7%
12%-12.99%	13	19,717,549	26,540,000	53%
13% or greater	3	2,183,030	2,407,200	6%
<b>Total:</b>	<b>27</b>	<b>36,900,006</b>	<b>47,107,200</b>	<b>100%</b>
<b>Original Funding Date *</b>				
Calendar 2023	3	2,351,511	2,507,200	6%
Calendar 2022	11	13,509,305	19,210,000	37%
Calendar 2021	9	13,145,872	17,540,000	36%
Calendar 2020	3	5,389,927	5,350,000	15%
Calendar 2019	1	2,503,391	2,500,000	7%
<b>Total:</b>	<b>27</b>	<b>36,900,006</b>	<b>47,107,200</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

Ideal operating conditions for our business exist when strong demand for construction financing combines with elevated conventional lender interest rates. Such conditions continued through the third quarter of 2023 this propagated another strong performance in both quarterly revenue and total comprehensive income results. This allowed us to pay our planned third quarter distributions to our Class A shareholders and to pay 16% annualized returns to our class B shareholders (\$.39 per share on April 28, \$.40 per share on July 31, 2023 and \$.40 per share on October 31, 2023), while also continuing to build our retained earnings.

Higher interest rates in general continue to support our loan demand as the rate gap between our products and other lenders has narrowed. Renewals and new mortgage generation has seen our interest rates increase so that the weighted average rate on our portfolio is now 12.02%, up from 10.72% at September 30, 2022.

Strong capital utilization was another positive contributor to our results as we not only kept our mortgage book full, but built on it by utilizing our line of credit to fund additional mortgage advances. By quarter-end, net mortgages receivable represented 123% of our shareholders' equity, a level that we expect will continue to moderate in Q4. Reducing our assets held for sale by 45% year-over-year also assisted in growing our mortgage portfolio as we channeled proceeds from property sales into productive mortgages. At quarter-end we continued to have one unsold property remaining in the portfolio with a conditional sales agreement on that property.

In the third quarter housing price gains have moderated in most of our markets with a notable trend to slower turnover in the properties priced over one million dollars. Growing scarcity in well qualified tradespeople combined with increases in the cost of construction materials are driving higher costs for our builder clients. We continue to monitor our markets carefully and are refocusing our loan portfolio on more affordable products in jurisdictions that continue to support development.

As always, we have maintained a sharp focus on monitoring portfolio risk. During the third quarter we re-directed our underwriting away from the lower mainland in British Columbia as a preventative measure against what we view as a dwindling value proposition. We currently have three loans on which we are pursuing enforcement actions, in all three cases we expect to fully recover our principal and accrued interest due to the value of the underlying security. Mortgages on which we instigate the collection process continue to accrue interest at the mortgage's prevailing rate and have provisions to include a full recovery of the expenses to enforce our security.

## Operating Results for the Three and Nine Months Ended September 30, 2023

Market conditions remained positive for our business in the third quarter, continuing the trend set in Q1 and Q2. Our builder customers were generally able to sell their projects within a reasonable timeframe upon completion that, in turn, generated strong third quarter and nine months interest and lender fee revenues for Builders Capital.



In anticipation of a potentially slowing market, we doubled our loan loss provisions in the quarter to \$113,000 (9.4% of revenues) compared to \$54,000 (5.8% of revenues) in the same period last year. For the nine months of 2023, our provision for mortgage losses increased by 8.8% to \$172,000 (5.0% of revenues), from \$158,000 (5.8% of revenues) in the first nine months of 2022.

For the three months ended September 30, 2023, cash advances and invoiced interest was down to \$9.5 million compared to \$11.1 million in 2022. This represented 38% of shareholders' equity as we continued to turn-over our mortgage portfolio at approximately our targeted rate. Nine month cash advances and invoiced interest of \$29.5 million was stable compared to \$30.1 million in the nine months of 2022, representing 100% of shareholders' equity.

Third quarter mortgage repayments of \$8.6 million, while 19.6% lower than the \$10.7 million received in the year prior, created total turnover (calculated by averaging total loan repayments and total loan advances) of 29.1% of our shareholders' equity. This was slightly better than the 33% of capital required to meet our goal of turning over our capital approximately every nine months. Nine month mortgage repayments of \$23.1 million were lower than repayments of \$25.8 million in the nine months 2022.

We are pleased that we maintained our targeted 75% approximate weighted average loan-to-value ratio ("LTV") of our mortgage portfolio through the third quarter.

Generally, the only debt that we employ is through our line of credit, which is used primarily as a cash flow tool, but also to fund quality mortgage investments opportunities as they become available. In the third quarter we did not increase the line of credit balance, maintaining it at \$6.6 million. However, to the extent opportunities arise, we will continue to fund mortgages from the line of credit as long as the mortgages at rates achieved are in excess of our incremental borrowing costs.

At the end of the quarter, the total value of our mortgage portfolio, before considering our \$573,000 allowance for mortgage losses, had grown to \$37.1 million. This was a 1.1% increase as compared to Q2 2023 and a significant 18.2% increase year-over-year. At September 30, 2023, our loan portfolio was made up of 27 mortgages with an average outstanding balance of \$1.37 million. This compares to 34 mortgages averaging \$0.91 million as at September 30, 2022.

## **Revenue**

For the three months ended September 30, 2023, we achieved the best quarterly revenues in our history with total third quarter revenues growing 28% to over \$1.2 million from \$0.94 million in the same period last year. This included interest revenues of \$1.1 million (up 30.6% year-over-year from \$0.83 million) and lender fee revenues of \$119,000 (up 9.0% year-over-year from \$109,000). Our Q3 revenue results represented 4.07% of shareholders' equity at quarter-end and equated to an annualized gross revenue of 16.3% of equity, representing our highest quarterly sales to equity performance since Q1 2016.

For the nine months ended September 30, 2023, our revenues grew 26.6% to a record \$3.4 million, up from \$2.7 million in the same period last year.

Our strong Q3 and nine months revenue results reflect a combination of fewer unproductive assets held for sale, higher turnover rates in the quarter, higher interest rates charged to borrowers, and a larger

capital base. Because our revenues are comprised primarily of interest charges, increasing market rates provide an opportunity to increase the rates we charge to borrowers. The weighted average interest rate charged on our loans grew to 12.1% in the third quarter, up from an average of 10.7% a year earlier and 11.7% three months prior at the end of June. As mortgages renew and new ones are issued, we expect this average to continue exceed 12% by the end of Q4 2023.

## **Expenses**

Operating expenses, excluding funds set aside to provide for loan losses and interest expense, were \$112,000 in the third quarter, an increase of 10.3% from \$104,000 in the same period last year. A higher management fee expense related to the growth in our share capital accounts for \$6,000 of this \$8,000 increase, while the remainder is the result of bank and legal fees charged on increasing the limit on our line of credit. As a percentage of revenues, our third quarter operating expenses remained tightly managed at 9.3%, as compared to 11.1% of revenues in the same period last year. Our goal is to keep operating expenses below 10% of revenues. For the nine months ended September 30, 2023, operating expenses were \$333,000 as compared to \$306,000 in the nine months of 2022, an increase of 9.1%.

Our third quarter 2023 provision for mortgage losses increased by 109% to \$113,000, from \$54,000 in Q3 2022. Year-to-date, our provision of \$172,000 was 8.8% higher than the provision required in the nine months of 2022. The Q3 and full nine months 2023 provisions represent 9.4% and 5.0% of revenues, respectively. During the third quarter, we continued with foreclosure proceedings on two mortgages and initiated enforcement action on a third. On the first, we have been through the court process and received a judge's order listing the properties for sale. This has resulted in sales offers sufficient to payout our mortgage and costs. On the second property we have also received a judge's order listing the properties for sale though we have received no offers to date. The third property is waiting for a judicial hearing date. As foreclosures are always subject to uncertainty, we have proactively increased our bad debt provision in the quarter to ensure we are properly covered in the face of a potential market slowdown.

Our interest expense has been increasing in recent quarters reflecting both the growth in our mortgage portfolio in response to improved market conditions and higher bank interest rates. Our third quarter interest expense was \$159,000 in 2023, as compared to \$79,000 in Q3 2022, while nine months interest expense increased to \$430,000 from \$174,000.

We primarily utilize our line of credit as a cash flow tool allowing us to keep our own capital as fully employed as possible while still meeting the peak demands of our borrowers. In general, the summer construction season results in the highest demand for construction draws. At the end of the third quarter, our line of credit balance stood at \$6.7 million, as compared to \$5.7 million at December 31, 2022 and \$4.4 million a year earlier at September 30, 2022.

## **Total Comprehensive Income**

Total comprehensive income grew to \$817,000 in the third quarter, an increase of 16.6% from \$701,000 in the same period last year. Nine months comprehensive income of \$2.48 million was up 20.4% from \$2.06 million in the nine months of 2022. Our earnings trend is such that in the three years since Q1 2020, our four-quarter moving average total comprehensive income has increased by 47%. This increase

has been the result of reasonably strong real estate markets, increasing interest rates, reduced loss provisions and a growing capital base.

Third quarter earnings per share grew to \$0.26, from \$0.24 in the same period in 2022, while nine months earnings per share increased to \$0.78 from \$0.74. The year-over-year improvements reflect the success of our strategies for strengthening and diversifying our mortgage portfolio and reducing our provisions for mortgage losses. Though we see some sectors of the market struggling to maintain historic profitability we are confident that our builder clients have adjusted their market exposure and we have strategically pivoted our portfolio away from sectors that we believe will have a lower value proposition in the coming quarters.

One important aspect of our publicly traded Class A Non-Voting Shares is the dividend priority over the Class B Non-Voting Shares that they are afforded. 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. This means that all of the earnings attributable to the capital that Class B shareholders have invested in the Company go firstly to satisfy the Class A dividend. Earnings in the current quarter were \$0.26 per share overall, equating to \$0.36 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 1.81 times. Class B shareholders bear a much greater proportion of the risk of income fluctuations than do Class A shareholders, which makes our \$.80 Class A annual distribution compare extremely favourably to other similar investments on a risk-adjusted basis.

### **Statement of Financial Position**

Our goal is to always keep our capital as fully invested in quality mortgages as possible while ensuring that sufficient cash is available to fund construction draw requests as they are received. At September 30, 2023, our net funded mortgages totaled \$36.3 million (December 31, 2022 – \$34.1 million), comprising 97.7% of our total assets of \$37.2 million (December 31, 2022 – \$35.7 million) and 123% of our shareholders' equity. This represents a 17.4% increase from our net funded mortgage balance of \$30.9 million balance at September 30, 2022 and reflects the following factors: \$524,000 being shifted from unproductive inventory to productive mortgages, and expanded utilization of our credit facility.

The remaining 1.8% of our total assets, or \$651,000, remains in property held for sale. Assets held for sale are typically properties which we have obtained in foreclosure actions. In most cases, these properties are unfinished at the time, and we typically expend resources to complete them and prepare them for sale. At quarter-end we were holding one such property, consisting of a vacant building lot in Cochrane, Alberta, on which we foreclosed in Q1 2022. This property is now under a conditional contract for sale and we have received non-refundable deposits against its eventual sale, resulting in a lower carrying value. We expect the sale to complete by the end 2023.

Liabilities at quarter-end, excluding our line of credit, totaled \$1,032,000 (December 31, 2022 – \$733,000), the largest component of which was dividends relating to the fiscal quarter paid on October 31, 2023. The remaining 62% of our liabilities consist of 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 \$6.7 million (December 31, 2022 - \$5.7 million) up from \$4.4 million a year prior. Use of the line of credit is an indication that our equity is fully invested and that we have sufficient quality mortgage investment opportunities available. Over the last 12 months we have successfully invested additional funds into our mortgage portfolio with additional use of the line of credit being an important component.

Shareholders' Equity consists of net share capital and retained earnings. In January 2023, pursuant to a private placement we issued 10,752 Class A Non-Voting shares for net proceeds after share issuance costs of \$94,000. This compares to the January 2022 share issue of 2,322 shares for net proceeds of \$23,000 to participants in our Dividend Re-investment Plan (DRIP). The DRIP plan allows shareholders to automatically re-invest the distributions we make to them in additional shares. We issue shares from treasury to satisfy the plan's requirements when sufficient shares are not available to purchase in the market for a price of \$10.00 or less per share. There were no other share issuances or redemptions during the quarter or the nine month period.

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 September 30, 2023 \$	Quarter ended June 30, 2023 \$	Quarter ended March 31, 2023 \$	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 \$
Revenues	1,201,781	1,128,856	1,084,900	1,061,004	938,523	914,929	844,516	884,194	780,972
Total comprehensive earnings	817,368	833,340	829,315	647,964	700,808	694,575	664,861	642,857	575,009
Total assets	37,189,078	36,746,415	36,010,916	35,720,048	32,117,611	32,055,029	30,682,037	30,518,304	29,778,385
Assets held for sale	651,288	649,768	765,695	1,187,064	1,175,338	1,243,197	1,240,113	1,752,075	2,474,098
Shareholders' equity	29,503,926	29,503,919	29,482,917	29,269,826	27,075,517	27,031,412	26,951,410	26,887,779	26,854,608
Earnings per share	0.26	0.26	0.26	0.22	0.24	0.24	.23	.22	.20
Cash dividends declared	817,358	812,339	710,434	706,804	654,078	647,134	624,450	609,686	584,765
Cash dividends declared per Class A share	0.20	0.20	0.1972	0.2016	0.2016	0.1995	0.1972	0.2016	0.2016
Cash dividends declared per Class B share	0.40	0.3945	0.2898	0.2773	0.2742	0.2712	0.2521	0.2268	0.1995

## 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 September 22, 2023, based on income for the third quarter of 2023, our Board of Directors declared a dividend of \$0.20 per Class A Non-Voting Share to shareholders of record on September 30, 2023. This distribution was paid on October 31, 2023 and is recorded as payable in the accompanying condensed consolidated interim financial statements.

Subsequent to the quarter-end, on October 24, 2023, again based on income for the third quarter of 2023, the Board declared a dividend of \$0.40 per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on October 31, 2023. This dividend is not recorded in these condensed consolidated interim financial statements as it was declared after the quarter-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 and protect the interests of our investors.

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 typically turns over in just under a year. 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 \$47.1 million, which exceed the current amounts funded by \$10.2 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 \$7.5 million 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 directors Sandy Loutitt is an owner. 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 one request for redemption in 2023 for 9,300 shares.

## **Related-Party Transactions**

Our manager is a company controlled by Sandy Loutitt, who is also a director and officer 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 \$79,000 for the quarter (Q3 2022 - \$73,000), the increase being attributable to a higher share capital balance.

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 third quarter of 2023, fees collected on behalf of the manager totaled \$297,000 (Q3 2022 - \$259,000).

The Company engages in the purchase and sale of mortgages, primarily as a cash management tool. 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 Q3 2023, and due to higher utilization of our cash, two mortgages were sold with an aggregate value of \$.7 million and no mortgages were purchased.

## 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.

Inflation pressures are moderating slightly in October to 3.1% year-over-year, decreasing the possibility of further interest rate increases. Overall market sentiment (turnover and price appreciation) are starting to slow particularly in the higher-priced segment where the continued in-migration to Alberta from other provinces has offset some of these factors in the regional market. Though higher interest rates can have the effect of dampening demand for housing, this also creates opportunities for our Company to both increase the interest rates we charge to borrowers and to gain additional market share as competitors increase their rates as well. We continue to see our competitors becoming more conservative in their lending, in turn enabling us to be more conservative in our own lending while still maintaining or growing our market share. We are currently fully invested with more demand for mortgages than we can meet.

We believe that despite short-term variability in home prices and sales levels, demand for housing will remain strong in the long run, and that new home construction will remain at levels which will continue to provide us sufficient opportunity to keep our lending book full. In its Spring 2023 Housing Market Outlook, Canada Mortgage and Housing Corporation (CMHC) stated, "We expect annual prices, sales and starts to record growth in the 2023-2024 period onward. Inflation will come back to the 2% target by the end of the forecast period, so mortgage rates, for their part, will gradually decline from 2023 levels. Together, these changes, along with renewed growth in income and employment, will support housing demand and supply."

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 price and sale volumes in Alberta. We will continue to closely monitor the markets we serve and will focus our resources on exploiting opportunities offered by regional differences.

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 successfully reduced the approximate weighted average loan-to-value ratio on our portfolio to our target level of 75% and will focus on keeping it at this level. Given the historic escalation in prices that occurred across much of the country in recent years, 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 increase, we believe the necessary safeguards are in place 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 which enable 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's risk level has become too high, we will work on



converting our investments to cash, and will forego returns in order to protect the capital with which we have 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 fluctuate.

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 condensed consolidated interim 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 condensed consolidated interim 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 condensed consolidated interim 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 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 condensed consolidated interim financial statements for the quarter ended September 30, 2023.

### **Outstanding Share Data**

The Company's authorized share capital as at November 29, 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. Second, 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.

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).