

# **Madison Pacific Properties Inc.**

Consolidated Financial Statements  
For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars)



November 23, 2017

## **Independent Auditor's Report**

### **To the Shareholders of Madison Pacific Properties Inc.**

We have audited the accompanying consolidated financial statements of Madison Pacific Properties Inc. and its subsidiaries, which comprise the consolidated balance sheets as at August 31, 2017 and August 31, 2016 and the consolidated statements of changes in equity, income and comprehensive income, and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Madison Pacific Properties Inc. and its subsidiaries as at August 31, 2017 and August 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

*PricewaterhouseCoopers LLP*

**Chartered Professional Accountants**

# Madison Pacific Properties Inc.

## Consolidated Balance Sheets

As at August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars)

	2017 \$	2016 \$
<b>Assets</b>		
<b>Non-current assets</b>		
Investment properties (note 4)	476,714	416,587
Other non-current assets (note 6)	22,930	27,911
	<u>499,644</u>	<u>444,498</u>
<b>Current assets</b>		
Cash and cash equivalents	11,237	33,427
Amounts receivable and other current assets (note 7)	3,193	2,359
Income taxes receivable (note 15)	215	255
Assets held for sale (notes 4 and 5)	3,830	-
	<u>18,475</u>	<u>36,041</u>
<b>Total assets</b>	<u>518,119</u>	<u>480,539</u>
<b>Liabilities</b>		
<b>Non-current liabilities</b>		
Debt on investment properties (note 8)	165,285	170,640
Deferred income tax liabilities (note 15)	23,087	16,073
	<u>188,372</u>	<u>186,713</u>
<b>Current liabilities</b>		
Current portion of debt on investment properties (note 8)	35,881	27,618
Accounts payable and accrued liabilities (note 9)	8,107	8,936
	<u>43,988</u>	<u>36,554</u>
<b>Total liabilities</b>	<u>232,360</u>	<u>223,267</u>
<b>Equity</b>		
<b>Equity attributable to shareholders of the Company</b>		
Share capital (note 11)	67,472	67,472
Contributed surplus	1,093	1,037
Retained earnings	208,051	181,218
	<u>276,616</u>	<u>249,727</u>
<b>Non-controlling interests</b>	<u>9,143</u>	<u>7,545</u>
<b>Total equity</b>	<u>285,759</u>	<u>257,272</u>
<b>Total liabilities and equity</b>	<u>518,119</u>	<u>480,539</u>

Approved by the Board of Directors

“Sam Grippo” Director

“Marvin Haasen” Director

The accompanying notes are an integral part of these consolidated financial statements.

**Madison Pacific Properties Inc.**  
**Consolidated Statements of Changes in Equity**  
**For the Years Ended August 31, 2017 and August 31, 2016**  
(expressed in thousands of Canadian dollars)

	<u>Attributable to shareholders of the Company</u>				Non- controlling interests \$	Total equity \$
	Share capital \$	Contributed surplus \$	Retained earnings \$	Total \$		
<b>Balance – August 31, 2015</b>	67,472	921	134,138	202,531	8,295	210,826
Stock-based compensation	-	116	-	116	-	116
Net income and comprehensive income	-	-	53,230	53,230	2,201	55,431
Dividends (note 12)	-	-	(6,150)	(6,150)	-	(6,150)
Distributions to non-controlling interests	-	-	-	-	(2,951)	(2,951)
<b>Balance – August 31, 2016</b>	67,472	1,037	181,218	249,727	7,545	257,272
Stock-based compensation	-	56	-	56	-	56
Net income and comprehensive income	-	-	52,985	52,985	2,086	55,071
Dividends (note 12)	-	-	(26,152)	(26,152)	-	(26,152)
Distributions to non-controlling interests	-	-	-	-	(488)	(488)
<b>Balance – August 31, 2017</b>	<b>67,472</b>	<b>1,093</b>	<b>208,051</b>	<b>276,616</b>	<b>9,143</b>	<b>285,759</b>

The accompanying notes are an integral part of these consolidated financial statements.

# Madison Pacific Properties Inc.

## Consolidated Statements of Income and Comprehensive Income

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except per share data)

	2017	2016
	\$	\$
Property revenues (notes 13 and 17)	30,391	30,270
Property operating expenses (notes 14 and 17)	8,249	7,770
	<u>22,142</u>	<u>22,500</u>
General and administrative expenses (notes 14 and 17)	2,382	2,805
	<u>19,760</u>	<u>19,695</u>
Net gain on fair value adjustment on investment properties (note 4)	40,297	50,960
Equity earnings of associate (note 6)	4,494	1,143
	<u>64,551</u>	<u>71,798</u>
Interest income (note 17)	165	1,117
Interest expense	7,010	7,579
Gains (losses) on fair value adjustment on interest rate swaps and disposition of loan receivable (notes 8 and 17)	4,569	(532)
	<u>62,275</u>	<u>64,804</u>
Income before income taxes	62,275	64,804
Income taxes (note 15)	7,204	9,373
	<u>55,071</u>	<u>55,431</u>
Net income and comprehensive income	<u>55,071</u>	<u>55,431</u>
<b>Net income and comprehensive income attributable to:</b>		
Shareholders of the Company	52,985	53,230
Non-controlling interests	2,086	2,201
	<u>55,071</u>	<u>55,431</u>
<b>Income per share (note 16)</b>		
Basic	\$0.91	\$0.91
Diluted	\$0.91	\$0.91

The accompanying notes are an integral part of these consolidated financial statements.

# Madison Pacific Properties Inc.

## Consolidated Statements of Cash Flows

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars)

	2017	2016
	\$	\$
<b>Cash flows from operating activities</b>		
Net income	55,071	55,431
Items not affecting cash		
Net gain on fair value adjustment on investment properties	(40,297)	(50,960)
Amortization	871	672
Equity earnings of associate	(4,494)	(1,143)
Stock-based compensation	56	116
(Gains) losses on fair value adjustment on interest rate swaps and disposition of loan receivable	(4,569)	532
Recognition of rental revenue on a straight-line basis	(303)	(255)
Deferred income taxes	7,014	9,402
	<u>13,349</u>	<u>13,795</u>
(Increase) decrease in amounts receivable and other assets	(2,837)	907
Decrease (increase) in income taxes receivable	39	(47)
Increase (decrease) in accounts payable and accrued liabilities	3,718	(584)
	<u>14,269</u>	<u>14,071</u>
<b>Cash flows (used by) from investing activities</b>		
Acquisition of investment properties	(20,085)	(6,412)
Additions to investment properties and property development costs	(3,342)	(2,014)
Other investment property expenditures	(746)	(119)
Net proceeds from disposition of investment properties	-	45,062
Investment in associate (note 17)	(1,199)	(2,500)
Proceeds from disposition of loan receivable (loan advances), net (notes 6 and 17)	12,677	(181)
	<u>(12,695)</u>	<u>33,836</u>
<b>Cash flows used by financing activities</b>		
Net proceeds from debt on investment properties	19,383	52,774
Bank indebtedness, net	-	(7,252)
Repayment of debt on investment properties	(16,507)	(55,007)
Distributions to non-controlling interests	(488)	(2,951)
Dividends paid	(26,152)	(6,150)
	<u>(23,764)</u>	<u>(18,586)</u>
(Decrease) increase in cash and cash equivalents	(22,190)	29,321
Cash and cash equivalents - beginning of year	33,427	4,106
Cash and cash equivalents - end of year	<u>11,237</u>	<u>33,427</u>
<b>Supplemental cash flow information</b>		
Interest received	170	2,142
Interest paid	6,986	7,752

The accompanying notes are an integral part of these consolidated financial statements.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 1. General information

Madison Pacific Properties Inc. (the “Company”) owns, develops and operates office, industrial, and commercial real estate properties located in British Columbia, Alberta, and Ontario. The Company is incorporated and domiciled in Canada. The head office of the Company is located at 389 West 6<sup>th</sup> Avenue, Vancouver, British Columbia, V5Y 1L1, and its registered office is located at 25<sup>th</sup> Floor, Toronto-Dominion Bank Tower, 700 West Georgia Street, Vancouver, British Columbia, V7Y 1B3.

### 2. Summary of significant accounting policies and critical accounting estimates

#### a. Basis of presentation

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). IFRS comprises IFRS, International Accounting Standards (“IAS”), and interpretations issued by the IFRS Interpretations Committee (“IFRIC”) and the former Standing Interpretations Committee (“SIC”).

These consolidated financial statements were approved by the Board of Directors on November 21, 2017.

#### b. Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for investment properties and financial derivatives, which are measured at fair value.

#### c. New accounting standards and amendments

During the year ended August 31, 2017, the Company did not adopt any new accounting standards or amendments, or make changes to its accounting policies.

#### d. Principles of consolidation

##### *Subsidiaries*

These consolidated financial statements incorporate the assets and liabilities of all entities controlled by the Company and the results of all controlled entities. Controlled entities are those entities over which the Company has i) the power to govern the financial and operating policies, ii) the right to receive benefits from that entity, and iii) the ability to use its operating decisions to alter the benefits received. These criteria are met by having a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. In addition, for consolidation purposes, factors may exist where an entity may consolidate without having more than 50% of the voting power through ownership or agreements, or in the circumstances of enhanced minority rights, as a consequence of *de facto* control. *De facto* control is control without the legal right to exercise unilateral control, and involves decision-making abilities that are not shared with others and the ability to give direction with respect to the operating and financial policies of the entity concerned. Where control of a subsidiary ceases during a financial year, its results are included up to the point in the year when control ceases. Where control of an entity is acquired during a financial year, its

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

results are included in the consolidated statement of income and comprehensive income from the date on which control commences.

The Company's subsidiaries are Metro Vancouver Properties Corp. ("Metro"), MP Western Properties Inc., 1073774 Properties Inc., 3530639 Canada Inc., 801325 B.C. Ltd., the MPW Properties Partnership, 1100935 B.C. Ltd., the MT Properties LP, and MT Management Inc. The Company holds a 100% interest in MP Western Properties Inc., 1073774 Properties Inc., 3530639 Canada Inc., and a 99.8% interest in Metro which holds a 100% interest in the MPW Properties Partnership and 801325 B.C. Ltd, a 60.9% interest in the MT Properties LP, and a 75% interest in MT Management Inc.

All inter-company balances, transactions, and unrealized profits resulting from inter-company transactions are eliminated.

### *Non-controlling interests*

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Changes in the parent company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

### *Joint arrangements*

The Company classifies its interests in joint arrangements as either a joint venture or a joint operation. A joint arrangement is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control. A joint arrangement is classified as a joint venture when the parties to the joint arrangement have rights over the net assets of the joint arrangement, whereas a joint arrangement is classified as a joint operation when the arrangement provides rights to assets and obligations for liabilities for the parties sharing joint control. Joint ventures are accounted for using the equity method, and joint operations are accounted for using the proportionate consolidation method whereby the Company's share of assets, liabilities, income, expenses and cash flows of jointly controlled operations are combined with the equivalent items in the results on a line-by-line basis.

### *Associates*

Associates are entities over which the Company has significant influence but not control. Investments in associates are accounted for using the equity method as follows:

- Investments are initially recognized at cost.
- Investments in associates include goodwill and intangible assets identified on acquisition, net of any accumulated impairment loss.
- The Company's share of its associates' post-acquisition profits or losses is recognized in the consolidated statement of income and comprehensive income.
- Dividends and distributions receivable from associates reduce the carrying amount of the investment.
- The Company's liability with respect to its associates is limited to its net investment where it has no obligation to fund any subsequent losses should they arise. There is no obligation beyond the initial investment.
- Associates are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### e. Investment properties

Investment properties are held to earn rental income, for capital appreciation, or for both. Investment properties also include properties being constructed or developed for future use, including existing investment properties which undergo redevelopment for continued future use. Property interests held under operating leases are not treated as investment properties.

An investment property is initially measured at cost, which includes the cost of the acquisition, property transfer taxes, due diligence costs, and standard closing costs.

After initial recognition, investment properties are carried at fair value. Fair value represents the estimated amount at which the properties could be exchanged between a knowledgeable and willing buyer and seller in an arm's length transaction at the date of valuation. Valuations are prepared by management based primarily on assumptions relating to cash flow from current leases, rental income from future leases in light of current market conditions, and capitalization rates. The capitalization rates used are generally based on ranges provided by external valuers. These assumptions are further compared against information obtained from independent industry experts. Adjustments are made to the fair values of the investment properties when changes in the underlying valuation assumptions occur. Changes in fair values are recognized in the consolidated statement of income and comprehensive income.

Fair value measurement on property under construction is only applied if the fair value is considered to be reliably measurable.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that the Company will receive future economic benefits associated with the expenditures and the fair value of the investment property exceeds its carrying amount plus subsequent expenditures. All other repair and maintenance costs are expensed when incurred.

For investment properties being constructed, developed or redeveloped for future use, all direct expenditures incurred in connection with the construction or development are capitalized during the development period. This period begins from the date that activities commence to prepare the property for its intended use and ends when such activities are substantially complete.

Depreciation is not taken on investment properties.

Investment properties are derecognized either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss arising on the derecognition of an investment property is recognized as a net gain in the fair value adjustment on investment properties in the consolidated statement of income and comprehensive income in the period in which the investment property is derecognized.

Investment properties are classified as held for sale when the criteria in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, are met. The resulting sale is recognized when title passes to the purchaser, all or substantially all of the proceeds have been received or are receivable, and all material conditions of the sales agreement have been met.

# **Madison Pacific Properties Inc.**

## **Notes to the Consolidated Financial Statements**

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### **f. Leases**

The Company has retained substantially all of the risks and benefits of ownership of its revenue properties and therefore accounts for leases with its tenants as operating leases. Properties leased out under operating leases are included in investment properties in the consolidated balance sheet.

When a tenant lease provides for free rent periods and/or periodic increases in base rent over the lease term, the total amount of net rental revenue to be received from these leases is accounted for on a straight-line basis over the term of the applicable lease. Accordingly, an asset is recorded for the current difference between the straight-line rent recorded as rental revenue and the rent that is contractually due from the tenant. As the lease term progresses and the step-rate increase is received, the asset is drawn down. The asset is included in the carrying amount of the related investment property.

Tenant incentives comprise costs incurred to make leasehold improvements to tenants' space and are included in the carrying amount of the related investment property. Such incentives are recognized as a reduction of rental income on a straight-line basis over the term of the applicable lease.

Leasing commissions are fees paid in connection with negotiating lease contracts with lessees. Such fees are included in the carrying amount of the related investment property and are amortized on a straight-line basis over the term of the applicable lease.

### **g. Cash and cash equivalents**

Cash and cash equivalents include cash on hand, deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less.

### **h. Financial instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the financial instruments were acquired:

- i. Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. Derivatives, including interest rate swaps, are also included in this category unless they are designated as hedges.
- ii. Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company currently has no available-for-sale investments.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

Available-for-sale investments are initially recognized at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current, unless the investment matures within 12 months, or management expects to dispose of it within 12 months.

Dividends on available-for-sale equity instruments are recognized in the consolidated statement of income and comprehensive income as part of other gains and losses when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the consolidated statement of income and comprehensive income.

- iii. Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise loans receivable, cash and cash equivalents, and amounts receivable. The current portion of loans receivable, cash and cash equivalents, and amounts receivable are included in current assets due to their short-term nature. The balance of loans receivable that is not current is included in non-current assets. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.
- iv. Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, bank indebtedness drawn on the line of credit, and debt on investment properties. Accounts payable and accrued liabilities and bank indebtedness drawn on the line of credit are recognized at the amount required to be paid. Debt on investment properties is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

### **i. Derivative financial instruments**

The Company enters into interest rate swaps from time to time to manage interest rate risk. Interest rate swaps are financial derivatives and are classified as carried at fair value through profit or loss. The fair value of an interest rate swap is included in the consolidated balance sheet within accounts payable and accrued liabilities if the fair value of the interest rate swap results in an unrealized loss, and the fair value of an interest rate swap is included within other current assets if the fair value of the interest rate swap results in an unrealized gain. Gains and losses on re-measurement are included in the consolidated statement of income and comprehensive income (note 8).

### **j. Revenue recognition**

Property revenues include rental revenue and property management revenue.

Rental revenue from operating leases is recognized on a straight-line basis over the applicable lease term. The cost of tenant incentives is recognized over the term of the applicable lease as a reduction in rental revenue.

# **Madison Pacific Properties Inc.**

## **Notes to the Consolidated Financial Statements**

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

Rental revenue includes the recovery of certain operating expenses and property taxes.

Unearned revenue represents deposits received in advance of rent being earned and property taxes recovered prior to their due date.

Property management revenue is recorded monthly as earned.

### **k. Stock-based compensation**

Pursuant to the terms of employment contracts entered into in 2013, certain executives of the Company are granted a specified number of shares of a significant shareholder of the Company on the anniversary dates of their employment. The Company expenses the fair value of these stock awards. The Company determines the fair value of these stock awards at the date of grant using the Black-Scholes option pricing model and recognizes the fair value over the vesting period as stock-based compensation expense with a corresponding adjustment to contributed surplus.

### **l. Provisions**

Provisions for restructuring costs, warranties and legal claims, where applicable, are recognized in other liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material.

### **m. Income taxes**

The Company follows the asset and liability method of accounting for income taxes whereby deferred income tax assets and liabilities are recognized for differences between the bases of assets and liabilities used for financial statement and income tax purposes. Deferred income tax assets and liabilities are calculated using substantively enacted tax rates for the period in which the differences are expected to reverse. Deferred income tax assets are recognized only to the extent that management determines that it is more likely than not that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

### **n. Income per share**

Basic income per share is calculated by dividing the net income or loss for the year attributable to shareholders of the Company by the weighted average number of Class B voting and Class C non-voting common shares outstanding during the year.

Diluted income per share is calculated by adjusting the weighted average number of Class B voting and Class C non-voting common shares outstanding for dilutive instruments.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### **o. Fair value**

Fair value measurements recognized in the consolidated balance sheet are categorized in accordance with the following levels:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement in its entirety.

### **p. Critical accounting estimates and judgements**

The preparation of financial statements requires management to use judgement in applying its accounting policies and to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

Significant areas requiring the use of management judgements, estimates, and assumptions relate to:

#### **i. Fair value of investment properties**

After initial recognition, valuations of investment properties are prepared by management based primarily on assumptions relating to cash flows from current leases, rental income from future leases in light of current market conditions, and capitalization rates. The capitalization rates used are generally based on ranges provided by external valuers. These assumptions are further compared against information obtained from independent industry experts. Adjustments are made to the carrying values of the investment properties when changes in the underlying valuation assumptions occur.

#### **ii. Income taxes**

Management has estimated the income tax provision and deferred income tax balances in accordance with its interpretation of the various income tax laws and regulations. It is possible, due to the complexity inherent in estimating income taxes, that the tax provision and deferred income tax balances could change.

In accordance with IAS 12, *Income Taxes*, the Company has recognized income tax losses and undeducted expenditures as deferred income tax assets. At this time, management has estimated that there will be sufficient future taxable income to utilize the losses and expenditures.

The Company has unrecognized investment tax credits. At this time, management has estimated that the recoverability is still in doubt as the Company has not established when it will be in a taxable position.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

Management uses judgement based on underlying facts and assumptions when determining whether a provision for a tax liability or derecognition of a deferred income tax asset is required for tax positions in dispute with tax authorities (note 15).

iii. Allocation of purchase price on investment property acquisitions

On the acquisition of an investment property, the Company is required to make an allocation for the building component of the property in order to calculate depreciation for income tax purposes.

iv. Stock-based compensation

The Company determines the fair value of the stock options and other stock awards at the date of grant using the Black-Scholes option pricing model.

v. Assets held for sale

The Company makes estimates and assumptions about the fair values and selling costs of assets held for sale in determining their carrying amounts. The classification of an investment property as an asset held for sale requires the use of judgement regarding whether the criteria are met for this classification as at the date of the consolidated financial statements.

### 3. Accounting standards and amendments issued but not effective

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*. IFRS 15 establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company has not completed its assessment of the effect, if any, of IFRS 15, but does not expect the new standard to have a significant effect on its consolidated financial statements.

In July 2014, the IASB issued the final version of IFRS 9, *Financial Instruments*, which addresses the classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. In addition, IFRS 7, *Financial Instruments – Disclosures*, has been amended to require additional disclosures on transition from IAS 39 to IFRS 9. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Company has not completed its assessment of the effect, if any, of IFRS 9, but does not expect the new standard to have a significant effect on its consolidated financial statements.

In January 2016, the IASB issued IFRS 16, *Leases*. The new standard replaces IAS 17, *Leases*, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, distinguishing between a lease and a service contract on the basis of whether the customer controls the asset being leased. For those assets determined to meet the definition of a lease, IFRS 16 introduces significant changes to the accounting by lessees, introducing a single, on-balance sheet accounting model that is similar to current finance lease accounting, with limited exceptions for short-term leases or leases of low value

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

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assets. Lessor accounting remains similar to current accounting practice. The standard is effective for annual periods beginning on or after January 1, 2019, with early application permitted for entities that apply IFRS 15. The Company has not completed its assessment of the effect, if any, of IFRS 16, but does not expect the new standard to have a significant effect on its consolidated financial statements.

In January 2016, the IASB issued amendments to IAS 12, *Income Taxes*, to clarify the requirements for recognizing deferred tax assets on unrealized losses, deferred tax where an asset is measured at a fair value below the asset's tax base, and certain other aspects of accounting for deferred tax assets. The amended standard is effective for annual periods beginning on or after January 1, 2017. The Company has not completed its assessment of the effect, if any, of the amendments to IAS 12, but does not expect the amendments to have a significant effect on its consolidated financial statements.

In January 2016, the IASB issued amendments to IAS 7, *Statement of Cash Flows*, to require disclosures about changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amended standard is effective for annual periods beginning on or after January 1, 2017. The Company has not completed its assessment of the effect, if any, of the amendments to IAS 7, but does not expect the amendments to have a significant effect on its consolidated financial statements.

In June 2017, the IASB issued IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments*, to clarify the application of recognition and measurement requirements in IAS 12, *Income Taxes*, when there is uncertainty over income tax treatments. The interpretation is effective for annual periods beginning on or after January 1, 2019, with early application permitted. The Company has not completed its assessment of the effect, if any, of this interpretation on its consolidated financial statements.

#### 4. Investment properties

	August 31, 2017 \$	August 31, 2016 \$
Balance at beginning of year	416,587	403,022
Additions:		
Acquisitions (note 4(b))	20,085	6,412
Other additions	3,267	1,539
Dispositions (note 4(c))	-	(45,062)
Recognition of rental revenue on a straight-line basis	303	255
Tenant improvements	606	192
Amortization of tenant improvements	(615)	(654)
Leasing commissions	238	142
Amortization of leasing commissions	(224)	(219)
Net gain on fair value adjustment	40,297	50,960
	<u>480,544</u>	<u>416,587</u>
Assets held for sale (note 5)	(3,830)	-
	<u>476,714</u>	<u>416,587</u>
Balance at end of year	476,714	416,587

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### a. Valuations

After initial recognition, valuations are prepared by management based primarily on assumptions relating to cash flows from current leases, rental income from future leases in light of current market conditions, and capitalization rates. The capitalization rates used are generally based on ranges provided by external valuers. These assumptions are further compared against information obtained from independent industry experts. Adjustments are made to the carrying values of the investment properties when changes in the underlying valuation assumptions occur.

The fair value of the Company's investment properties is considered to be at Level 3 in the fair value hierarchy (note 2(o)), as significant unobservable inputs are required to determine fair value.

### b. Investment property acquisitions

For the year ended August 31, 2017, the Company acquired \$20,085 in investment properties in the Metro Vancouver region, some of which were acquired through 50% co-ownership structures.

For the year ended August 31, 2016, the Company acquired \$6,412 in investment properties in the Metro Vancouver region, some of which were acquired through 50% co-ownership structures.

### c. Investment property dispositions

For the year ended August 31, 2017, the Company had no dispositions of investment properties.

For the year ended August 31, 2016, the Company sold three properties in the Metro Vancouver region and three properties in Eastern Canada for total proceeds before closing costs of \$46,325.

### d. Sensitivity

The following table provides a sensitivity analysis for the weighted average capitalization rate applied at August 31, 2017, excluding properties under development and held for sale:

Capitalization rate increase (decrease)	Weighted average capitalization rate	Fair value of investment properties (at Company's ownership) \$	Fair value variance \$	% change
(0.75%)	3.88%	566,491	104,311	22.6%
(0.50%)	4.18%	525,473	63,293	13.7%
(0.25%)	4.47%	491,354	29,174	6.3%
August 31	4.75%	462,180	-	-
0.25%	5.03%	436,768	(25,412)	(5.5%)
0.50%	5.30%	414,329	(47,851)	(10.4%)
0.75%	5.57%	394,308	(67,872)	(14.7%)

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 5. Assets held for sale

The carrying values of assets held for sale are established to be the lower of their carrying values or their estimated fair values less selling costs.

As at August 31, 2017, the Company classified one industrial investment property located in British Columbia as held for sale.

As at August 31, 2016, no investment properties were classified as held for sale.

### 6. Other non-current assets

	August 31, 2017	August 31, 2016
	\$	\$
Loans receivable (note 17(c))	495	13,173
Deposits (note 15)	10,878	8,739
Investment in associate	11,416	5,723
Other	141	276
	<u>22,930</u>	<u>27,911</u>

On October 4, 2016, the Company assigned its interest in a loan receivable of \$12,650 due from a 50% related joint venture, to Madison Venture Corporation, a significant shareholder of the Company and a partner in the joint venture, for consideration of \$15,500, resulting in a gain on disposition of the loan receivable of \$2,850. Loans receivable include unsecured loans to tenants of \$495 (August 31, 2016 - \$523) with interest at fixed rates up to 6.0% (August 31, 2016 - 6.0%).

Deposits include amounts paid for income tax reassessments in dispute (note 15).

The investment in associate includes an equity investment in Grant Street Properties Inc. ("GSP"), a related private company that owns and manages commercial and industrial properties. On May 25, 2017, the Company acquired 309,838 newly issued shares in GSP for cash consideration of \$1,199, resulting in a total ownership interest of 33.83%. The Company has also provided a limited bank loan guarantee of \$496 for bank debt of the associate. This investment has been accounted for using the equity method and includes equity earnings for the year of \$4,494 (year ended August 31, 2016 - \$1,143). The Company's share of assets, liabilities, revenue and other income, and expenses as at and for the year ended August 31, 2017 is \$16,381, \$5,086, \$5,437 and \$943 (August 31, 2016 - \$9,252, \$3,482, \$1,606 and \$463), respectively.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 7. Amounts receivable and other current assets

	August 31, 2017	August 31, 2016
	\$	\$
Accounts receivable	191	125
Interest receivable and current portion of loans receivable (notes 6 and 17(c))	126	97
Prepaid expenses, deposits and other	2,328	2,137
Fair value assets on interest rate swaps (note 8)	548	-
	<u>3,193</u>	<u>2,359</u>

### 8. Debt on investment properties

	August 31, 2017	August 31, 2016
	\$	\$
Balance at beginning of year	198,258	200,693
Net proceeds from debt issuances	19,383	52,774
Amortization of deferred finance costs	197	203
Amortization of acquisition date fair value adjustments on assumed debt	(165)	(405)
Repayment of debt	<u>(16,507)</u>	<u>(55,007)</u>
Balance at end of year	201,166	198,258
Less: current portion	<u>35,881</u>	<u>27,618</u>
Non-current portion	<u>165,285</u>	<u>170,640</u>

Mortgage and construction loans are secured by charges against the related properties and corporate guarantees. Of the total mortgage and construction loans (before netting of deferred financing costs and fair value adjustments to assumed debt), \$193,381 (August 31, 2016 - \$195,203) bears interest at fixed rates ranging from 2.40% to 5.68% (August 31, 2016 - 2.40% to 5.68%) per annum and \$8,220 (August 31, 2016 - \$3,386) bears interest at bank prime rate plus 0.70% to 1.25% (August 31, 2016 - 0.70% to 1.25%) per annum. The weighted average interest rate on fixed rate debt as at August 31, 2017 was 3.58% (August 31, 2016 - 3.63%).

See note 20 for minimum principle repayments.

#### Interest rate swaps

The Company has entered into interest rate swaps with Canadian chartered banks on three mortgages to fix the Company's interest rates on those mortgages. The swaps had notional amounts as at August 31, 2017 totalling \$64,173 (August 31, 2016 - \$66,279), fixed swap rates ranging from 2.92% to 3.14%, and maturity

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

dates ranging from June 2020 to June 2021. The total notional amount of the interest rate swaps represented 31.8% as at August 31, 2017 (August 31, 2016 - 33.4%) of the total debt on investment properties (before netting of deferred financing costs and fair value adjustments to assumed debt) and bank indebtedness. The Company anticipates holding the mortgages and interest rate swap contracts until maturity.

The total fair value of the interest rate swaps and net realized and unrealized gains (losses) on those contracts are as follows:

	<u>Fair value assets (liabilities)</u>		<u>Net gains (losses) on interest rate swaps</u>	
	August 31,		Year ended August 31,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Interest rate swaps	548	(1,171)	1,719	(532)

### 9. Accounts payable and accrued liabilities

	August 31, 2017	August 31, 2016
	\$	\$
Trade payables	647	562
Dividends payable	3,075	3,075
Accrued interest payable	484	460
Fair value liabilities on interest rate swaps (note 8)	-	1,171
Other accrued liabilities	1,001	1,212
Tenant deposits	1,043	982
Unearned revenue	1,857	1,474
	<u>8,107</u>	<u>8,936</u>

### 10. Bank indebtedness

The Company has a line of credit of up to \$20,000 (August 31, 2016 - \$20,000) bearing interest at bank prime rate plus 1% or the Bankers Acceptance rate (August 31, 2016 - bank prime rate plus 1% or the Bankers Acceptance rate) with a Canadian chartered bank. As at August 31, 2017, \$nil (August 31, 2016 - \$nil) had been drawn against this line of credit. The amount available under this line of credit varies with the fair value of investment properties pledged, up to a maximum of \$20,000. Second mortgages against certain of the Company's investment properties, assignments of rents and insurance, as well as general security agreements creating floating charges over all of the Company's assets, have been provided as security. Amounts advanced under this line of credit are repayable on demand. The line of credit agreement contains the

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

following financial ratios that must be maintained, with which the Company was in compliance as at August 31, 2017:

- Not permit the debt service coverage ratio to be less than 1.25 to 1.00;
- Not permit the ratio of EBITDA to interest expense on all debt secured by the investment properties pledged to be less than 1.50 to 1.00;
- Not permit the aggregate amount of all outstanding borrowings secured by the investment properties pledged to exceed 65% of their appraised values; and
- Not permit the tangible net worth of the Company to be at any time less than \$125,000.

### 11. Share capital

#### Authorized and issued

The authorized share capital of the Company consists of an unlimited number of Class A non-voting preferred shares without par value, an unlimited number of Class B voting common shares without par value, and an unlimited number of Class C non-voting common shares without par value.

The following table summarizes the issued share capital as at August 31, 2017 and August 31, 2016:

	<u>Class B common shares</u>		<u>Class C common shares</u>		<u>Total</u>	
	<u>Number</u>	<u>Amount</u> <u>\$</u>	<u>Number</u>	<u>Amount</u> <u>\$</u>	<u>Number</u>	<u>Amount</u> <u>\$</u>
Balance – August 31, 2017 and August 31, 2016	7,255,500	7,720	51,315,089	59,752	58,570,589	67,472

No shares were issued or cancelled during the years ended August 31, 2017 and August 31, 2016.

### 12. Dividends

On July 13, 2017, the Company declared a dividend of \$0.0525 per class B common share and Class C common share payable on September 7, 2017.

On January 12, 2017, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on February 24, 2017.

On September 6, 2016, the Company declared the payment of a special cash dividend of \$0.3415 per Class B common share and Class C common share payable on September 30, 2016 to shareholders of record on September 22, 2016.

On July 12, 2016, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on September 7, 2016.

On January 13, 2016, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on February 24, 2016.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 13. Property revenues

The following table summarizes the components of property revenues for the years ended:

	August 31, 2017 \$	August 31, 2016 \$
Rental revenue	29,661	29,489
Property management revenue	730	781
	<u>30,391</u>	<u>30,270</u>

Future minimum rental commitments on non-cancellable tenant operating leases on a calendar year basis beginning January 1, 2018 are summarized in the following table:

	\$
Not later than 1 year	21,653
Later than 1 year and not later than 5 years	64,094
Later than 5 years	<u>31,805</u>
	<u>117,552</u>

### 14. Property operating and general and administrative expenses

For the year ended August 31, 2017, property operating expenses consisted of property taxes of \$5,555 (year ended August 31, 2016 - \$5,603) and other property-related expenses of \$2,694 (year ended August 31, 2016 - \$2,167). Property operating expenses that relate to investment property vacancies amounted to \$84 (year ended August 31, 2016 - \$97).

For the year ended August 31, 2017, general and administrative expenses consisted of employee compensation and benefits of \$1,480 (year ended August 31, 2016 - \$1,640), professional fees of \$385 (year ended August 31, 2016 - \$698), and other administrative expenses of \$517 (year ended August 31, 2016 - \$467).

The following table summarizes employee compensation and benefits expense for the years ended:

	August 31, 2017 \$	August 31, 2016 \$
Salaries and short-term employee benefits	1,424	1,524
Stock-based compensation	56	116
	<u>1,480</u>	<u>1,640</u>

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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### 15. Income taxes

The following table provides the components of income taxes for years ended:

	August 31, 2017	August 31, 2016
	\$	\$
Current income tax expense (recovery)	190	(29)
Deferred income tax expense	7,014	9,402
	<u>7,204</u>	<u>9,373</u>

Income taxes vary from the amount that would be expected if computed by applying the Canadian federal and provincial statutory income tax rates to the Company's income before income taxes as shown in the following table for the years ended:

	August 31, 2017		August 31, 2016	
	\$		\$	
Income before income taxes	62,275		64,804	
	\$	%	\$	%
Expected income taxes at statutory rates	16,247	26.1	16,912	26.1
Adjustments				
Non-taxable portion of realized and unrealized capital gains	(5,497)	(8.8)	(6,722)	(10.4)
Recognition of previously unrecognized tax assets	(730)	(1.2)	-	-
Adjustment in respect of prior years	(454)	(0.7)	-	-
Equity earnings in investee	(1,169)	(1.9)	(297)	(0.2)
Other items	(1,193)	(1.9)	(520)	(1.0)
Income taxes	<u>7,204</u>	<u>11.6</u>	<u>9,373</u>	<u>14.5</u>

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

Deferred income tax liabilities comprise the following:

	<b>August 31, 2017</b>	<b>August 31, 2016</b>
	<b>\$</b>	<b>\$</b>
Benefit of non-capital losses carried forward	(1,507)	(2,227)
Benefit of capital losses carried forward	(907)	(1,177)
Undeducted expenditures	(9,342)	(9,339)
Deferred income tax assets not recognized	946	946
Investment tax credits	140	-
Investment properties	31,667	25,862
Tenant improvements and leasing costs	1,269	1,268
Straight-line rental revenue in excess of base rents	821	740
	<u>23,087</u>	<u>16,073</u>

The entire change in deferred income tax liabilities for the years ended August 31, 2017 and August 31, 2016 has been recognized in net income for those respective years.

As at August 31, 2017, the Company has approximately \$35,846 of scientific research and development expenditures available for unlimited carry forward and approximately \$5,540 of non-capital losses which begin to expire in 2030, which may be used to reduce future Canadian income taxes otherwise payable. The Company also has approximately \$7,726 of unrecognized federal investment tax credits and approximately \$174 of unrecognized provincial investment tax credits which begin to expire in 2018, and can also be carried forward to be used to reduce future Canadian income taxes otherwise payable.

The federal investment tax credits and non-capital losses expire as follows:

	<b>Federal investment tax credits</b>	<b>Non-capital losses carried forward</b>
	<b>\$</b>	<b>\$</b>
2018	317	-
2019	602	-
2020	679	-
2021	625	-
2022	880	-
2023	1,048	-
2024	934	-
2025	865	-
2026	727	-
2027	689	-
2028	360	-
2030	-	5,089
2037	-	451
	<u>7,726</u>	<u>5,540</u>

# Madison Pacific Properties Inc.

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In addition, the Company has capital losses carried forward of approximately \$6,974 which may be used to reduce future taxable capital gains in Canada and do not expire.

### Contingencies

The Company and certain subsidiaries have received from the Canada Revenue Agency (“CRA”) and Alberta Tax and Revenue Administration (“ATRA”) tax notices of reassessment for various taxation years. The reassessments deny the application and usage of certain non-capital losses, capital losses, deductions and investment tax credits arising from prior years. In addition, the CRA and ATRA are disallowing unclaimed carry-forward non-capital losses of \$11,378, carry-forward capital losses of \$9,824, carry-forward scientific research and development expenditures of \$35,846, and investment tax credits of \$7,726. As a result, additional taxes payable for the reassessed years, including interest, total \$22,944. The Company and its subsidiaries have filed notices of objection to the reassessments with the CRA and ATRA. To object to the reassessments, the Company and its subsidiaries were required to make deposits totalling \$10,878 for a portion of the taxes and interest the CRA and ATRA have claimed are owed. The Company and its subsidiaries have made these deposits and they are included in other non-current assets. Additional estimated interest accruing on the unpaid portion of the reassessments was approximately \$1,707 as at August 31, 2017.

The Company and its counsel believe that its filing positions for the Company and subsidiaries described above are appropriate and in accordance with the law. It intends to vigorously defend such positions as required. Accordingly, the Company has not recorded a liability in these consolidated financial statements for the reassessed taxes payable and related interest described above nor has it reduced the carrying value of deferred income tax assets recorded for unused carry-forward amounts. If the Company is ultimately successful in defending its positions, deposits made plus applicable interest will be refunded to the Company. There is no assurance that the Company’s objections and appeals will be successful. If the CRA and ATRA are successful, the Company will be required to pay the balance of taxes reassessed plus applicable interest and derecognize deferred income tax assets related to the carry-forward amounts.

### 16. Income per share

	Year ended August 31,	
	2017	2016
Net income attributable to shareholders of the Company	\$52,985	\$53,230
Weighted average number of common shares outstanding	58,570,589	58,570,589
Basic and diluted income per share	\$0.91	\$0.91

### 17. Related party transactions

The following transactions occurred in the normal course of operations and are measured at the exchange amounts, which are the amounts agreed upon by the related parties.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### a. Transactions and balances with related parties

On May 25, 2017, the Company acquired 309,838 newly issued shares in its equity investee GSP, for \$1,199, resulting in an ownership interest of 33.83%.

The Company has engaged the services of a landscaping company owned by a related party. During the year ended August 31, 2017, landscaping and maintenance expenses paid to this company were \$292 (year ended August 31, 2016 - \$254).

### b. Transactions and balances with affiliates

During the year ended August 31, 2017, the Company engaged the services of an electrical contractor controlled by a shareholder of the Company for which it paid fees of \$32 (year ended August 31, 2016 - \$nil).

During the year ended August 31, 2017, rental revenues of \$2,008 (year ended August 31, 2016 - \$1,874) were received from tenants that are companies controlled by a shareholder of the Company.

During the year ended August 31, 2017, the Company paid management consulting fees of \$64 to a shareholder and a party related to a shareholder of the Company (year ended August 31, 2016 - \$148).

The Company has provided a limited guarantee of \$16,830 on the MT Properties LP mortgage debt. During the year ended August 31, 2017, a guarantee fee of \$50 (year ended August 31, 2016 - \$50) was paid to the Company.

### c. Transactions and balances with joint ventures

On October 4, 2016, the Company assigned its interest in a loan receivable of \$12,650 due from a 50% related joint venture, to Madison Venture Corporation, a significant shareholder of the Company and a partner in the joint venture, for cash consideration of \$15,500, resulting in a gain on disposition of the loan receivable of \$2,850.

### d. Key management personnel

Key management personnel include the Company's directors and officers. The following table summarizes compensation awarded to key management personnel for the years ended:

	August 31, 2017	August 31, 2016
	\$	\$
Salaries and short-term employee benefits	1,238	1,101
Stock-based compensation	56	116
	<u>1,294</u>	<u>1,217</u>

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 18. Interests in joint arrangements

The Company's interests in investment properties owned through joint operations accounted for using proportionate consolidation are as follows:

Location	Description	Ownership interest as at	
		August 31, 2017	August 31, 2016
<b>Richmond, British Columbia</b>			
3351 Jacombs Road	Industrial	50%	50%
11388 No. 5 Road	Industrial	50%	50%
<b>Burnaby, British Columbia</b>			
7700 Riverfront Gate	Industrial	50%	50%
4750 Tillicum Street	Industrial	50%	50%
8155 North Fraser Way	Industrial	50%	50%
<b>Vancouver, British Columbia</b>			
1625 West 3 <sup>rd</sup> Avenue & 1855 Fir Street	Retail	50%	50%
148 West 6 <sup>th</sup> Avenue	Industrial	50%	50%
110-122 West 2 <sup>nd</sup> Avenue	Industrial	50%	-
<b>Mission, British Columbia</b>			
Silverdale	Development lands	50%	-

For these joint operations, the fair value of investment properties and carrying value of debt on those investment properties, at 50%, were \$53,437 and \$18,885, respectively, as at August 31, 2017 (August 31, 2016 - \$28,038 and \$14,445, respectively). The Company is contingently liable for the obligations of its joint operations. Management believes that the assets of its joint operations are available and sufficient for the purpose of satisfying such obligations.

### 19. Segment information

The Company's chief executive officer and chief financial officer examined the Company's performance and have concluded that the Company has one reportable segment - that being the rental of office, industrial, and commercial real estate properties located in Canada. Although properties are in different Canadian regions and in different asset classes, they have reasonably similar returns and risks.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 20. Financial instruments

#### Financial assets and liabilities

The Company classifies its financial instruments as follows:

	Loans and receivables	Other financial liabilities	Financial assets (liabilities) at fair value through profit or loss
August 31, 2017	\$	\$	\$
Other non-current financial assets	11,373	-	-
Cash and cash equivalents	11,237	-	-
Amounts receivable and other current financial assets	316	-	-
Debt on investment properties	-	(201,166)	-
Accounts payable and accrued liabilities	-	(8,107)	-
Fair value assets on interest rate swaps	-	-	548
Total	22,926	(209,273)	548

	Loans and receivables	Other financial liabilities	Financial assets (liabilities) at fair value through profit or loss
August 31, 2016	\$	\$	\$
Other non-current financial assets	21,912	-	-
Cash and cash equivalents	33,427	-	-
Amounts receivable and other current financial assets	222	-	-
Debt on investment properties	-	(198,258)	-
Accounts payable and accrued liabilities	-	(7,765)	-
Fair value liabilities on interest rate swaps	-	-	(1,171)
Total	55,561	(206,023)	(1,171)

#### Credit risk

The Company's credit risk is limited to the carrying amount of its cash and cash equivalents, amounts receivable, and long-term receivables.

##### a. Cash and cash equivalents

Deposits of cash are made with major Canadian banks and only with counterparties meeting certain credit criteria.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2017 and August 31, 2016

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### b. Amounts receivable

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments or repay loans advanced to assist them with leasehold improvements.

The Company follows a program of credit evaluations of tenants and limits the amount of credit extended when deemed necessary. The Company maintains provisions for potential credit losses, and any such losses to date have been within management's expectations.

Additionally, the Company mitigates tenant credit risk through staggered lease maturities and diversification of revenue sources resulting from a large tenant base and avoids dependence on any single tenant by ensuring no individual tenant contributes a significant percentage of the Company's gross revenue.

As at August 31, 2017, excluding revenue and leases related to properties under development and assets held for sale:

- No one tenant accounted for more than 14.53% (August 31, 2016 – 15.07%) of the Company's rental revenue.
- Lease maturities were staggered such that no more than 20.44% (August 31, 2016 – 20.27%) of the rental space was subject to renewal in any one year.

### Interest rate risk

Borrowings under the Company's operating line of credit and certain debt on investment properties bear interest at variable rates. The majority of mortgages bear interest at fixed rates, and therefore, the Company is not exposed to significant interest rate risk on those fixed rate mortgages. As at August 31, 2017, \$nil (August 31, 2016 - \$nil) had been drawn on the line of credit and the Company had \$8,220 (August 31, 2016 - \$3,386) in variable rate mortgages and construction loans. These variable rate borrowings represent 4.08% (August 31, 2016 - 1.70%) of the Company's total borrowings. The impact of a 1% change in the Company's variable rate borrowings would increase or decrease interest expense or pre-tax earnings for the year by \$82 (year ended August 31, 2016 - \$48). Additionally, the Company earns interest on its cash and cash equivalent balances at variable rates.

### Liquidity risk

The Company manages liquidity by maintaining adequate cash balances and by having an appropriate line of credit available. In addition, the Company regularly monitors and reviews both actual and forecasted cash flows. Refinancing risks are minimized by ensuring debt on investment properties has a balanced maturity schedule. Management does not anticipate any difficulty in refinancing debt on investment properties as the debt matures.

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

The following table details the minimum principal repayments for debt on investment properties. The amount in 2018 includes demand loans totalling \$6,599 on certain properties. Principal repayments on these demand loans are made monthly until their maturities between 2017 and 2022.

	\$
2018	35,982
2019	27,603
2020	78,929
2021	21,195
2022	31,225
2023 and thereafter	<u>6,667</u>
	<u>201,601</u>

### Fair value

Cash and cash equivalents, amounts receivable, and accounts payable and accrued liabilities have fair values that approximate their carrying values. The estimated fair value of debt on investment properties is \$203,950 (August 31, 2016 - \$204,857). The fair value of outstanding interest rate swaps is disclosed in note 8.

The estimated fair values of debt on investment properties and interest rate swaps are based on values derived using market interest rates of similar instruments and incorporate assumptions regarding current market interest rates, terms, and the related risk. Accordingly, changes in these assumptions would result in a variance in the fair value estimates.

## 21. Commitments

At August 31, 2017, future minimum commitments with respect to a land lease are as follows:

	<b>Direct commitment on land leases</b>
	\$
2018	92
2019	93
2020	94
2021	94
2022	94
2023 and thereafter	2,590

# Madison Pacific Properties Inc.

## Notes to the Consolidated Financial Statements

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 22. Capital management

The primary objective of the Company's capital management is to ensure that it maintains adequate capital resources in order to support its business and maximize shareholder value. The Company manages its capital structure with the goal of minimizing risk to the stability of cash flows from properties. Other goals include maintaining debt service coverage, interest coverage, and debt to equity ratios as well as maintaining minimum amounts of shareholders' equity as required by the Company's line of credit agreement. The Company's capital includes mortgage loans, construction loans, a line of credit, and equity.

The Company's principal source of financing is from mortgage loans. The ability to obtain a mortgage loan is dependent on the value of a specific property and the cash flows the property generates and the availability of funds from time to time from lending institutions. The Company expects to renew mortgage loans as they become due.

There have been no changes in the Company's approach to capital management in the year ended August 31, 2017.

The calculation of the total capital, excluding the undrawn line of credit, is summarized as follows:

	<b>August 31, 2017</b>	<b>August 31, 2016</b>
	\$	\$
Fixed rate mortgage loans	193,381	195,203
Variable rate mortgages and construction loans	8,220	3,386
	<u>201,601</u>	<u>198,589</u>
Equity	276,616	249,727
	<u>478,217</u>	<u>448,316</u>