

**MADISON PACIFIC PROPERTIES INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**(as of November 21, 2017)**

**(\$,000's)**

**Overview**

Madison Pacific Properties Inc. (“Madison” or the “Company”) is in the business of acquiring, developing and managing revenue producing office, industrial, and commercial real estate properties located in British Columbia, Alberta, and Ontario.

The following table shows the leasable area and base annual rent (except for properties under development and held for sale) as of November 21, 2017, for the three real estate property portfolios held by Madison:

<b>Province</b>	<b>Area and Rent<sup>(1), (2)</sup></b>	<b>Industrial</b>	<b>Retail/highway-commercial</b>	<b>Office</b>	<b>Total</b>
British Columbia	Leasable area (sq. ft.)	1,173,424	146,331	116,689	1,436,444
	Base annual rent (\$)	13,209	3,065	3,782	20,056
Alberta	Leasable area (sq. ft.)	268,218	-	-	268,218
	Base annual rent (\$)	2,658	-	-	2,658
Ontario	Leasable area (sq. ft.)	63,030	-	-	63,030
	Base annual rent (\$)	434	-	-	434
Total	Leasable area (sq. ft.)	1,504,672	146,331	116,689	1,767,692
	Base annual rent (\$)	16,301	3,065	3,782	23,148

(1) Leasable area includes 100% of the total leasable area of properties in the MT Properties LP of which the Company holds a 60.9% interest and 50% of the total leasable area of joint operations that are proportionally consolidated (at 50%) for financial statement purposes.

(2) Base annual rent is rent excluding recoveries for operating costs and property taxes and rents based on tenant revenue.

**Basis of Discussion and Analysis**

This management discussion and analysis (“MD&A”) of the consolidated financial condition of Madison as of August 31, 2017 and the results of its operations for the year ended August 31, 2017 was prepared as of November 21, 2017. The MD&A should be read in conjunction with the Company’s audited consolidated financial statements and accompanying notes for the years ended August 31, 2017 and August 31, 2016.

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”).

The consolidated financial statements include the operating results of Madison, its subsidiaries, and on a proportional basis, the accounts of its joint operations. All financial information is presented in Canadian dollars.

### **Forward-Looking Statements**

This MD&A contains forward-looking statements regarding the future success of Madison's business that are subject to risk and uncertainties. Forward-looking information typically contains statements with words such as "expect", "believe", "plan", "forecast", "intend" or similar words suggesting future outcomes. Examples of such forward-looking statements include statements regarding the Company's expectation to renew mortgage loans as they become due; the estimated amount of potential tax reassessments; the Company's belief that loan facilities together with funds on hand and cash generated from operations should provide adequate liquidity and sufficient funds to pay for potential tax reassessments; the Company's expectation to renew all credit facilities maturing in fiscal 2018 with interest rates and with terms comparable to those currently in place; the Company's expectation to hold interest rate swap contracts and the related floating rate mortgages until maturity; the Company's belief that there will be sufficient future taxable income to utilize income tax losses and undeducted expenditures; and the Company's belief that the recoverability of unrecognized investment tax credits is still in doubt. The material factors and assumptions used to develop forward-looking information include the current level of interest rates in the market, current relationships with the Company's lenders, current capitalization rates and long-term lease agreements supporting income expectations to utilize tax losses.

These forward-looking statements involve known and unknown risks and uncertainties that may cause Madison's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied in these forward-looking statements. These risks include risks related to the real estate industry generally such as, changes in interest rates, demand for office, industrial, and commercial rentals, illiquidity of real estate investments, non-renewal of tenant leases, fluctuation in real estate values, geographic concentration of the business, environmental matters and uninsured losses and income tax risk including reassessment and the sufficiency of taxable income to utilize losses. Although the forward-looking statements contained herein are based upon what management believes to be current and reasonable assumptions, Madison cannot assure readers that actual results will be consistent with these forward-looking statements. The forward-looking statements contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except as required by law, the Company undertakes no obligation to publicly update or revise any such forward-looking statements to reflect any change in its expectations or in events, conditions or circumstances on which any such forward-looking statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements.

### Selected Financial Information

The following table provides selected financial information as at and for the years ended:

(in \$000's except per share amounts)	August 31,		
	2017	2016	2015
Property revenues	30,391	30,270	30,363
Property operating expenses	8,249	7,770	7,798
General and administrative expenses	2,382	2,805	2,711
Net gain on fair value adjustment on investment properties	40,297	50,960	25,029
Equity earnings of associate	4,494	1,143	239
Interest income	165	1,117	940
Interest expense	7,010	7,579	8,765
Gains (losses) on fair value adjustment on interest rate swaps and disposition of loan receivable	4,569	(532)	(681)
Income before income taxes	62,275	64,804	36,616
Income taxes	7,204	9,373	5,922
Net income and comprehensive income	55,071	55,431	30,694
Net income and comprehensive income attributable to the shareholders of the Company	52,985	53,230	28,143
Income per share	\$0.91	\$0.91	\$0.48
Total assets	518,119	480,539	434,689
Non-current financial liabilities	165,285	170,640	148,801
Total debt on investment properties	201,166	198,258	200,693
Dividends per share	\$0.447	\$0.105	\$0.105

The Company's property revenues for 2017 were comparable to property revenues of 2016 with a 0.4% increase. The Company's property revenues for 2016 were comparable to property revenues of 2015 with a 0.3% decrease. For the explanations of the 2017 and 2016 income and net income attributable to shareholders of the Company, see "Results of Operations".

Total assets as at August 31, 2017 increased by \$37,580 compared to August 31, 2016. The increase is primarily attributable to investment property acquisitions totalling \$20,085 and fair value adjustments on investment properties of \$40,297 for the year ended August 31, 2017. The increase was partially offset by a decrease in cash and cash equivalents of \$22,190.

Total assets as at August 31, 2016 increased compared to August 31, 2015 due primarily to the acquisition of two properties located at 148 and 170 West 6<sup>th</sup> Avenue, Vancouver, British Columbia, the completion of the development at 12800 Bridgeport Road, Richmond, British Columbia, commencement of construction of the development at 8155 North Fraser Way, Burnaby, British Columbia, and from fair value adjustments on investment properties totalling \$50,960. The increases were partially offset from the disposition of six properties during the 2016 year.

Total debt on investment properties outstanding as at August 31, 2017 increased by \$2,908 compared to August 31, 2016, as a result of refinancing in the year and new debt financings on investment properties acquired.

Total debt on investment properties outstanding as at August 31, 2016 decreased slightly compared to August 31, 2015 due to the extinguishment of mortgages on the disposition of properties in the 2016 year and principal repayments, exceeding the increase in debt from the refinancing of some existing properties.

## **Results of Operations**

The following discussion highlights the significant activities that have occurred during the years ended August 31, 2017 and August 31, 2016, and up to the date of this MD&A:

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 (“MVC”), 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.

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.

### *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.

### *Investment property dispositions:*

For the year ended August 31, 2017, the Company has 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.

### *Operating results:*

*Property revenues* include rental revenue and property management revenue. Property revenues for the year ended August 31, 2017 were comparable to the year ended August 31, 2016 with only a 0.4% increase.

Excluding committed space, properties under development, and properties held for sale, vacancies were under 0.01% as at August 31, 2017 and under 0.01% as at August 31, 2016. Vacancies were 1.12% as of the date of this MD&A.

*Property operating expenses* were \$8,249 for the year ended August 31, 2017, compared to \$7,770 for the year ended August 31, 2016. The increase compared to the prior year is primarily attributable to an increase in property taxes, and recoverable and non-recoverable operating costs.

*General and administrative expenses* were \$2,382 for the year ended August 31, 2017 a decrease of 15% compared to the year ended August 31, 2016 of \$2,805. The decrease was primarily due to a reduction in compensation costs and professional fees.

*Net gain on fair value adjustment on investment properties* was \$40,297 for the year ended August 31, 2017. 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 valuation specialists. 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 gain for the year is primarily attributable to a reduction of cap rates across all asset classes in Metro Vancouver and higher lease rates achieved on some properties.

The table below provides the average capitalization rates (excluding properties under development and held for sale) and the ranges for each market category as at August 31, 2017 as it relates to the Metro Vancouver market where 79% of the Company's properties are located.

	<b>Company average cap rate</b>	<b>Market range</b>
Industrial	4.65%	4.00% to 5.25%
Retail/highway-commercial	5.60%	3.50% to 5.00%
Office	4.75%	4.25% to 4.75%

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

<b>Capitalization rate increase (decrease)</b>	<b>Weighted average capitalization Rate</b>	<b>Fair value of investment properties (at Company's ownership) \$</b>	<b>Fair value variance \$</b>	<b>% Change</b>
(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%)

*Equity earnings of associate:* Equity earnings of the Grant Street Properties Inc. ("GSP") investment, a related private company, for the year ended August 31, 2017 was \$4,494 compared to \$1,143 for the year ended August 31, 2016. The increase in equity earnings was primarily due to fair value adjustments on investment properties that GSP owns.

*Interest income:* For the year ended August 31, 2017, the Company earned interest income from loans and surplus cash of \$165. The decrease in interest income compared to the prior year is due to the disposition of a loan receivable of \$12,650 in fiscal 2017.

*Interest expense:* The decrease in interest expense of \$569 for the year ended August 31, 2017 compared to the year ended August 31, 2016 was due primarily to average lower interest rates on our debt on investment properties.

*Gains (losses) on fair value adjustment on interest rate swaps and disposition of loan receivable:* The gain on the fair value adjustment on interest rate swaps for the year ended August 31, 2017 was \$1,719 and relates to the total unrealized gains on three interest rate swaps with a total notional amount of \$64,173. The Company mitigates some interest rate risk by entering into fixed rate interest rate swaps on some of its mortgages. On October 4, 2016, the Company assigned its interest in a loan receivable of

\$12,650 due from a 50% related joint venture, to MVC for consideration of \$15,500, resulting in a gain on disposition of the loan receivable of \$2,850.

*Income taxes:* Income tax expense was \$7,204 for the year ended August 31, 2017 and \$9,373 for the year ended August 31, 2016. In addition to lower income before income taxes for the year ended August 31, 2017 compared to the prior year, the Company utilized some previously unrecognized federal and provincial investment tax credits in its 2016 tax filings, resulting in a lower tax expense compared to the year ended August 31, 2016. A reconciliation of the income tax provision can be found in note 15 of the consolidated financial statements.

*Net income and comprehensive income:* The overall decrease in net income and comprehensive income for the year ended August 31, 2017 compared to the year ended August 31, 2016 is explained in the analysis provided above.

*Operating capital:* Madison funds its current operations from its cash flows from operating activities, mortgages, construction loans and a bank line of credit. For the year ended August 31, 2017, Madison generated \$13,349 of cash flows from continuing operations (before changes in non-cash balances). Madison has a \$20,000 operating line of credit with a Canadian chartered bank. The Company and its subsidiaries had collectively drawn \$nil on the line of credit as at August 31, 2017 (August 31, 2016 - \$nil). Madison has been able to obtain new mortgage financing and renew its existing mortgages at interest rates and on terms comparable to fiscal 2016.

### **Summary of Quarterly Results**

<b>Quarter ended (in \$000's except per share amounts)</b>	<b>Property revenues</b>	<b>Net gain on fair value adjustment on investment properties</b>	<b>Net income and comprehensive income</b>	<b>Net income attributable to shareholders of the Company</b>	<b>Income per share attributable to shareholders of the Company</b>
November 30, 2015	7,557	5,206	6,849	6,698	\$0.11
February 29, 2016	7,723	5,571	6,551	6,480	\$0.11
May 31, 2016	7,525	14,358	16,980	15,221	\$0.26
August 31, 2016	7,465	25,825	25,051	24,831	\$0.43
November 30, 2016	7,461	5,156	11,393	11,042	\$0.19
February 28, 2017	7,744	10,329	14,537	14,233	\$0.24
May 31, 2017	7,504	10,129	12,370	12,179	\$0.21
August 31, 2017	7,682	14,683	16,771	15,531	\$0.27

### **2017 Quarterly Comparison**

*Overview:* Quarterly net income and comprehensive income is significantly impacted by the net gain on fair value adjustment on investment properties. The table above highlights the property revenues and net income and comprehensive income by quarter.

*Property revenues* for the quarter ended August 31, 2017 increased by approximately 2.4% compared to the prior quarter due primarily to an increase in recoverable operating costs. Overall, quarterly revenues for fiscal 2017 have been relatively comparable to the prior fiscal year.

*Net income and comprehensive income* was significantly impacted by the net gain on fair value adjustment on investment properties and from the gain on the disposition of a loan receivable. As a result, the quarterly net income and comprehensive income amounts are not comparable.

### **2016 Quarterly Comparison**

*Overview:* Quarterly net income and comprehensive income is significantly impacted by the net gain on fair value adjustment on investment properties. The table above highlights the property revenues and net income and comprehensive income by quarter.

*Property revenues* remained relatively consistent in fiscal 2016.

*Net income and comprehensive income* was significantly impacted by the net gain on fair value adjustment on investment properties. As a result, the quarterly net income and comprehensive income amounts are not comparable.

### **Results for the fourth quarter ended August 31, 2017 compared to August 31, 2016**

<b>(in \$000's)</b>	<b>Quarter ended August 31,</b>	
	<b>2017</b>	<b>2016</b>
Property revenues	7,682	7,465
Property operating expenses	2,110	1,661
General and administrative expenses	510	679
Net gain on fair value adjustment on investment properties	14,683	25,825
Equity earnings (loss) of associate	96	(241)
Interest income	31	308
Interest expense	1,763	1,835
Gains (losses) on fair value adjustment on interest rate swaps	1,071	(316)
Income before income taxes	19,180	28,866
Income taxes	2,409	3,815
Net income and comprehensive income	16,771	25,051

*Property revenues* increased by \$217 or 2.9% for the quarter ended August 31, 2017 compared to the quarter ended August 31, 2016. The increase in property revenues is due primarily to new revenue generated from the 8155 North Fraser Way, Burnaby development which was completed in February 2017, rental rate increases on some properties, and an increase in recoverable operating costs.

*Property operating expenses* for the quarter ended August 31, 2017 increased compared to the quarter ended August 31, 2016 due to higher property taxes, and recoverable and non-recoverable operating costs.

*General and administrative expenses* for the quarter ended August 31, 2017 were lower by 24.9% compared to the quarter ended August 31, 2016 due to lower compensation costs and professional fees.

*Net gain on fair value adjustment on investment properties* can vary significantly from quarter to quarter due to changes in capitalization rates in the market place which are beyond the control of the Company and rental rate changes. The gain for the quarter is reflective of lower capitalization rates on substantially all asset classes in the Metro Vancouver region.

*Equity earnings of associate* was a gain of \$96 for the quarter ended August 31, 2017 compared to a loss of \$241 in 2016, which is attributable to higher operating income in GSP.

*Interest income* was lower for the quarter ended August 31, 2017 compared to the quarter ended August 31, 2016 due to the disposition of a loan receivable of \$12,650 in the year.

*Interest expense* was lower for the quarter ended August 31, 2017 compared to the quarter ended August 31, 2016 due primarily to lower average interest rates on our debt on investment properties.

*Gains (losses) on fair value adjustment on interest rate swaps* was a gain of \$1,071 for the quarter ended August 31, 2017 compared to a loss of \$316 for the quarter ended August 31, 2016, as a result of rising interest rates compared to the prior year.

### **Liquidity and Capital Resources**

As at August 31, 2017, the Company had cash on hand of \$11,237 (August 31, 2016 - \$33,427) and had drawn \$nil (August 31, 2016 - \$nil) against its line of credit. The Company has a maximum line of credit of \$20,000. The line of credit with a Canadian chartered bank, bears interest at bank prime rate plus 1.0% or the Bankers Acceptance rate. The line of credit may be used for general business purposes and the amount available for such uses varies with the 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 the line of credit are repayable on demand. The line of credit agreement contains financial ratios which must be maintained for which the Company is in compliance.

The primary objective of the Company's capital management is to ensure that it maintains adequate capital 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 its 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 and construction loans, a line of credit and shareholders' equity.

The Company's principal source of financing is from mortgage loans. The ability to obtain a mortgage loan is dependent upon the value of the property and the cash flows the specific 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.

The Company believes it has sufficient funds and sources of funds to pay for potential tax reassessments.

### **Risks and Uncertainties**

#### **Real Estate Industry**

Investment properties are subject to varying degrees of risk. Such risks include changes in general economic conditions (such as the availability and cost of mortgage funds), local conditions (such as an over-supply of space or a reduction in demand for real estate in the area), the attractiveness of the properties to tenants, competition from others with available space and the ability of Madison to provide adequate maintenance at an economic cost.

Certain significant expenditures, including property taxes, maintenance costs, mortgage payments, insurance costs and related charges, must be made regardless of whether or not a property is producing sufficient income to cover such expenses. The real estate properties of Madison are subject to mortgages that require ongoing debt payments and repayments of outstanding amounts on maturity. If Madison is unable or unwilling to make mortgage repayments on any property, losses could be sustained as a result of the lenders exercising their rights of foreclosure or sale.

Real estate is relatively illiquid. Such illiquidity will tend to limit Madison's ability to vary its portfolio promptly in response to changing economic or investment conditions. Financial difficulties of other property owners resulting in distress sales may further depress real estate values in many of the markets in which Madison operates.

Madison manages these risks through ownership of good quality properties combined with a diverse tenant base. As at August 31, 2017, no one tenant accounted for more than 14.53% (August 31, 2016 - 15.07%) of the rental revenue of Madison and lease maturities are staggered such that as at August 31, 2017, no more than 20.44% (August 31, 2016 - 20.27%) of the rental space was subject to renewal in any one year.

### **Revenue Producing Properties**

The revenue producing properties of Madison generate income through rental receipts from tenants. Upon the expiry of any lease, there is no assurance that the lease will be renewed or the tenant replaced. The terms of any subsequent lease may be less favourable to Madison than the existing lease. Furthermore, at any time, a tenant of Madison's properties may seek the protection of bankruptcy, insolvency or similar laws which could result in the rejection and termination of such tenant's lease and a resultant reduction in cash flow available to Madison.

### **Fluctuations in Real Estate Values**

The commercial and industrial real estate industry is subject to variability and fluctuations in real estate values. The Company has elected to report its investment properties at fair value. Fair value represents the 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. Adjustments will be made to the fair values when changes in the underlying valuation assumptions occur.

### **Geographic Concentration**

Madison currently carries on the majority of its business in British Columbia, and more specifically Metro Vancouver. However, the Company has some geographic diversification with properties located in Alberta and Ontario. An economic downturn in any of these markets could cause leasing rates to decline, which could have a material adverse effect on the business and negatively affect the results of operations and financial condition of Madison.

### **Environmental Matters**

As an owner of investment properties, Madison is subject to various Canadian federal, provincial, and municipal laws relating to environmental matters. Such laws provide that Madison could be liable for costs of removal and remediation of certain hazardous substances or wastes released or deposited on or in its properties or disposed of at other locations. The failure to remove or remediate such substances, if any, could adversely affect Madison's ability to sell such real estate or pledge real estate as collateral for borrowing. In addition, such a situation could potentially result in claims against Madison. Madison is not

aware of any material pending or threatened investigations or actions by environmental regulatory authorities in connection with any of its properties or any material pending or threatened claims relating to environmental conditions at its properties. It is also possible that asbestos containing material (“ACM”) and polychlorinated biphenyls (“PCB”) in light fixtures may be present at some properties which may result in future removal and disposal costs; however, management is not aware of any such presence.

Madison has formal procedures to review and monitor environmental exposure on an ongoing basis and conducts thorough environmental due diligence as part of its acquisition process. Madison has made and will continue to make the necessary capital expenditures to ensure compliance with environmental laws and regulations. Environmental laws and regulations can change at any time and Madison may become subject to more stringent environmental laws and regulations in the future. Compliance with more stringent environmental laws and regulations could have a material adverse effect on Madison’s business, financial condition and results of operations.

### **General Uninsured Losses**

Madison carries comprehensive general liability, fire, flood, extended coverage and rental loss insurance with policy specifications, limits and deductibles customarily carried for similar properties. There are, however, certain types of risks (generally of a catastrophic nature such as from wars or environmental contamination) which are either uninsurable or not insurable on an economic basis. Madison currently has insurance for earthquake risks, subject to certain policy limits, deductibles, and self-insurance arrangements, and will continue to carry such insurance so long as it is economical to do so. Should an uninsured or underinsured loss occur, Madison could lose its investment in, and anticipated profits and cash flows from, one or more of its properties, while still being obligated to repay any recourse mortgage indebtedness on such properties. If a loss occurs in excess of insured limits, Madison could lose all or part of its investment in, and anticipated profits and cash flows from such property.

### **Income Taxes**

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 the 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.

### **Interest Rate Fluctuations**

Madison's capital structure involves risks primarily associated with leverage and interest rates. Madison's financing includes some indebtedness with interest rates set on a floating rate basis which could result in fluctuations in Madison's cost of borrowing. Madison has mitigated interest rate risk by refinancing 96% of its debt on investment properties (mortgage loans) at fixed rates ranging from 2.40% to 5.68% per annum and staggering maturities up to six years so that no more than 42% of such debt matures in one year. The Company has not experienced any difficulties in renewing mortgages as they have become due. The Company also mitigates interest rate risk by entering into interest rate swaps. As at August 31, 2017, the Company had entered into interest rate swaps with Canadian chartered banks on three mortgages to reduce the impact of fluctuating interest rates and fix the Company's interest rates on those mortgages. The swaps had notional amounts as at August 31, 2017 totalling \$64,173, fixed swap rates ranging from 2.92% to 3.14%, and maturity 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 weighted average interest rate on fixed rate mortgage debt as at August 31, 2017 was 3.58% (August 31, 2016 - 3.63%). Madison has approximately \$8,220 of floating rate mortgages and construction loans.

The Company has a line of credit that bears interest at bank prime rate plus 1.0% or the Banker's Acceptance rate. The line of credit may be used for general business purposes and the amount available for such uses varies with the value of investment properties pledged, up to a maximum of \$20,000. As at August 31, 2017, \$nil had been drawn on the line of credit. The Company's variable interest rate borrowings represent 4.08% of total borrowings. The impact of a 1.0% interest rate change on the Company's variable rate debt would increase or decrease interest expense and pre-tax earnings by \$82 per year.

These loan facilities, together with funds on hand and cash generated from operations, should provide adequate liquidity to meet the Company's obligations as they become due.

### **Contractual Obligations**

<b>(in \$000's)</b>	<b>Payments due by fiscal year</b>				
	<b>Total</b>	<b>September 2017 - August 2018</b>	<b>September 2018 - August 2020</b>	<b>September 2020 - August 2022</b>	<b>September 2022 and thereafter</b>
Debt on investment properties <sup>(1)</sup>	201,601	35,982	106,532	52,420	6,667
Land lease	3,057	92	187	188	2,590

(1) The amount in the period from September 2017 to August 2018 includes demand loans totalling \$6,599. Principal repayments on these demand loans are made monthly until their maturities between 2020 and 2022.

### **Off-Balance Sheet Arrangements**

Madison is required to provide letters of credit to municipalities in connection with development charges and rezoning applications. As of November 21, 2017, there were no outstanding letters of credit.

The Company enters into interest rate swaps. See "Risks and Uncertainties".

### **Transactions with Related Parties**

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

The Company has engaged the services of G.W. Property Services Ltd., 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). There are no long-term commitments with this company, which provides required landscaping and maintenance on some investment properties.

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

For the year ended August 31, 2017, rental revenues totalling \$2,008 (year ended August 31, 2016 - \$1,874) were received from Arrow Speed Controls Limited, Continental Electrical Motor Services Ltd., 0777061 B.C. Ltd., and Madison Industrial Equipment Inc. which are tenants and companies controlled by MVC, a shareholder of the Company. These companies have lease agreements with the Company.

For the year ended August 31, 2017, the Company paid consulting fees for various administration and support services of \$64 (year ended August 31, 2016 - \$148) to MVC, a shareholder of the Company.

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.

On October 4, 2016, the Company assigned its interest in a loan receivable of \$12,650 due from a 50% related joint venture, to MVC, 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. The transaction improved the Company's liquidity position.

Key management personnel include the Company's directors and officers. For the year ended August 31, 2017, compensation awarded to key management personnel included salaries and short-term employee benefits of \$1,237 (year ended August 31, 2016 - \$1,101) and stock-based compensation of \$56 (year ended August 31, 2016 - \$116).

The transactions with the related parties noted above have been recorded at their exchange amounts, which are the amounts agreed to by the related parties.

### **Outstanding Share Data**

As of November 21, 2017, there were 7,255,500 Class B voting common shares and 51,315,089 Class C non-voting common shares outstanding.

### **Cash Flows from Operating Activities**

The following table provides the Company's cash flows from operating activities for the years ended:

<b>(in \$000's)</b>	<b>August 31, 2017</b>	<b>August 31, 2016</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
	13,349	13,795
(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)
	14,269	14,071

For the year ended August 31, 2017, Madison generated \$13,349 of cash flows from continuing operations (before changes in non-cash balances) compared to \$13,795 for the year ended August 31, 2016. The decrease compared to the prior year is due primarily to lower interest income for the year ended August 31, 2017 compared to the year ended August 31, 2016.

### **Financial Instruments**

Madison finances its investment properties primarily through conventional mortgage loans. These mortgages have terms of between one and six years, and as at August 31, 2017, had a weighted average interest rate of 3.58% (August 31, 2016 - 3.63%). Of the total amount of debt on investment properties outstanding as at August 31, 2017, \$23,567 of mortgages is scheduled to mature by August 31, 2018.

Madison anticipates being able to renew all credit facilities maturing in fiscal 2018 at interest rates and with terms comparable to those currently in place.

As at August 31, 2017, the Company had 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 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 the 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.

Interest rate swaps are classified as financial assets and liabilities at fair value through profit or loss. 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)

### **Critical Accounting Estimates and Judgements**

Madison's significant accounting policies are described in note 2 to the consolidated financial statements. In certain cases, it is necessary to use judgements and estimates in applying these policies. In determining estimates, management uses the information available to Madison at the time of preparing the estimates. Management reviews key estimates on a regular basis to determine their appropriateness and updates estimates as required.

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 and are generally based 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 within ranges provided by external valuers. These assumptions are further compared against information obtained from independent industry experts.

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 income tax provision and deferred income tax balances could change. In accordance with IAS 12, *Income Taxes*, Madison 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 assumed that the recoverability is still in doubt as the Company has not established when it will be in a taxable position. Management uses judgment 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.

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

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.

The Company makes estimates and assumptions about the fair value 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 judgment regarding whether the criteria are met for this classification as at the date of the consolidated financial statements.

### **Changes in Accounting Policies**

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.

### **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 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.

### **Effectiveness of the Internal and Disclosure Controls and Procedures**

An evaluation has been carried out on the effectiveness of the Company's internal control over financial reporting and disclosure controls and procedures as defined in National Instrument 52-109. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer of the Company concluded that the design and operation of these internal and disclosure controls and procedures were effective.

The Company did not make any changes to the design of its internal controls over financial reporting in the year ended August 31, 2017 that would have materially affected, or would be reasonably likely to materially affect the Company's internal controls over financial reporting.

Management of Madison is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Internal financial controls and procedures have been designed under the supervision of management of Madison.

It should be noted, that while Madison believes that the current disclosure controls and procedures and internal controls over financial reporting provide a reasonable level of assurance, it cannot be expected that existing disclosure controls and procedures or internal financial controls will prevent all human error and circumvention or overriding of the controls and procedures. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

### **Additional Information**

Additional information relating to Madison may be found in the Annual Information Form and the Information Circular for its most recent annual general meeting of shareholders. Both of these prescribed filings may be found on the SEDAR web site ([www.sedar.com](http://www.sedar.com)).