

Madison Pacific Properties Inc.

Condensed Interim Consolidated Financial Statements
For the Three and Nine Months Ended May 31, 2019 and 2018

(expressed in thousands of Canadian dollars)

Notice of No Auditor Review of Interim Financial Statements

Under National Instrument 51-102 “Continuous Disclosure Obligations”, Part 4, Subsection 4.3(3a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed interim consolidated financial statements of the Company have been prepared by and are the responsibility of the Company’s management.

The Company’s independent auditor, PricewaterhouseCoopers LLP, has not performed a review of these financial statements in accordance with standards established by CPA (Chartered Professional Accountants) Canada for a review of interim financial statements by an entity’s auditor.

July 11, 2019

Madison Pacific Properties Inc.

Interim Consolidated Balance Sheets

As at May 31, 2019 and August 31, 2018

(unaudited)

(expressed in thousands of Canadian dollars)

	May 31, 2019 \$	August 31, 2018 \$
Assets		
Non-current assets		
Investment properties (note 5)	488,330	464,285
Other non-current assets (note 6)	70,189	59,215
	<u>558,519</u>	<u>523,500</u>
Current assets		
Cash and cash equivalents	56,817	46,207
Amounts receivable and other current assets	2,229	4,699
Income taxes receivable (note 11)	271	261
	<u>59,317</u>	<u>51,167</u>
Total assets	<u>617,836</u>	<u>574,667</u>
Liabilities		
Non-current liabilities		
Debt on investment properties (note 7)	199,963	173,264
Deferred income tax liabilities (note 11)	35,719	31,584
	<u>235,682</u>	<u>204,848</u>
Current liabilities		
Current portion of debt on investment properties (note 7)	31,397	36,946
Accounts payable and accrued liabilities	6,699	9,644
	<u>38,096</u>	<u>46,590</u>
Total liabilities	<u>273,778</u>	<u>251,438</u>
Equity		
Equity attributable to shareholders of the Company		
Share capital (note 9)	67,472	67,472
Contributed surplus	1,105	1,105
Retained earnings	264,264	243,882
	<u>332,841</u>	<u>312,459</u>
Non-controlling interests	<u>11,217</u>	<u>10,770</u>
Total equity	<u>344,058</u>	<u>323,229</u>
Total liabilities and equity	<u>617,836</u>	<u>574,667</u>

Approved by the Board of Directors

“Peter J. Bonner” Director

“Marvin Haasen” Director

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

Madison Pacific Properties Inc.

Interim Consolidated Statements of Changes in Equity

For the Nine Months Ended May 31, 2019 and 2018

(unaudited)

(expressed in thousands of Canadian dollars)

	Attributable to shareholders of the Company				Non-controlling interests \$	Total equity \$
	Share capital \$	Contributed surplus \$	Retained earnings \$	Total \$		
Balance – August 31, 2017	67,472	1,093	208,051	276,616	9,143	285,759
Share-based compensation	-	12	-	12	-	12
Net income and comprehensive income	-	-	31,759	31,759	1,350	33,109
Dividends (note 10)	-	-	(3,075)	(3,075)	-	(3,075)
Distributions to non-controlling interests	-	-	-	-	(388)	(388)
Balance – May 31, 2018	67,472	1,105	236,735	305,312	10,105	315,417
Balance – August 31, 2018	67,472	1,105	243,882	312,459	10,770	323,229
Net income and comprehensive income	-	-	23,457	23,457	967	24,424
Dividends (note 10)	-	-	(3,075)	(3,075)	-	(3,075)
Distributions to non-controlling interests	-	-	-	-	(520)	(520)
Balance – May 31, 2019	67,472	1,105	264,264	332,841	11,217	344,058

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

Madison Pacific Properties Inc.

Interim Consolidated Statements of Income and Comprehensive Income

For the Three and Nine Months Ended May 31, 2019 and 2018

(unaudited)

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

	Nine Months Ended		Three Months Ended	
	May 31, 2019	May 31, 2018	May 31, 2019	May 31, 2018
	\$	\$	\$	\$
Property revenues (note 13)	23,111	23,574	7,759	7,582
Property operating expenses (note 13)	6,542	6,410	2,236	2,006
	<u>16,569</u>	<u>17,164</u>	<u>5,523</u>	<u>5,576</u>
General and administrative expenses (note 13)	2,438	2,196	774	844
	<u>14,131</u>	<u>14,968</u>	<u>4,749</u>	<u>4,732</u>
Net gain on fair value adjustment on investment properties (note 5)	19,687	27,905	5,693	5,654
Equity earnings of associate and joint ventures	1,129	1,504	75	1
	<u>34,947</u>	<u>44,377</u>	<u>10,517</u>	<u>10,387</u>
Interest income	874	321	282	237
Interest expense	5,923	5,698	2,014	1,951
(Losses) gains on fair value adjustment on interest rate swaps (note 7)	(941)	715	(385)	(24)
	<u>28,957</u>	<u>39,715</u>	<u>8,400</u>	<u>8,649</u>
Income before income taxes	28,957	39,715	8,400	8,649
Income taxes (note 11)	4,533	6,606	1,278	1,496
	<u>24,424</u>	<u>33,109</u>	<u>7,122</u>	<u>7,153</u>
Net income and comprehensive income	<u>24,424</u>	<u>33,109</u>	<u>7,122</u>	<u>7,153</u>
Net income and comprehensive income attributable to:				
Shareholders of the Company	23,457	31,759	6,789	6,912
Non-controlling interests	967	1,350	333	241
	<u>24,424</u>	<u>33,109</u>	<u>7,122</u>	<u>7,153</u>
Income per share (note 12)	\$0.40	\$0.54	\$0.12	\$0.12

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

Madison Pacific Properties Inc.
Interim Consolidated Statements of Cash Flows
For the Nine Months Ended May 31, 2019 and 2018
(unaudited)

(expressed in thousands of Canadian dollars)

	May 31, 2019	May 31, 2018
	\$	\$
Cash flows from operating activities		
Net income	24,424	33,109
Items not affecting cash		
Net gain on fair value adjustment on investment properties	(19,687)	(27,905)
Amortization	780	724
Equity earnings of associate and joint ventures	(1,129)	(1,504)
Share-based compensation	-	12
Losses (gains) on fair value adjustment on interest rate swaps	941	(715)
Recognition of rental revenue on a straight-line basis	(1)	(96)
Deferred income taxes	4,135	6,473
	<u>9,463</u>	<u>10,098</u>
(Increase) decrease in amounts receivable and other assets	(2,684)	53
(Increase) decrease in income taxes receivable	(10)	13
Increase in accounts payable and accrued liabilities	1,005	1,053
	<u>7,774</u>	<u>11,217</u>
Cash flows (used by) from investing activities		
Acquisition of investment properties	-	(14,757)
Additions to investment properties and property development costs	(4,603)	(2,185)
Other investment property expenditures	(1,302)	(454)
Net proceeds from disposition of investment properties	-	24,676
Investments in joint ventures (note 6(b))	(5,701)	-
Repayment of loans receivable	69	42
	<u>(11,537)</u>	<u>7,322</u>
Cash flows from financing activities		
Net proceeds from debt on investment properties (note 7)	48,716	46,730
Repayment of debt on investment properties (note 7)	(27,673)	(27,128)
Distributions to non-controlling interests	(520)	(388)
Dividends paid	(6,150)	(6,150)
	<u>14,373</u>	<u>13,064</u>
Increase in cash and cash equivalents	10,610	31,603
Cash and cash equivalents - beginning of period	46,207	11,237
Cash and cash equivalents - end of period	<u>56,817</u>	<u>42,840</u>
Supplemental cash flow information		
Interest received	872	321
Interest paid	5,770	5,477

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

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

(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 6th Avenue, Vancouver, British Columbia, V5Y 1L1, and its registered office is located at 25th 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

These condensed interim consolidated financial statements for the nine months ended May 31, 2019 have been prepared in accordance with International Accounting Standard (IAS) 34, “Interim Financial Reporting”. The condensed interim consolidated financial statements should be read in conjunction with the Company’s annual consolidated financial statements for the year ended August 31, 2018, which have been prepared in accordance with International Financial Reporting Standards (IFRS).

The condensed interim consolidated financial statements have been prepared using the same accounting policies and methods as those used in the annual consolidated financial statements for the year ended August 31, 2018 except for the adoption of new standards and amendments effective as of September 1, 2018 (see note 3). The condensed interim consolidated financial statements have been presented in Canadian dollars rounded to the nearest thousand unless otherwise indicated.

These condensed interim consolidated financial statements were approved by the Board of Directors for issue on July 11, 2019.

b. Principles of consolidation

Subsidiaries

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

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

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, Madison Silverdale Developments Corp., Madison Developments 2800 Barnet Ltd., the MT Properties Limited Partnership, and MT Management Inc. The Company holds a 100% interest in MP Western Properties Inc., 1073774 Properties Inc., 3530639 Canada Inc., Madison Silverdale Developments Corp. and a 99.8% interest in Metro which holds a 100% interest in the MPW Properties Partnership, 801325 B.C. Ltd., and Madison Developments 2800 Barnet Ltd., a 60.9% interest in the MT Properties Limited Partnership, 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.

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

- Associates are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

c. Critical accounting estimates and judgements

The preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The critical accounting estimates have been set out in Note 2 to the Company's consolidated financial statements for the year ended August 31, 2018.

3. Accounting standard changes

The Company has applied, for the first time, certain standards and amendments, which are effective for annual periods beginning on or after September 1, 2018. The nature and the impact of the new standards and amendments are described below.

IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15")

Effective September 1, 2018, the Company adopted IFRS 15 using the modified retrospective basis with no restatement of comparative periods. IFRS 15 replaces IAS 18, *Revenue* ("IAS 18") and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The standard requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

The Company's assessment included a review of relevant contracts for the following key areas that are in scope of IFRS 15: common area maintenance recoveries and property management fees.

The Company has concluded that there is no material impact in revenue recognition for these revenue streams between the point of transfer of risks and rewards under IAS 18 and the point of transfer of control under IFRS 15. No transitional adjustment has been recorded as at September 1, 2018.

The Company has adopted each of the policies noted below on September 1, 2018:

i. Rental revenue

Rental revenue comprises the majority of the Company's revenue and is generated through operating leases, which create a legally enforceable right to use the underlying asset by the tenant and require the Company to provide other services. Base rent, property taxes and insurance recoveries are accounted for pursuant to IAS 17, *Leases* ("lease components") and are therefore outside the scope of IFRS 15, while common area maintenance ("CAM") recoveries ("non-lease components") are within the scope of IFRS 15.

CAM services are integrated property management services provided to tenants in exchange for CAM recoveries and property management fees. CAM services are considered to be a single performance

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

obligation delivered to tenants over time. The Company receives variable consideration for the CAM recoveries and recognizes this as revenue over the period those services are provided.

ii. Property management fees

The Company has interests in various investment properties through joint arrangements and partnerships. The Company provides property management services, and construction and development services to co-owners, and partners for which it earns market-based fees.

Property management services and construction and development services are each considered a single performance obligation for which fees are recognized as revenue over the periods those services are provided. Revenue is recognized at the agreed transaction price in each contract.

IFRS 9, *Financial Instruments* (“IFRS 9”)

Effective September 1, 2018, the Company adopted IFRS 9 using the modified retrospective basis with no restatement of comparative periods. IFRS 9 replaces IAS 39, *Financial Instruments: Recognition and Measurement* (“IAS 39”) and all previous versions of IFRS 9. The standard introduces new requirements for: (i) classification and measurement of financial assets and financial liabilities, (ii) impairment of financial assets and (iii) hedge accounting.

i. Classification and measurement

Under IFRS 9, financial assets are classified and measured on the basis of both the business model in which the assets are managed and the contractual cash flow characteristics of the asset. Financial assets after initial recognition are classified and measured based on three categories: (i) amortized cost, (ii) fair value through other comprehensive income (“FVOCI”) with fair value gains or losses recycled to net income on de-recognition, or (iii) fair value through profit and loss (“FVTPL”). Financial liabilities are classified and measured on two categories: (i) amortized cost or (ii) FVTPL.

Financial assets and liabilities are recognized at fair value at initial recognition, adjusted in some cases for transaction costs (i.e. when financial assets and liabilities are carried at amortized cost). The exception is for trade receivables that do not contain a significant financing component, as defined by IFRS 15. These are measured at the transaction price. Financial assets are recorded at amortized cost when financial assets are held with the objective of collecting contractual cash flows and those cash flows represent solely payments of principal and interest and are not designated as FVTPL.

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

The following table compares the classification of financial instruments under IFRS 9 and IAS 39, and reconciles the IAS 39 and IFRS 9 carrying amounts as at September 1, 2018:

	Classification Category			Changes due to:		
	IAS 39	IFRS 9		IAS 39	Reclassification	Remeasurement
Financial Assets						
Cash and cash equivalents	Held for trading	Amortized cost	\$ 46,207	\$ -	\$ -	\$ 46,207
Amounts receivable and other current financial assets	Loans and receivables	Amortized cost	447	-	-	447
Other non-current financial assets	Loans and receivables	Amortized cost	12,628	-	-	12,628
Interest rate swap assets	FVTPL	FVTPL	1,260	-	-	1,260
Financial Liabilities						
Debt on investment properties	Other liabilities	Amortized cost	\$ 210,210	\$ -	\$ -	\$ 210,210
Accounts payable and other liabilities	Other liabilities	Amortized cost	9,644	-	-	9,644

The Company does not currently have any financial assets classified as FVOCI.

ii. Impairment of financial assets measured at amortized cost

IFRS 9 introduces a new single expected credit loss (“ECL”) impairment model for the Company’s financial assets measured at amortized cost. The ECL model results in an allowance for credit losses being recorded on financial assets regardless of whether there has been an actual loss event. ECLs are based on the difference in cash flows the Company expects to receive and the contractual cash flows due in accordance with the contract, discounted at the asset’s original effective interest rate.

At each reporting date, each financial asset measured at amortized cost is assessed for impairment under the ECL model.

The adoption of the ECL model did not have a material impact on the Company’s financial assets carried at amortized cost.

iii. Hedging

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management. The new model no longer specifies quantitative measures for effectiveness testing and does not permit hedge de-designation.

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

The Company uses fixed-for-floating interest rate swaps to manage interest rate risk. At the date of the initial application, none of the interest rate swaps were eligible to be treated as hedging relationships. As such, the adoption of the hedge accounting requirements of IFRS 9 had no material impact to the Company's condensed interim consolidated financial statements.

4. Accounting standards and amendments issued but not effective

In January 2016, the IASB issued IFRS 16, *Leases* ("IFRS 16"). 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 substantially completed its assessment of the effect of IFRS 16, and has determined that the new standard will not have a material 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.

5. Investment properties

	Nine months ended May 31, 2019 \$	Year ended August 31, 2018 \$
Balance at beginning of period	464,285	480,544
Other additions and property development costs	3,647	4,111
Dispositions (note 5(c))	-	(23,330)
Transfer to investment in joint ventures	-	(32,174)
Recognition of rental revenue on a straight-line basis	1	110
Tenant improvements	1,214	349
Amortization of tenant improvements	(487)	(636)
Leasing commissions	169	214
Amortization of leasing commissions	(186)	(271)
Net gain on fair value adjustment	19,687	35,368
	<hr/>	<hr/>
Balance at end of period	488,330	464,285

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

(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, as significant unobservable inputs are required to determine fair value.

b. Investment property acquisitions

For the nine months ended May 31, 2019, and year ended August 31, 2018, the Company had no acquisitions of investment properties.

c. Investment property dispositions

For the nine months ended May 31, 2019, the Company had no dispositions of investment properties.

For the year ended August 31, 2018, the Company sold one industrial property and a 50% interest in a commercial property, both located in British Columbia, for net proceeds of \$24,676. Concurrent with the sale of a 50% interest in the commercial property, the Company entered into a 50/50 joint venture with a residential developer to rezone and redevelop the property for residential and commercial use. The Company's 50% interest retained in the investment property was transferred to the 2798 Barnet Development Limited Partnership and is accounted for as an investment in joint venture. Rezoning and redevelopment of the property is subject to receipt of all necessary approvals, none of which are certain.

d. Sensitivity

The following table provides a sensitivity analysis for the weighted average capitalization rate applied at May 31, 2019, excluding properties under development:

Capitalization rate increase (decrease)	Weighted average capitalization rate	Fair value of investment properties (at Company's ownership) \$	Fair value variance \$	% change
(0.75%)	3.78%	596,674	108,344	22.2%
(0.50%)	4.07%	554,150	65,820	13.5%
(0.25%)	4.34%	518,787	30,457	6.2%
May 31	4.61%	488,330	-	-
0.25%	4.88%	461,609	(26,721)	(5.5%)
0.50%	5.15%	437,878	(50,452)	(10.3%)
0.75%	5.41%	416,610	(71,720)	(14.7%)

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

6. Other non-current assets

	May 31, 2019	August 31, 2018
	\$	\$
Deposits	16,245	12,184
Investment in associate	13,891	12,946
Investments in joint ventures (note 6(a) and (b))	39,411	33,526
Loans receivable and other	642	559
	<u>70,189</u>	<u>59,215</u>

a. Corporate guarantee

The Company has provided a guarantee of \$14,625 for a \$29,250 bank loan owed by the 2798 Barnet Development Limited Partnership of which the Company has a 50% interest.

b. Investment in the Silverdale Hills Limited Partnership

In the nine month period ended May 31, 2019, the Company made additional equity investments of \$5,701 in the Silverdale Hills Limited Partnership. The additional equity was required to fund development costs and the acquisition of additional parcels of undeveloped residential land.

7. Debt on investment properties

	Nine months ended May 31, 2019	Year ended August 31, 2018
	\$	\$
Balance at beginning of period	210,210	201,166
Net proceeds from debt issuances	48,716	40,907
Amortization of deferred financing costs	198	227
Amortization of acquisition date fair value adjustments on assumed debt	(91)	(122)
Repayment of debt	<u>(27,673)</u>	<u>(31,968)</u>
Balance at end of period	231,360	210,210
Less: current portion	<u>31,397</u>	<u>36,946</u>
Non-current portion	<u>199,963</u>	<u>173,264</u>

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

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), \$226,476 (August 31, 2018 - \$206,023) bears interest at fixed rates ranging from 2.40% to 4.83% (August 31, 2018 - 2.40% to 5.39%) per annum and \$5,472 (August 31, 2018 - \$4,744) bears interest at bank prime rate plus 0.70% to 0.75% (August 31, 2018 - 0.70% to 0.75%) per annum. The weighted average interest rate on fixed rate debt as at May 31, 2019 was 3.30% (August 31, 2018 - 3.40%).

Interest rate swaps

The Company has entered into interest rate swaps with Canadian chartered banks on four mortgages to fix the Company's interest rates on those mortgages. The swaps had notional amounts as at May 31, 2019 totalling \$62,935 (August 31, 2018 - \$64,654), fixed swap rates ranging from 2.92% to 3.90%, and maturity dates ranging from June 2020 to September 2022. The total notional amount of the interest rate swaps represented 27.1% as at May 31, 2019 (August 31, 2018 - 30.7%) of the total debt on investment properties (before netting of deferred financing costs and fair value adjustments on assumed debt). The Company anticipates holding the mortgages and interest rate swap contracts until maturity.

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

	Fair value assets		Net unrealized (losses) gains on interest rate swaps	
	May 31, 2019	August 31, 2018	May 31, 2019	May 31, 2018
Interest rate swaps	\$ 319	\$ 1,260	\$ (941)	\$ 715

8. Bank indebtedness

The Company has a line of credit of up to \$20,000 (August 31, 2018 - \$20,000) bearing interest at bank prime rate plus 1% or the Bankers Acceptance rate (August 31, 2018 - bank prime rate plus 1% or the Bankers Acceptance rate) with a Canadian chartered bank. As at May 31, 2019, \$nil (August 31, 2018 - \$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 following financial ratios that must be maintained, with which the Company was in compliance as at May 31, 2019:

- Not permit the debt service coverage ratio to be less than 1.25 to 1.00;

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

- 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.

9. Share capital

a. Authorized and issued shares

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 (“Class B Shares”), and an unlimited number of Class C non-voting shares without par value (“Class C Shares”).

The following table summarizes the issued share capital as at May 31, 2019 and August 31, 2018:

	Class B Shares		Class C Shares		Total	
	Number	Amount \$	Number	Amount \$	Number	Amount \$
Balance – May 31, 2019 and August 31, 2018	7,255,500	7,720	51,315,089	59,752	58,570,589	67,472

No shares were issued or cancelled during the nine months ended May 31, 2019.

b. Share option plan

The Company implemented a share option plan (the “Plan”) effective January 1, 2019. Under the Plan, the Company reserves Class B Shares equal to 2% of aggregate outstanding Class B Shares and Class C Shares for issuance upon the exercise of share options granted under the Plan. As at July 11, 2019, 1,171,411 Class B Shares are reserved for the issuance under the Plan. The Plan provides that share options may be issued only to executives, employees and outside directors of the Company or of any of its subsidiaries and that options granted to insiders (as defined by Toronto Stock Exchange rules) shall not exceed 10% of the outstanding Class B Shares.

The Plan and the terms of options granted, including the exercise price, the expiry time, the vesting period and other terms and conditions relating to such options, shall be administered by the Board of Directors or any committee to which such authority is delegated by the Board of Directors.

As at July 11, 2019, no share options had been granted under the Plan.

10. Dividends

On July 11, 2019, the Company declared a dividend of \$0.0525 per Class B Share and Class C Share payable on September 6, 2019.

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

On January 14, 2019, the Company declared a dividend of \$0.0525 per Class B Share and Class C Share payable on February 22, 2019.

On July 12, 2018, the Company declared a dividend of \$0.0525 per Class B Share and Class C Share payable on September 6, 2018.

On January 11, 2018, the Company declared a dividend of \$0.0525 per Class B Share and Class C Share payable on February 22, 2018.

11. Income taxes

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

	May 31, 2019	May 31, 2018
	\$	\$
Current income tax expense	398	133
Deferred income tax expense	4,135	6,473
	<u>4,533</u>	<u>6,606</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 nine months ended:

	May 31, 2019		May 31, 2018	
	\$	%	\$	%
Income before income taxes	28,957		39,715	
Expected income taxes at statutory rates	7,816	27.0	10,575	26.6
Adjustments				
Non-taxable portion of realized and unrealized capital gains	(2,805)	(9.7)	(3,454)	(8.7)
Recognition of previously unrecognized tax assets	(330)	(1.1)	(428)	(1.1)
Adjustment in respect of prior years	93	0.3	63	0.2
Effect of future income tax rate increases	-	-	740	1.9
Equity earnings in investee	(304)	(1.0)	(399)	(1.0)
Other items	63	0.2	(491)	(1.2)
Income taxes	<u>4,533</u>	<u>15.7</u>	<u>6,606</u>	<u>16.7</u>

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

Deferred income tax liabilities comprise the following:

	May 31, 2019	August 31, 2018
	\$	\$
Benefit of non-capital losses carried forward	(1,268)	(861)
Benefit of capital losses carried forward	(942)	(942)
Undeducted expenditures	(2,363)	(3,497)
Deferred income tax assets not recognized	946	946
Investment properties	37,056	33,838
Tenant improvements and leasing costs	1,413	1,222
Straight-line rental revenue in excess of base rents	877	878
	<u>35,719</u>	<u>31,584</u>

The entire change in deferred income tax liabilities for the nine months ended May 31, 2019 and August 31, 2018 has been recognized in net income for those respective years.

As at May 31, 2019, the Company has approximately \$8,758 of scientific research and development expenditures available for unlimited carry forward and approximately \$4,182 of non-capital losses which begin to expire in 2037, which may be used to reduce future Canadian income taxes otherwise payable. The Company also has approximately \$6,957 of unrecognized federal investment tax credits which begin to expire in 2019, 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:

	Federal investment tax credits	Non-capital losses carried forward
	\$	\$
2019	150	-
2020	679	-
2021	625	-
2022	880	-
2023	1,048	-
2024	934	-
2025	865	-
2026	727	-
2027	689	-
2028	360	-
2037	-	417
2038	-	2,383
2039	-	1,382
	<u>6,957</u>	<u>4,182</u>

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.

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

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 \$417, carry-forward capital losses of \$6,974, carry-forward scientific research and development expenditures of \$12,991, and investment tax credits of \$7,409. As a result, additional taxes payable for the reassessed years, including interest, total \$33,601. 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 \$16,245 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 \$3,045 as at May 31, 2019.

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.

12. Income per share

	Nine months ended		Three months ended	
	May 31, 2019	May 31, 2018	May 31, 2019	May 31, 2018
Net income attributable to shareholders of the Company	\$23,457	\$31,759	\$6,789	\$6,912
Weighted average number of shares outstanding	58,570,589	58,570,589	58,570,589	58,570,589
Basic and diluted income per share	\$0.40	\$0.54	\$0.12	\$0.12

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

13. 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:

a. Transactions and balances with related parties

The Company has engaged the services of a landscaping and building services company owned by a related party. During the nine months ended May 31, 2019, landscaping, maintenance, and construction management services paid to this company were \$263 (nine months ended May 31, 2018 - \$221).

b. Transactions and balances with affiliates

During the nine months ended May 31, 2019, the Company engaged the services of an electrical contractor controlled by a shareholder of the Company for which it paid fees of \$26 (nine months ended May 31, 2018 - \$13).

During the nine months ended May 31, 2019, rental revenues of \$1,450 (nine months ended May 31, 2018 - \$1,421) were received from tenants that are companies related to a shareholder of the Company.

During the nine months ended May 31, 2019, the Company paid management consulting fees of \$117 to a shareholder of the Company (nine months ended May 31, 2018 - \$151).

The Company has provided a limited guarantee of \$16,830 on the MT Properties Limited Partnership mortgage debt. During the nine months ended May 31, 2019, a guarantee fee of \$39 (nine months ended May 31, 2018 - \$39) was paid to the Company.

On December 11, 2017, the Silverdale Hills LP, of which the Company owns a 50% interest, acquired 459 acres of undeveloped residential lands in Mission, British Columbia for \$29,514. The vendor in the transaction is a party related to a significant shareholder of the Company.

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 nine months ended:

	May 31, 2019	May 31, 2018
	\$	\$
Salaries and short-term employee benefits	1,232	1,014
Share-based compensation	-	12
	<u>1,232</u>	<u>1,026</u>

Madison Pacific Properties Inc.

Notes to the Condensed Interim Consolidated Financial Statements

For the Nine Months Ended May 31, 2019 and 2018

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

14. 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.

15. 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 nine months ended May 31, 2019.

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

	May 31, 2019	August 31, 2018
	\$	\$
Fixed rate mortgage loans	226,476	206,023
Variable rate mortgages and construction loans	5,472	4,744
	<u>231,948</u>	<u>210,767</u>
Equity	<u>332,841</u>	<u>312,459</u>
	<u>564,789</u>	<u>523,226</u>