

Management's Discussion & Analysis

March 7, 2018

The following discussion of Melcor's financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2017.

The financial statements underlying this MD&A, including 2016 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted. All dollar amounts included in this MD&A are Canadian dollars unless otherwise specified.

The statement of financial position is presented without reference to current assets or current liabilities. The operating cycle of an entity involved in real estate investment and development is normally considered to be longer than one year. Thus, the concept of current assets and current liabilities is not considered relevant and there is no need to segregate the balance sheet to disclose assets or liabilities that are expected to be settled within the immediately following year.

Melcor's Board of Directors, on the recommendation of the Audit Committee, approved the content of this MD&A on March 7, 2018.

Other Information

Additional information about Melcor, including our annual information form, information circular and annual and quarterly reports, is available on SEDAR at www.sedar.com.

Non-standard Measures

We refer to terms that are not specifically defined in the CPA Handbook and do not have any standardized meaning prescribed by IFRS. These non-standard measures may not be comparable to similar measures presented by other companies. We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results. For a definition of these measures, refer to the section "Non-standard Measures".

Forward-looking Statements

In order to provide our investors with an understanding of our current results and future prospects, our public communications often include written or verbal forward-looking statements.

Forward-looking statements are disclosures regarding possible events, conditions, or results of operations that are based on assumptions about future economic conditions or courses of action and include future-oriented financial information.

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent Melcor's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Forward-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2018 and beyond, future development plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

By their nature, forward-looking statements require assumptions and involve risks and uncertainties related to the business and general economic environment, many beyond our control. There is significant risk that the predictions, forecasts, valuations, conclusions or projections we make will not prove to be accurate and that our actual results will be materially different from targets, expectations, estimates or intentions expressed in forward-looking statements. We caution readers of this document not to place undue reliance on forward-looking statements. Assumptions about the performance of the Canadian and US economies and how this performance will affect Melcor's business are material factors we consider in determining our forward-looking statements. For additional information regarding material risks and assumptions, please see the discussion under Business Environment and Risks in our annual MD&A.

Readers should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Except as may be required by law, we do not undertake to update any forward-looking statement, whether written or oral, made by Melcor or on its behalf.

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Our Business

Melcor is a diversified real estate development and asset management company. We transform real estate from raw land to high-quality residential communities and commercial developments. We develop and manage mixed-use residential communities, business and industrial parks, office buildings, retail commercial centres and golf courses.

For 94 years, our focus has been the business of real estate. We've built over 100 communities across western Canada since the 1950s and have helped to shape much of Alberta's landscape. We manage 3.92 million square feet (sf) in commercial real estate assets and 609 residential rental units.

We are committed to building communities that enrich quality of life - communities where people live, work, shop and play.

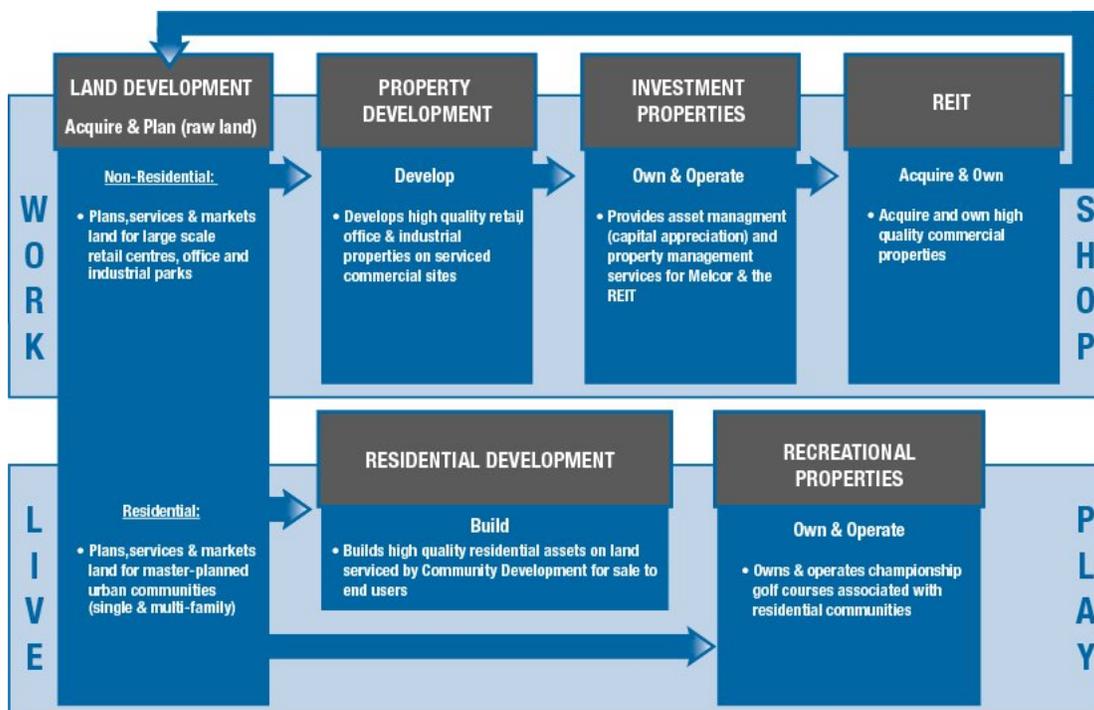
We are celebrating our 50th year as a public company (TSX:MRD). On May 1, 2013, we formed Melcor Real Estate Investment Trust (the REIT) through an initial public offering (the IPO). We retain a controlling 53.0% effective interest in the REIT and continue to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement.

We operate four integrated divisions that together manage the full life cycle of real estate development:

- acquiring raw land and planning residential communities and commercial developments (Community Development)
- project managing development, leasing and construction of commercial properties (Property Development)
- operating a portfolio of commercial and residential properties, focused on property improvements and capital appreciation of owned properties and property management of REIT owned properties (Investment Properties)
- acquiring and owning high quality leasable office, retail, industrial and residential sites (the REIT)

In addition, we own and operate championship golf courses associated with our residential communities in our fifth division, Recreation Properties. Melcor has \$1.99 billion in assets.

The following diagram illustrates how each of our operating divisions complements one another to create and enhance value from our real estate assets.



In addition to extending the value of our asset base, these diversified operating divisions enable us to manage our business through real estate cycles (both general market conditions and the seasonality associated with construction and development) and diversify our revenue base.

While building a sustainable business, we also focus on building sustainable communities by sharing our time and resources to make them stronger. We are proud to support a number of worthy causes and charities that enrich the communities where we operate.

Our headquarters are in Edmonton, Alberta, with regional offices across Alberta, in Kelowna, British Columbia and in Phoenix, Arizona. Our developments span western Canada and Colorado and Arizona in the US.

Our history and our culture form our strong foundation: the traditional values of a family-run organization, the golden rule, and building deep relationships with our clients, our business partners and our employees.

Strategy

Our fundamental goals are to:

- protect shareholder investment through prudent risk management and careful stewardship of company assets
- grow shareholder value by achieving strong operating performance and return on invested capital
- distribute profit to shareholders through a reliable dividend
- promote a strong and healthy corporate culture by taking care of our exceptional team
- build strong and positive relationships with our stakeholders

Our operating focus is to deliver high quality products and industry-leading value in each of our divisions: developing master-planned communities, constructing and leasing business parks, managing our income-producing portfolio and operating championship golf courses.

We balance our capacity to take advantage of strategic opportunities with sustaining and improving our existing business.

Throughout 2017, the economic environment in Alberta remained steady, with signs of improvement in some regions and sectors following the challenge created by the low price of oil of the past several years. We continued to approach development with caution and focused on selling lots early in the year and reducing overall inventory on the residential community side and delaying commercial development until pre-leasing thresholds were met. Throughout the past few years, we have shifted the product type in our residential developments to meet changes in market demand. This resulted in healthy sales in 2017 in many neighbourhoods and early demand in 2018.

We have 90+ years of experience in Alberta's cyclical economy. Throughout this time, we have managed through many downturns and have learned to not only weather the cycle, but to make our business stronger by recognizing and taking advantage of opportunities while balancing our risk and exposure.

Sustain & Improve

We execute our proven business model for sustainable results by:

- continuing to develop and manage real estate assets for revenue, earnings and cash flow growth
- continuing to drive key performance measures

Grow & Diversify

We build for future growth by:

- acquiring strategic land and property assets
- exploring strategic opportunities to increase capital resources while maintaining a strong balance sheet

Assets

Our raw and developed assets and conservative approach to debt place Melcor in a strong position to achieve our growth strategy. We will continue to develop our real estate assets to support current and future revenue, earnings and cash flow growth.

Property Development completed and transferred 4 buildings (38,199 sf) to Investment Properties during 2017. A further 125,300 sf remain under development. We expect to begin construction on additional phases in five existing developments in 2018.

Division	Assets	Strategy
Community Development	10,418 acres of raw land inventory in strategic growth corridors	Maintain right mix of inventory, available at the right time to meet market needs Increase market share by maintaining best in class design and community standards
Property Development	Prospects for over 6.6 million sf of new development based on existing plans Completed and transferred 38,199 sf in 2017	Plan, build and lease retail, office, industrial and multi-family residential real estate projects Maintain 3-5 year inventory of developable assets Maximize value of existing assets through vertical development or re-development
Investment Properties & REIT	Over 3.92 million sf of commercial property and 609 residential units under management, diversified across 4 asset classes in 3 provinces and 2 states New buildings coming online as Property Development projects are completed	Improve existing assets with value-added investments to achieve higher occupancy rates and increase rent / square foot Be the landlord of choice by providing consistent, high-quality service
Recreational Properties	4 championship golf courses	Maintain strong reputation through consistent course quality and player experience Grow revenue from food and beverage operations

Diversification

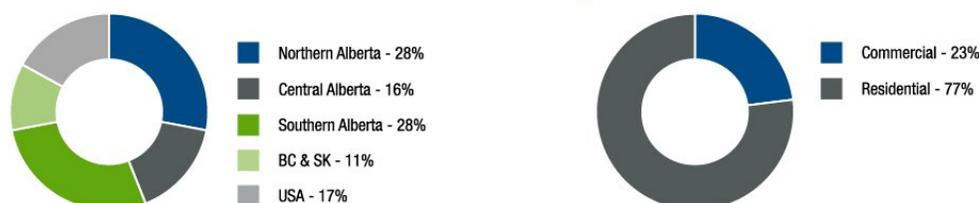
Our operating divisions diversify our revenue streams in a number of ways:

- The mix of land and property types held (residential, office, retail, industrial)
- The regional profile of our assets (Alberta, Saskatchewan, BC & western/southwestern US)
- The type of revenue each asset generates (including steady revenue from income-producing properties and revenue that fluctuates by season and by market demand)

Community Development is one of our most geographically diversified divisions and invests in Canada and the US to build inventory for future development. This division holds a variety of land types for future residential or commercial development in strategic growth corridors. It is also diversified through the life cycle phase of different land parcels: a balance is struck between lands that are immediately developable ('shovel ready'), those that will be ready for development in 3 to 5 years, and those with a development horizon of 5+ years.

Melcor has been planning and developing innovative communities since the 1950s. We have developed over 40,000 lots in over 100 communities across Alberta, BC and the United States.

Land Inventory

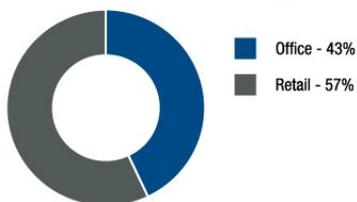


Property Development adds value to raw land by developing retail, office and industrial properties in Alberta.

The Property Development division supports Melcor’s strategic objectives of asset diversification, income growth and value creation by constructing income-producing developments, primarily on land acquired from the Community Development division. On completion, the properties are transferred to Investment Properties, thus completing value chain from raw land to annuity income. The REIT has the right of first offer to purchase completed and leased properties, enabling us to monetize the value created while retaining a long-term controlling interest in the asset.

Melcor has been developing commercial properties since the 1970s and has built over 2 million sf. Our future development pipeline is over 6.7 million sf based on development plans.

GLA Under Development

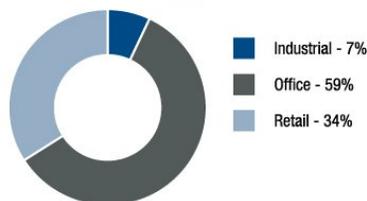
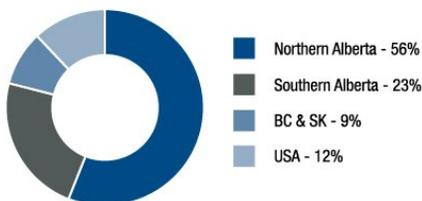


GLA For Future Development



Investment Properties manages 3.92 million sf of geographically diversified income-producing assets - including those owned by the REIT - to provide consistent annuity income and cash flow. Our total portfolio under management is well diversified across asset class, property mix and region. The regional asset mix is primarily commercial in western Canada, with the majority of these assets owned by the REIT. With a number of commercial acquisitions and residential dispositions completed since 2014, our US portfolio is a blend of residential and commercial properties. The goals of the Investment Properties division are to be the landlord of choice by providing exceptional customer care and to continually enhance and improve existing properties through capital investment to maximize occupancy, rental rates and tenant retention and prepare properties for vend-in to the REIT.

Total Gross Leasable Area Managed



The REIT owns 2.71 million sf of income-producing assets that are managed by Investment Properties. The REIT is a vehicle for realizing the value created throughout the Melcor value chain as raw land is developed for commercial use (Community Development) and commercial properties are built (Property Development) or redeveloped (Investment Properties) and sold to the REIT. The REIT will continue to seek and execute acquisitions to grow its portfolio, both through the Property Development pipeline and third party acquisitions.

Total Gross Leasable Area Owned by REIT as at March 7, 2018



Industrial - 7%
Office - 55%
Retail - 38%



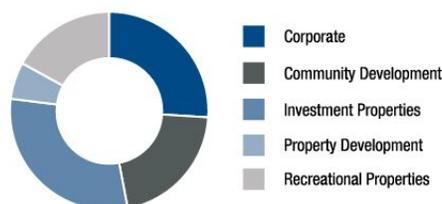
Northern Alberta - 59%
Southern Alberta - 28%
BC & Saskatchewan - 13%

Key Performance Drivers

A High Performance Team

A strong and engaged workforce is a key component of achieving our growth objectives. Our team fuels our success by profitably managing residential and commercial developments, continually moving future projects through the municipal approval process, managing our assets and ensuring tenant satisfaction, and developing strong relationships with our suppliers, contractors, builders, tenants and other stakeholders. The average tenure of our team is 7.5 years and we have 21 team members (11 active) on Melcor's Quarter Century Club.

Employees by Division



This team, with its complementary combination of seasoned experience and new talent, contributed to stable company results over the past several years as we navigated both record years and economic uncertainty. We continue to build our management team depth and emphasize succession planning and training and development to ensure today's young talent is ready to lead our company in the future.

Our culture is based on over nine decades of strong corporate values. We offer rewarding career and development opportunities, competitive compensation and benefits, and employer-matched RRSP and employee share purchase programs (ESPP).

Real Estate Inventory

Our existing real estate inventory puts us in a good position to continue to grow our business. We have:

- 10,418 acres of developable land
- 3,920,092 sf of leasable commercial property and 609 residential units under management in 3 provinces and 2 states
- Potential to develop over 6.7 million sf of new leasable property (based on existing planned development)

We create shareholder value out of our land assets by developing them into revenue and income earning properties.

Inventory management is a critical component of our future success. Land development is a capital-intensive process requiring long time horizons to obtain permits and development agreements. As such, we closely monitor the fundamentals of the regions where we operate to ensure that we have the correct land mix to meet market demands and that the land is ready for sale when demand dictates.

Developed lot inventory

A summary of the movement in our developed lot inventory follows:

	December 31, 2017			December 31, 2016		
	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)
(including joint arrangements at 100%)						
Open	1,004	64.61	142.37	1,433	63.12	144.41
Transfers	—	(3.65)	3.65	—	—	—
New developments	1,682	10.42	3.04	529	22.81	32.13
Internal sales	—	—	(4.15)	—	—	(18.81)
Sales	(1,405)	(2.82)	(8.78)	(958)	(21.32)	(15.36)
	1,281	68.56	136.13	1,004	64.61	142.37

Development ramped up in 2017 to meet demand following several years of softer markets. New developments were up by 218% and include 294 single family lots purchased in the US. Smaller, more cost efficient product types have been particularly successful over the past few years.

Single-family lot inventory was up 28% at the end of 2017 largely due to the purchase of 294 single family lots in the US. Maintaining a maximum of one year of serviced lot inventory of diverse product types is one of our key disciplines.

Raw land inventory

To support future growth, we acquire land in strategic growth corridors and maintain an inventory of land for future development in our primary markets. Raw land acquisitions are based on management's anticipation of market demand and development potential. The markets we operate in require significant infrastructure development and heavy capital investment, creating a barrier to entry. We continually investigate high potential raw lands that complement our existing land holdings or provide attractive projects that are consistent with our overall strategy and management expertise. We acquire land when we find a good fit within these criteria.

Following is a summary of land acquisitions during the year (figures include land acquired through equity transactions and swap agreements):

<i>Land purchases (in acres, net of joint arrangement interests)</i>	2017	2016	Total Land Holdings
Edmonton & Region	107.84	39.91	2,940
Red Deer & Region	14.04	8.08	1,657
Calgary & Region	31.32	—	2,317
Lethbridge	59.40	54.35	600
British Columbia	43.06	—	567
Saskatchewan	—	—	616
United States	515.78	42.24	1,721
	771.44	144.58	10,418

We acquired 771.44 acres of land in strategic growth corridors in 2017 and continue to seek investment opportunities. The majority of land acquired in 2017 was in the United States as we continue to advance our geographic diversification strategy. We acquired 318.00 acres adjacent to the new community we are developing in Colorado and 197.78 acres and 294 finished lots in Arizona.

Financial Resources

Land and property development are capital-intensive activities. We require access to sufficient capital to continue to grow, develop new land and properties and take advantage of acquisition opportunities that fit our growth strategy.

We have developed strong relationships with our major lenders, which, combined with our capital structure and liquidity, provide the company access to financing on attractive terms in spite of fluctuating credit markets and ongoing changes in the economic environment.

We use fixed rate, long-term mortgage financing on our income-producing assets to raise capital for acquisitions, development activities, and other business expenditures. As such, most of our borrowings are in the form of long-term, property specific financings such as mortgages or project financings secured by specific assets. At the end of 2017, Melcor also had project specific financings on two residential and three commercial projects totaling \$20.93 million.

The REIT is expected to be an important financial resource going forward as it exercises its option to purchase assets developed by our Property Development division, thus monetizing the value of our Investment Property assets. In 2017, the REIT did not acquire any assets from Melcor; however, the REIT announced the acquisition of five commercial properties for \$80.88 million which closed on January 12, 2018 (the Melcor Acquisition). Subsequent to the closing of the Melcor Acquisition (see note 31 in the financial statements) our effective ownership in the REIT is 53.0% (December 31, 2017 - 56.7%).

Our operations are supported by a syndicated operating line of credit with total availability of \$205.60 million, which margins our land development assets (raw land inventory, land under development and agreements receivable). With a strong focus on collecting on receivables and reducing overall leverage throughout 2017, Melcor is well positioned to take advantage of acquisition and growth opportunities.

For additional information on our financial resources, please refer to the Financing and Liquidity & Capital Resources sections.

2017 Highlights

<i>(\$000s except as noted)</i>	2017	2016	Change
Revenue	257,950	242,461	6.4 %
Gross margin (%) *	45.1%	44.7%	0.9 %
Fair value adjustment on investment properties	(8,828)	15,795	(155.9)%
Net income	38,525	34,433	11.9 %
Net margin (%) *	14.9%	14.2%	4.9 %
Funds from operations *	59,021	42,564	38.7 %
Shareholders' equity	1,008,590	994,721	1.4 %
Total assets	1,990,983	1,891,988	5.2 %
<i>Per Share Data</i>			
Basic earnings	1.15	1.04	10.6 %
Diluted earnings	1.15	1.04	10.6 %
Funds from operations *	1.77	1.28	38.3 %
Book value *	30.21	29.83	1.3 %

* See non-standard measures for definitions and calculations.

The economic environment improved in many of our markets in 2017, contributing to strong results. We also continued to advance several strategies to position Melcor for future growth and success.

Community Development ramped up to meet demand following several years of softer markets. Single-family lot sales increased 47% and development of new single-family lots was up by 162% (including the purchase of 294 lots in the US) over 2016. Our strategy of diversifying residential product types to respond to demand in price-sensitive markets has proven successful, with smaller, more cost efficient product types leading sales. Promotions were in place throughout 2017 in certain communities to continue moving inventory; however, most promotions have been withdrawn going into 2018 due to normalized demand.

Investment Properties maintained stable occupancy rates and healthy renewals in spite of market challenges. Investment Properties manages 3.92 million sf of commercial properties and 609 residential units, down slightly from last year as we sold some properties to monetize the value created and re-invest capital.

Revenue from our income-producing portfolio (including REIT properties) remained steady over 2016 while the Community Development division saw an increase of 3%. Diversity in the Community Development division's product types (from multi-family to estate) contributed to steady activity in under-served asset classes.

Throughout the year, we maintained our conservative and disciplined approach to investment and development activities and the management of our assets and liabilities.

Property Development completed and transferred 4 buildings (38,199 sf) in 2017 with a further 125,300 sf under development. Revenue from the Property Development division is eliminated on consolidation. Total revenue was down over 2016 as 58% less GLA was completed and transferred in the year. Transfers to Investment Properties will positively impact results in future years as we continue to grow our income-producing assets for long-term holding or for sale to the REIT. We continued to progress commercial land through the development, approvals and lease-up process and have an additional 5 buildings in 4 developments expected to be completed and transferred to Investment Properties in 2018.

We completed the following dispositions during the year, resulting in a 1% reduction of GLA in our portfolio of managed properties:

- a parking lot in Edmonton, Alberta for \$2.99 million (net of transaction costs),
- a residential building in the US for \$0.17 million (net of transaction costs), and
- the REIT disposed of an industrial property in Lethbridge, Alberta for \$7.76 million (net of transaction costs).

We continued to invest in land inventory and increased our land holdings by 771.44 acres in strategic growth corridors. The acquired land is primarily allocated to residential development and includes 515.78 acres acquired in the US. We continue to move land use approvals through the municipal approval process to increase our supply of shovel ready assets so that we are ready to capitalize on improved demand.

Occupancy in our income-producing properties owned by Melcor and the REIT remained steady at 92%.

Subsequent to the year end, the REIT purchased five commercial properties (172,629 sf of owned GLA) from Melcor for \$80.88 million. This was the fourth sale completed to the REIT and represents a key part of our value chain. Through the REIT, we are able to monetize the value we create as we move land from raw inventory to completed commercial project. As majority owner of the REIT, we receive monthly distributions from the REIT. Growing the asset management side of our business helps to stabilize our overall revenue throughout the year.

Return to Shareholders

We continue to distribute profits to our shareholders. During 2017, we paid dividends of \$0.52 per share, representing growth of 8%.

We declared a \$0.13 per share dividend on March 7, 2018 payable on March 29, 2018 to shareholders of record on March 15, 2018. The dividend is an eligible dividend for Canadian tax purposes.

We have been paying dividends since 1969.

Revenue & Margins

Revenue growth of 6% to \$257.95 million in 2017 was driven by the 3% increase in Community Development division revenue. Swings in intercompany revenue resulted in a larger portion of revenue related to land sales being eliminated on consolidation in 2016, also contributing to the increase in consolidated revenue in 2017. Revenue from our income-producing portfolio (including REIT properties) remained stable over 2016. Property Development transfer revenue (down 76%) is eliminated on consolidation.

Gross margin was up 0.40% to 45% in 2017. This improvement was led by Community Development, which had gross margin of 37% compared to 34% in 2016 as improved market conditions resulted in fewer promotions to drive sales activity. Community Development gross margin is affected by a number of factors, including the lot type sold, development costs, the timing of the original land purchase and the relative real-estate market strength at the time of sale. Land that has been in inventory for many years typically generates higher margin on sale. The 60% gross margin on income properties (Investment Properties and the REIT combined) is more stable in nature and serves to neutralize volatility in Community Development margin.

Net margin was also slightly improved at 15% due to higher gross profit and revenue, offset by higher general and administrative expense and swings in fair values adjustments recorded on our investment properties and REIT units. Net income was \$38.53 million.

Fair value losses of \$8.83 million were recorded in 2017 (2016: fair value gains of \$15.80 million) as a result of:

- the transfer of land inventory (measured at cost) to Property Development where it is classified as investment properties on the balance sheet (measured at fair value), resulting in fair value gains of \$0.34 million (2016: \$1.79 million);
- leasing activity and completion of construction on Property Development projects resulting in fair value gains of \$3.31 million (2016: \$6.13 million); and
- net fair value losses recorded in our Investment Properties and REIT divisions, driven primarily by continued pressure on Edmonton office capitalization rates which increased 25 to 100 basis points over 2016 on certain properties.

Funds From Operations (FFO)

Funds From Operations (FFO) is a non-standard measure used in the real estate industry to measure operating performance. We believe that FFO is an important measure of the performance of our real estate assets. FFO per share adjusts for certain non-cash items included in income such as fair value adjustments on investment properties and stock based compensation.

Melcor views FFO as an internal metric used to assess our business and does not follow the REALpac guidance on FFO.

Below is a reconciliation of net income to FFO:

(\$000s)	Year Ended	
	2017	2016
Net income for the year	38,525	34,433
Amortization of operating lease incentives	6,304	6,344
Fair value adjustment on investment properties	8,828	(15,795)
Depreciation on property and equipment	1,436	1,571
Stock based compensation expense	408	302
Non-cash financing costs	414	1,179
Gain on sale of asset	(17)	(37)
Deferred income taxes	2,565	628
Fair value adjustment on REIT units	558	13,939
FFO *	59,021	42,564
<i>Per Share Data</i>		
FFO per share *	1.77	1.28

* See non-standard measures for definitions and calculations.

FFO increased by 39% to \$59.02 million. Our income properties (Investment Properties and REIT divisions, excluding fair value adjustments) remain a steady source of FFO and help to stabilize overall income. Reductions in our overall leverage resulted in finance cost savings of \$4.40 million, also contributing to higher FFO.

Divisional Results

Our business is comprised of five integrated and complementary operating divisions:

- Community Development, which acquires raw land for future commercial and residential community development;
- Property Development, which develops high-quality retail, office and industrial revenue-producing properties on serviced commercial sites developed by Community Development;
- Investment Properties, which manages and leases the commercial developments produced by the Property Development division and an externally purchased portfolio of assets, as well as assets held in the REIT;
- The REIT, which owns and holds 37 income-producing properties; and
- Recreational Properties, which owns and operates championship golf courses associated with Melcor residential communities.

Our Corporate division carries out support functions including accounting, treasury, information technology, administration, legal and human resources.

The following tables summarize results of our operating divisions:

	Community Development		Property Development		Investment Properties		REIT		Recreational Properties	
	Year ended December 31		Year ended December 31		Year ended December 31		Year ended December 31		Year ended December 31	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
<i>(\$000s except as noted)</i>										
Revenue	158,285	154,201	11,015	45,729	34,792	35,774	66,613	66,042	8,650	9,176
Portion of total revenue	57%	50%	4%	15%	12%	12%	24%	21%	3%	3%
Cost of sales	(99,114)	(102,508)	(10,700)	(45,650)	(13,876)	(13,994)	(26,500)	(25,770)	(5,889)	(6,180)
Gross profit	59,171	51,693	315	79	20,916	21,780	40,113	40,272	2,761	2,996
Gross margin (%)	37%	34%	3%	—%	60%	61%	60%	61%	32%	33%
Portion of total gross profit	48%	44%	—%	—%	17%	19%	33%	34%	2%	3%
General and administrative expense	(8,908)	(8,537)	(2,065)	(1,858)	(3,197)	(2,620)	(2,718)	(2,653)	(2,183)	(2,275)
Fair value adjustment on investment properties	—	—	3,308	6,130	(2,668)	11,449	(12,800)	(6,546)	—	—
Gain on sale of assets	—	—	—	—	—	—	—	—	35	37
Interest income	906	1,119	16	4	33	6	62	35	—	—
Segment Earnings	51,169	44,275	1,574	4,355	15,084	30,615	24,657	31,108	613	758

Community Development

Our Community Development division acquires raw land in strategic urban corridors and subsequently plans, develops and markets this land as builder-ready urban communities and large-scale commercial and industrial centres. This process includes identifying and evaluating land acquisitions, site planning, obtaining approvals from municipalities, developing the land, construction, marketing and ultimately selling the lots to home builders (for residential communities) or developers (for commercial/industrial centres). The division also sells sites to our Property Development division, who in turn develops commercial properties on the land.

Master planned mixed-use residential communities comprise the majority of Community Development's portfolio. We create efficient and sustainable urban communities by establishing an overall vision for each community and the amenities that will make it a desirable place to live. Residential lots and parcels are sold to homebuilders who share our passion for quality and with whom we have long-standing relationships.

Our focus is to grow market share and income levels by ensuring that we have an appropriate land mix and the right inventory in high demand areas in growing regions. We proactively manage our agreement receivables by maintaining an exclusive builder clientele and working closely with those builders.

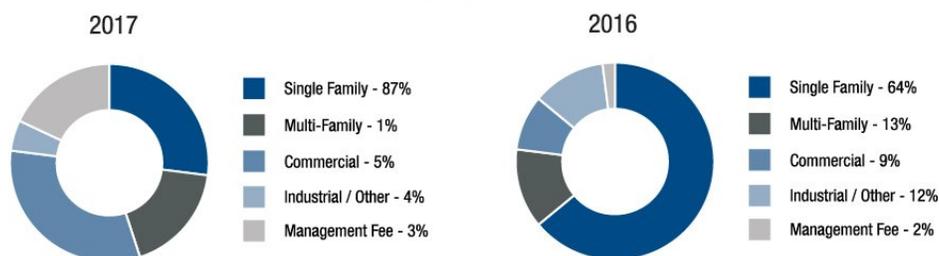
As at December 31, 2017 we held 10,418 acres of raw land for future development which positions the division well for future growth. Our developed land inventory at December 31, 2017 included 1,281 single-family lots, 69 acres for multi-family unit development, and 136.13 non-residential acres.

Sales Activity

Income can fluctuate significantly from quarter to quarter due to the timing of plan registrations, the cyclical nature of real estate markets and the mix of land sold. The seasonality caused by the timing of plan registrations and the real estate construction cycle typically evens out over the course of the year.

The majority of our operations are in Alberta where overall market conditions improved in 2017.

Revenue by Type



The following table summarizes our activity:

Consolidated	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	1,405	958
Gross average revenue per single family lot (\$)	134,700	142,800
Multi-family sales (acres)	2.82	21.32
Gross average revenue per multi-family acre (\$)	800,000	127,460
Commercial sales (acres)	12.93	18.81
Gross average revenue per commercial land acre (\$)	1,087,800	781,600
Other land sales - Industrial, Other (acres)	33.26	107.22
Gross average revenue per other land acre (\$)	176,800	174,700
<i>Financial results:</i>		
Revenue (\$000s)	158,285	154,201
Earnings (\$000s)	51,169	44,275

Regional Highlights

Edmonton & Region	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	828	499
Multi-family sales (acres)	2.82	15.86
Commercial sales (acres)	11.84	16.70
Other land sales - Industrial & Other (acres)	4.18	2.75
<i>Financial results:</i>		
Revenue (\$000s)	85,239	72,503
Earnings (\$000s)	28,318	17,713

The residential market in the Edmonton region rebounded in 2017, leading to a significant increase in single-family lots sold.

The average selling price was down by 6% as lower priced product segments - duplexes, townhomes and detached garage home - made up the bulk of sales. The communities of Jensen Lakes, Rosenthal, Aurora and Cavanagh Ridge performed well in the year.

We sold 4.15 acres of commercial land to Property Development for \$3.74 million (\$1.87 million net of JV%) and a further 4.65 acres to a third party for the development of The Shoppes at Jagare Ridge, a neighbourhood shopping centre in South Edmonton. We sold an additional 3.04 acres to a third party in SW Edmonton.

The promotion program established early in 2016 to move builder inventory and generate activity continued through 2017 and resulted in successfully moving certain product types. We expect interest in entry level products to remain strong in 2018, with increasing interest in traditional single-family lots.

Red Deer & Region	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	83	67
Other land sales - Industrial & Other (acres)	10.53	90.06
<i>Financial results:</i>		
Revenue (\$000s)	12,406	14,322
Earnings (\$000s)	5,647	4,846

Single-family lot sales in the Red Deer market rebounded slightly in 2017 as we continued to move inventory in mature communities. Our city of Red Deer communities of Laredo and Vanier Woods are nearing completion, with a strong focus on single-family product with good builder support. The new community of Evergreen will have its first lots available for sale in 2018 and will help us offer a diverse range of product types in 2018 and beyond.

Calgary & Region	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	296	138
Multi-family sales (acres)	—	5.46
Commercial sales (acres)	1.09	2.11
Other land sales - Industrial & Other (acres)	18.55	14.41
<i>Financial results:</i>		
Revenue(\$000s)	31,903	36,521
Earnings (\$000s)	11,404	13,381

The housing market in the Calgary region improved in 2017, with the highest level of annual starts since 2015. This resulted in a 114% increase in single-family lots sold. Total finished lot inventory remains at target levels of not more than one year of supply.

Construction on infrastructure continued in Greenwich, a mixed-use community consisting of multi-family residential, retail and office space. We sold 1.09 acres of land for multi-family development to a third party.

We also sold 18.55 acres of raw land in the region for gross proceeds of \$3.68 million.

The Cobblestone community received land use approval for the first six (of nine) phases.

Continued efforts to diversify product mix has increased the number of single-family lots sold. The market remains sensitive to price point, with lower priced product being more desirable. We will continue to maintain adequate supply to accommodate diverse housing options.

We expect similar market conditions in 2018 and will continue to focus on lower priced housing options in small phases with high pre-sale thresholds. We also remain focused on advancing planning and approvals for new developments.

Lethbridge	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	79	90
<i>Financial results:</i>		
Revenue (\$000s)	7,753	9,340
Earnings (\$000s)	1,725	2,315

The Lethbridge housing market was slightly softer in 2017 as a result of oversupply. This contributed to a 17% reduction in revenue compared to 2016. West Lethbridge has been highly competitive with 7 new neighbourhoods. Our new phase in Legacy Ridge with townhouse and starter home product sold well in the year.

For 2018, we plan to add more entry price point product with a new phase at Garry Station and build a central park amenity in the neighbourhood.

Kelowna	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	25	39
<i>Financial results:</i>		
Revenue (\$000s)	10,953	13,175
Earnings (\$000s)	388	2,248

The Kelowna market remained steady in 2017; however, revenue decreased by 17% over 2016 as a result of limited lot inventory in the Blue Sky project during the year. A phase completed in 2017 is currently awaiting registration, which will provide inventory to support immediate term demand. We also began working on an additional phase at Blue Sky to maintain our target of a one year supply of inventory. During the year we purchased 43.06 acres of raw land adjacent to Blue Sky, adding potential for approximately 135 additional lots for future development.

Construction on the first phase of North Clifton Estates, a hillside community with lake views from every lot, commenced in 2017 and we expect it to be ready for registration by early summer.

We also continue to move a third development, Thomson Flats, through the planning process and expect area plan approval in 2018.

United States	2017	2016
<i>Sales data:</i>		
Single-family sales (number of lots)	94	125
<i>Financial results:</i>		
Revenue (\$000s)	10,031	8,340
Earnings (\$000s)	3,687	3,772

Activity in the US ramped up in 2017, resulting in a 20% increase in revenue. We sold an 80-acre parcel in Peoria, AZ which had approval to develop 94 lots.

We received final approvals, secured construction financing and commenced construction on the first phase of Harmony, a 1,100-acre land holding in Aurora, CO. Builder interest is high and we expect to close the first sales in the community in 2019. We acquired a further 318 acres adjacent to Harmony.

We also acquired 198 acres in Goodyear, AZ adjacent to an existing 120 acre parcel (Paseo Place).

We also acquired an 80% interest in 294 serviced lots (Mission Royale) in Casa Grande, AZ.

We continue to seek land acquisition opportunities in AZ and CO and to advance planning and approvals on all land holdings.

Property Development

Our Property Development division develops, manages construction, markets and initially leases high-quality retail, office and industrial revenue-producing properties on prime commercial sites purchased primarily from our Community Development division at fair market value. The division currently operates solely in Alberta.

The Property Development division supports our strategic objectives of asset diversification, income growth and value creation by constructing income-producing commercial developments.

The Property Development division increases the value of land assets and delivers long-term sustainable returns with high profile anchor tenants such as ATB, Bank of Montreal, Canadian Tire, Canadian Western Bank, Cara, CIBC, Home Depot, Loblaws, McDonald's, Rexall Drugs, Rona, Royal Bank, Save-on Foods, Scotiabank, Shoppers Drug Mart, Staples, Starbucks, Subway, TD Canada Trust, Tim Hortons, Wal-Mart, Winners and many others.

Completed buildings are transferred from Property Development to Investment Properties at fair market value (based on third party appraisals) once construction and leasing activities near completion. The transfer revenue and related costs are eliminated on consolidation and do not impact overall earnings.

Management fee revenue is comprised of fees paid by joint arrangement partners and is a percentage of total development costs incurred, which fluctuate period to period depending on the development stage of active projects.

The Property Development division realizes fair value gains resulting from development and leasing activities as construction is in progress. We generally expect to see the majority of fair value increases in the third and fourth quarters as construction and leasing are completed.

Division Highlights

<i>(\$000s and at JV%, except as noted)</i>	2017	2016
Total revenue	11,015	45,729
Revenue from property transfers	10,700	45,650
Management fees	315	79
Margin (%) on property transfers	43%	27%
Square footage transferred (sf, at 100%)	38,199	90,694
Number of buildings transferred	4	6
Fair value gains on investment properties	3,308	6,130

Property Development completed and transferred 4 buildings (38,199 sf) to Investment Properties during 2017. A further 125,300 sf remain under development for 2018 and we continue to move new projects through the planning and development approval process.

Regional Highlights

A breakdown of our fair value gains by region is as follows:

<i>(\$000s)</i>	2017	2016
Northern Alberta	2,094	2,822
Southern Alberta	1,214	3,308
	3,308	6,130

Northern Alberta transferred 17,137 sf (2 buildings) to Investment Properties. Notable activity during 2017 includes:

- **Clearview Market:** We completed and transferred the remaining CRU to Investment Properties. At 100%, we recognized \$5.40 million in revenue and 24% margin on transfer to Investment Properties (\$1.80 million in revenue at JV%).
- **West Henday Promenade:** We completed and transferred a multi-tenant building and recognized revenue of \$3.80 million and 31% margin on transfer. We have now developed 116,329 sf in the project.
- **Jensen Lakes Crossing:** We substantially completed construction of Landmark Cinemas Canada, our anchor tenant at our new neighbourhood shopping centre in St. Albert, Alberta which had a grand opening on February 14, 2018. During 2018 we expect to construct four CRUs and a gas station which will be completed in 2018 or early 2019.
- **The Shoppes at Jagare Ridge:** We commenced construction on this south Edmonton neighbourhood shopping centre. The development realized fair value gains of \$2.72 million (\$1.36 million at JV%) in 2017. These buildings are expected to transfer to Investment Properties in 2018.

Southern Alberta: This region transferred 21,062 sf (2 buildings) to Investment Properties in 2017, including:

- **Chestermere Station:** We completed construction on 2 buildings (a free standing restaurant and a CRU). At 100%, we recognized \$10.20 million in revenue and 33% margin on transfer to Investment Properties (\$5.10 million in revenue at JV%).
- **The District at North Deerfoot:** We resumed construction at this project in North Calgary. During 2018 we expect to substantially construct a free standing CRU, with completion projected for 2019.

Transfers occur upon completion of the buildings, while the fair value gains are recorded over the course of construction.

Future development opportunities

We continually identify parcels of land from our land inventory that are well suited for commercial development in the near future. We also work with municipalities to gain approvals to commence development on new projects.

The following table is a summary of current and future development projects:

Current Projects					
Project	Location	Type	Total SF *	Developed to Date*	SF Under Development
The Village at Blackmud Creek	South Edmonton	<i>Regional business park</i>	725,000	56,797	54,300
Telford Industrial	Leduc	<i>Industrial Park</i>	500,000	143,118	—
West Henday Promenade	West Edmonton	<i>Regional mixed use centre</i>	726,000	116,329	—
Kingsview Market	Airdrie	<i>Regional shopping centre</i>	331,000	181,927	—
Chestermere Station	Chestermere	<i>Neighbourhood shopping centre</i>	297,416	241,602	—
Clearview Market	Red Deer	<i>Neighbourhood shopping centre</i>	150,090	150,088	—
The District at North Deerfoot	North Calgary	<i>Regional business / industrial park</i>	2,250,000	494,359	—
Campsite Industrial	Spruce Grove	<i>Industrial Park</i>	170,000	13,654	—
The Shoppes at Jagare Ridge	South Edmonton	<i>Neighbourhood shopping centre</i>	105,000	—	16,500
Jensen Lakes Crossing	St. Albert	<i>Neighbourhood shopping centre</i>	150,000	—	54,500

Expected Future Projects					
Project	Location	Type	Total SF *	Ownership Interest	Expected Start (year)
The Shoppes at Canyons	Lethbridge	<i>Neighbourhood shopping centre</i>	105,000	100%	2020
Greenwich	West Calgary	<i>Regional mixed use centre</i>	395,000	100%	2019
Rollyview	Leduc	<i>Neighbourhood shopping centre</i>	150,000	100%	2019
Woodbend Market	Leduc	<i>Neighbourhood shopping centre</i>	140,000	100%	2019
Laredo	Red Deer	<i>Neighbourhood shopping centre</i>	30,000	100%	2019
Clearview Market 2	Red Deer	<i>Neighbourhood shopping centre</i>	80,000	33%	2019
Mattson	Edmonton	<i>Neighbourhood shopping centre</i>	78,000	50%	2020
Vista Ridge	Sylvan Lake	<i>Neighbourhood shopping centre</i>	25,000	50%	2019
Secord/Rosenthal	Edmonton	<i>Neighbourhood shopping centre</i>	120,000	100%	2020
Keystone Common	North Calgary	<i>Regional power centre</i>	775,000	100%	2022+
West Pointe Marketplace	Lethbridge	<i>Regional power centre</i>	750,000	100%	2022+
Westview Commercial	West Calgary	<i>Neighbourhood shopping centre</i>	150,000	100%	2022+

* Size represents the estimated total square footage projected for full build out. This includes sites that may be individually sold to retailers or end-users. Developed to date includes buildings built by third parties.

Investment Properties

Our Investment Properties division manages and leases our portfolio of high-quality office, retail, industrial and residential properties, which are located across western Canada and the US, including the properties owned by the REIT.

Our Investment Properties division oversees 3.92 million sf of income-producing commercial GLA and 609 residential units.

Our commercial property portfolio is primarily comprised of properties developed and transferred from our Property Development division. Our goal is to improve the operating efficiency of each property for stable and growing cash flows making them attractive assets for the REIT to purchase under its Right of First Offer (ROFO) option. In our management capacity, we are committed to

efficient property management for optimized operating costs, occupancy and rental rates, providing the REIT and our joint venture partners with best in class management services. We focus on client retention through continuous customer contact and ongoing service evaluations. We also enhance our portfolio by upgrading the appearance, functionality and desirability of our properties, thereby increasing their rental potential.

Our US properties provide the division with a stable income stream that diversifies our exposure to the western Canadian resource sector. We also own 6 parking lots and other assets which are held for the long-term, providing current stable income and future re-development opportunities.

Our portfolio under management has high occupancy rates with long-term tenancies from high-quality retail and commercial clients.

Operating Results

<i>(\$000s except as noted)</i>	2017	2016
Commercial properties GLA under management (sf, total)	3,920,092	3,953,196
Properties owned and managed (sf)	842,385	823,466
Properties managed (sf)	3,077,707	3,129,730
Revenue (total)	34,792	35,774
Canadian properties	14,359	12,439
US properties	14,266	17,022
Management fees	4,767	4,892
Parking lots and other assets	1,400	1,421
Net operating income (NOI) *	21,051	20,934
Funds from operations *	18,550	19,759
Funds from operations per share *	0.56	0.60

* See non-standard measures for calculation.

Since the formation of the REIT in 2013, the Investment Properties division's primary function is asset management and hands on property management.

Canadian properties

We continued to grow via Property Development in 2017. Over the past twelve months, Property Development transferred four buildings, adding 38,199 sf to owned and managed GLA which generated an increase in commercial property revenue and NOI over 2016. In 2016, six buildings were transferred from Property Development, adding 90,694 sf of GLA. With 125,300 sf of GLA under active development in the Property Development division, we expect continued growth. Subsequent to year-end, we sold five newly-constructed commercial properties from Melcor Developments to the REIT representing 172,629 sf of owned GLA.

Revenue generated on assets acquired from Property Development and held through the period was \$4.72 million in 2017 (2016 - \$4.44 million). Our residential property acquired in 2016 contributed \$1.10 million in revenue in 2017 (2016 - \$0.22 million).

Gross profit was up 14% to \$10.46 million in 2017 due to growth in the portfolio.

Occupancy on properties owned by Investment Properties was 91% at December 31, 2017 (2016 - 94%). The decline in occupancy is due to tenant rollovers and tenants in fixturing who have not taken occupancy at year-end. Weighted average base rental rates were \$25.86 (2016 - \$26.26).

The following is a reconciliation of Canadian properties same asset net operating income (NOI) to gross profit:

<i>(\$000s except as noted)</i>	2017	2016
Same asset NOI *	6,237	6,281
Third party acquisition	488	136
Properties transferred from PD	3,828	2,286
NOI	10,553	8,703
Amortization of operating lease incentives	(338)	(370)
Straight-line rent adjustment	247	873
Gross profit	10,462	9,206

* See non-standard measures for definition.

Divisional NOI is defined as rental revenue less property operating costs plus amortization of operating lease incentives plus/minus straight-line rent adjustment. Same asset NOI was stable over 2016 at \$6.24 million.

US properties

Our US property portfolio remained stable through 2017 with no significant acquisitions or dispositions completed during the year. Comparatively, in 2016, we completed three commercial property acquisitions and disposed of one residential property. Our portfolio is concentrated in the Phoenix and Denver areas; regions we view as a hedge to our Canadian resource derived economic exposure. Funds from the sale of Lakeside 121 in December 2016 have been redeployed into our US community development operations which has experienced significant growth over the past year.

Details of acquisitions and disposals completed through 2017 and 2016 are as follows:

	Date	Type	Area	Price (millions \$)
<i>Acquisitions</i>				
Offices at Promenade, Greater Denver Area, Colorado	Feb 2016	Office	128,383 sf / 8.74 ac	\$20.07 (US\$17.03)
Offices at Inverness, Greater Denver Area, Colorado	Mar 2016	Office	95,127 sf / 6.85 ac	\$13.07 (US\$9.75)
Syracuse Hill One, Greater Denver Area, Colorado	Mar 2016	Office	82,659 sf / 4.56 ac	\$13.22 (US\$10.19)
<i>Dispositions</i>				
Lakeside 121, Greater Dallas Area, Texas	Dec 2016	Multi-Residential	240 units / 11.01 ac	\$38.42 (US\$29.19)
The Edge, Greater Phoenix Area, Arizona	Nov 2017	Residential	1 unit	\$0.18 (US\$0.13)

Revenue decreased 16% over 2016, primarily due to the sale of Lakeside 121 in December 2016 (as outlined above). Revenues recognized from Lakeside 121 in 2016 were \$3.45 million (US\$2.65 million). The decline in residential revenue was partially offset by additional revenues from commercial assets acquired in 2017 adding \$6.81 million (US\$5.25 million) in 2017 compared to \$5.60 million (US\$4.30 million) in 2016. Same asset revenue was down 3% over 2016 due to higher vacancy in our Phoenix area commercial properties.

Occupancy on commercial US properties was 87% (2016 - 89%). This decrease is due to above average lease maturities in 2017 resulting in tenant rollover and increased vacancy at certain properties. Rental rates on commercial US properties were \$18.43 (2016 - \$17.83). The increase in rental rates is due to lease rollovers and tenants coming off rent free periods.

A reconciliation of US properties same asset NOI to gross profit is as follows:

(\$000s except as noted)	2017	2016
Same asset NOI *	2,268	2,462
Third party acquisitions	2,442	2,079
Third party disposals	8	1,276
NOI	4,718	5,817
Foreign currency translation	1,398	1,754
Amortization of operating lease incentives	(597)	(220)
Straight-line rent adjustment	416	558
Gross profit	5,935	7,909

* See non-standard measures for definition.

Divisional NOI is defined as rental revenue less property operating costs plus amortization of operating lease incentives plus/minus straight-line rent adjustment. Same asset NOI declined 8% over 2016 due to lower occupancy on our commercial assets in conjunction with the timing of maintenance projects undertaken on our residential assets.

Management fees & other

We earn management fees under the asset management and property management agreements with the REIT and under other joint venture agreements where Melcor acts as the asset manager. Management fees were down \$0.13 million or 3% compared to 2016. In 2016 we re-negotiated the management agreement on one of our joint arrangements in order to align the fee structure with other management agreements and fairly compensate Melcor for administration of the assets. The amended agreement was applied retroactively, resulting in higher than normal management fee income in 2016.

During 2017 we recognized \$1.40 million in revenues on our 488 (2016 - 516) parking stalls and other assets, which is consistent with 2016. In September 2017 we disposed of Phillips Lofts Parking Lot (28 stalls on 0.17 acres) in Edmonton, Alberta for \$2.99 million (net of transaction costs). These revenues fluctuate from period to period.

Funds from Operations

Funds from operations (FFO) decreased by \$1.21 million or 6% over 2016 as a result of lower gross profit and higher G&A. G&A costs were slightly higher than 2016 due to higher payments made to the REIT under Head and Bridge Lease Agreements entered into for property acquisitions from Investment Properties completed during December 2014. These amounts are eliminated on consolidation.

Fair Value of Investment Portfolio

	2017	2016
Fair value of portfolio (\$000s)	318,413	317,790
Weighted average capitalization rate	6.30%	6.37%
Weighted average terminal cap rate	6.61%	6.71%
Weighted average discount rate	7.40%	7.44%

The fair value of our portfolio increased by \$0.62 million over 2016. Growth in the portfolio was the result of \$10.30 million in buildings transferred from Property Development and \$2.47 million in property improvements. Other changes included fair value losses of \$3.30 million, disposals of \$3.16 million, foreign currency translation loss of \$7.53 million, and changes to tenant improvements and straight line rent.

For the year ended December 31, 2017, Melcor's internal valuation team performed the valuation assessment. Of 35 legal phases assessed, 21 investment properties with a fair value of \$295.57 million were valued by qualified independent external valuation professionals during the year. In 2016, 23 investment properties of 35 legal phases with a fair value of \$143.31 million were valued by qualified independent external valuation professionals during the year.

A breakdown of our fair value adjustment on investment properties by geographic region and significant asset type is as follows:

(\$000s)	2017	2016
Alberta - all assets	2,572	(5,030)
US - residential	(2,883)	20,269
US - commercial	(2,357)	(3,790)
	(2,668)	11,449

We recognized fair value losses on our US portfolio as a result of the decrease in stabilized NOI on certain assets in conjunction with capital and tenant spending which did not result in a significant increase in fair value. Losses were partially offset by gains in our Canadian portfolio, primarily on our Edmonton, AB parking lots and other assets, where we have seen an increase in land valuations. Fair value gains in 2016 were the result of US residential asset dispositions, where the sale price exceeded carrying value. Refer to note 30 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

REIT

The REIT owned 37 income-producing office, retail and industrial properties, comprising 2,710,862 sf GLA and a land lease community at December 31, 2017. The REIT's portfolio has a diversified tenant profile, with a mix of national, regional and local tenants operating in a variety of industries.

As at March 7, 2018 we hold a controlling 53.0% effective interest in the REIT through ownership of all Class B LP Units (December 31, 2016 and 2017 - 56.7%). As we have concluded that Melcor retains control of the REIT we consolidate 100% of the REIT's revenues, expenses, assets and liabilities.

Operating results

The following table summarizes the REIT's key performance measures:

(\$000s except as noted)	2017	2016
Rental revenue	66,613	66,042
Net operating income (NOI) *	42,101	42,329
Same asset NOI (see calculation following)	41,398	41,351
Fair value adjustments	(12,800)	(6,546)
Occupancy	92%	92%
Funds from operations *	26,670	26,668
Funds from operations per share *	0.80	0.79

* See non-standard measures for definition and calculation.

Rental revenue increased \$0.57 million or 1% over 2016. Higher operating cost and realty tax recoveries ("recoveries") in 2017 are due to an increase in direct operating expenses. The sale of LC Industrial in April 2017 combined with slightly lower same-asset average occupancy and base rent resulted in a 2% decrease in base rent.

We continue to be proactive and strategic in our leasing programs to meet the demands of an evolving market while retaining and attracting new tenants. In 2017 we signed 340,546 sf of new and renewed leases (including holdovers) for occupancy of 91.8%. We exceeded our retention rate target, with the renewal of 80.6% of expiring leases (representing 77 leases) in spite of challenging market conditions in many of our operating regions.

Weighted average base rent was \$15.88 per sf at December 31, 2017, an increase of 1% compared to 2016. Excluding LC Industrial, which had a base rate of \$8.68, base rates were down \$0.04 over 2016. This reduction is primarily due to market conditions and significant new inventory creating downward pressure on downtown Edmonton office rates, partially offset by step-ups on leases with multiple rent escalations. Leasing activity across Alberta and increased industrial rates offset the rate compression in our office portfolio. Increases in weighted average base rents were tempered by the compression of net effective rent due to increases in tenant incentives.

Direct operating expenses were up 3% over 2016. A 5% increase in property taxes was due to higher mill rates while the introduction of the carbon tax in Alberta, effective January 1, 2017, contributed to an 8% increase in utilities. In spite of continued pressure on

property taxes and utilities, we were able to hold operating expenses at 2016 levels in 2017. As a cornerstone of our property management strategy, we are committed to efficient and cost effective building maintenance to ensure maximum value to our tenants and unitholders.

<i>(\$000s except as noted)</i>	2017	2016
Same asset NOI *	41,398	41,351
Acquisitions	703	978
NOI before adjustments	42,101	42,329
Amortization of operating lease incentives	(3,062)	(3,216)
Straight-line rent adjustment	1,074	1,159
Divisional NOI	42,101	42,329

* See non-standard measures for definitions and calculations.

Net operating income (NOI) and same-asset NOI are non-standard metrics used in the real estate industry to measure the performance of investment properties. The IFRS measure most directly comparable to NOI and same-asset NOI is net income.

Slightly lower average occupancy and the sale of LC Industrial contributed to the 1% decline in NOI. On a same-asset basis, NOI was stable over 2016 on account of improved recovery ratio.

Funds from Operations

FFO remained stable over 2016. Stability in FFO demonstrates the REIT's consistency in helping stabilize Melcor's overall operating results year over year.

Fair Value of REIT Portfolio

	2017	2016
Number of properties	37	38
Total GLA (sf)	2,830,368	2,895,306
GLA (REIT owned %) (sf)	2,710,862	2,775,782
Fair value of portfolio (\$000s)	642,763	659,611
Weighted average capitalization rate	6.68%	6.63%
Weighted average terminal cap rate	6.79%	6.83%
Weighted average discount rate	7.75%	7.70%

For the year ended December 31, 2017, Melcor's internal valuation team performed the valuation assessment. In 2017, 27 phases of 46 legal phases with a fair value of \$392.70 million were valued by qualified independent external valuation professionals. Valuations performed during the year resulted in fair value losses of \$12.80 million. In 2016, 22 phases of 47 legal phases with a fair value of \$287.00 million were valued by qualified independent external valuation professionals, resulting in a fair value loss of \$6.55 million. Refer to note 30 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

A breakdown of our fair value adjustment on investment properties by geographic region is as follows:

<i>(\$000s)</i>	2017	2016
Northern Alberta	(16,959)	(3,773)
Southern Alberta	4,710	(3,322)
Saskatchewan & British Columbia	(551)	549
	(12,800)	(6,546)

Fair value losses in Northern Alberta were primarily driven by continued pressure on Edmonton office capitalization rates, which increased 25 to 100 basis points over Q4-2016 on certain properties. The significant drop is the result of recent asset transactions on comparable properties. Capitalization rates on retail assets have remained stable through 2017; however, lower projected market rents resulted in fair value losses on two retail properties in the greater Edmonton area. Fair value gains in Southern Alberta were the result of the sale of LC Industrial in Q2-2017 where the sale price exceeded the carrying value. We also realized fair value gains on

certain office and retail assets in the portfolio as a result of higher NOI. The remainder of fair value losses across the portfolio were due to capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. Fair value adjustments represent a change of approximately 2% in the fair value of our portfolio.

Recreational Properties

Our Recreational Properties division owns and manages championship golf courses built to add value to Melcor residential communities.

The division's goal is to provide a high standard of service to our customers so as to maximize their enjoyment at our golf courses and to enhance divisional performance through revenue growth and cost savings.

Our golf courses aspire to achieve consistent course conditions and quality, and to be recognized as championship public golf courses with state of the art clubhouses that contribute to our ability to attract tournaments and events. Achieving these goals enables us to find the appropriate balance between course fees, number of rounds played and customer satisfaction and enjoyment.

Operating Results

<i>(\$000s except as noted)</i>	2017	2016
Revenue	8,650	9,176
Gross profit	2,761	2,996
Gross margin (%)	31.9%	32.7%
Earnings	613	758

The financial performance of our golf courses is greatly influenced by the weather conditions during the golf season. Unfavourable weather conditions in Alberta throughout much of the season contributed to a 6% decrease in revenue and 19% decrease in earnings in 2017. The number of rounds played at all four courses was down 11% to 103,590 rounds.

We continue to focus on food and beverage initiatives as part of our strategy for attracting tournaments and growing revenue.

	Ownership interest	2017		
		Season opened	Season closed	Rounds of golf *
Managed by Melcor:				
Lewis Estates (Edmonton)	60%	April 6	October 29	27,711
The Links (Spruce Grove)	100%	April 7	October 29	23,047
Black Mountain (Kelowna)	100%	April 1	November 1	31,216
Managed by a Third Party:				
Jagare Ridge (Edmonton)	50%	April 29	October 22	21,616
		2016		
	Ownership interest	Season opened	Season closed	Rounds of golf *
Managed by Melcor:				
Lewis Estates (Edmonton)	60%	March 31	November 14	33,442
The Links (Spruce Grove)	100%	April 1	November 14	26,727
Black Mountain (Kelowna)	100%	March 11	November 15	33,002
Managed by a Third Party:				
Jagare Ridge (Edmonton)	50%	April 8	October 6	23,510

* Rounds of golf indicated at 100%.

General and Administrative Expense

General and administrative expenses increased by 20% over 2016. This increase was driven by bonus accruals, a one-time retirement allowance of \$1.27 million accrued in relation to an employee who resigned in the year, and increases in certain corporate expenses including stock based compensation, donations and professional fees.

Income Tax Expense

The statutory tax rate for the year ended December 31, 2017 is 27%, consistent with 2016. Significant adjustments that caused the 2017 effective tax rate to exceed the statutory rate include permanent differences related to revaluation adjustments on investment properties and REIT units. These adjustments are partially offset by the non-taxable portion of REIT income and the reduction in deferred tax liabilities caused by the recently enacted reduction in US federal corporate tax rates.

Financing

As at December 31, 2017, our total general debt outstanding was \$658.26 million compared to \$608.61 million in 2016. The financing function is managed by our corporate division and decisions on how to deploy operating and acquisitions funds is a centrally managed corporate decision. We use various forms of financing to fund our development and acquisition activities. We are often able to leverage the assets in one division to fund development opportunities in others.

A summary of our debt is as follows:

As at (\$000s)		2017	2016
Melcor - revolving credit facilities	a	76,529	32,728
REIT - revolving credit facility	b	—	17,324
Project specific financing	c	20,926	5,213
Secured vendor take back debt on land inventory	d	64,891	65,408
Debt on investment properties and golf course assets	e	444,807	455,189
REIT - convertible debentures	f	54,775	32,749
Less: Liability held for sale		(3,670)	—
		658,258	608,611

a) Melcor - revolving credit facilities

One of our primary sources of funding for development projects is an operating line of credit with a syndicate of major chartered banks. This line of credit margins our community development assets.

We benefit by being able to borrow at rates fluctuating with prime. Our current cost of borrowing on a floating basis is low when compared to historical cost of funds.

Under the terms of the facilities, Melcor pledges specific agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral. The facilities mature on July 31, 2019, are renewable one year in advance of expiry and may be modified.

A summary of the credit facilities is as follows:

As at (\$000s)		2017	2016
Credit limit approved	i)	205,603	205,649
Supportable credit limit	ii)	162,597	163,892
Credit used		(76,529)	(32,728)
Credit available		86,068	131,164

i) The portion of these loan limits that relate solely to Melcor Developments Ltd. is \$120.00 million (2016 - \$120.00 million) with the remaining balance pertaining to specific joint arrangements.

ii) Our supportable credit limit is calculated based on a formula and tests as required by the bank. The supportable credit limit is calculated based on agreements receivable balances and land inventory. As such, the supportable limit fluctuates in response to increases or decreases in these balance sheet accounts. Management monitors the supportable credit limit and keeps the bank informed at all times of its current collections and inventory production plans.

In the normal course of development operations, we are required to issue letters of credit as collateral for the completion of obligations pursuant to development agreements signed with municipalities. The credit facility described above also includes a letter of credit facility. Melcor's letter of credit balances, net of joint arrangement interests are:

As at (\$000s)	2017	2016
Total letter of credit facility	71,810	72,358
Letters of credit issued	(40,256)	(39,425)
Available for issue	31,554	32,933

b) REIT - revolving credit facility

The REIT has an available credit limit based on the carrying values of specific investment properties up to a maximum of \$35.00 million for general purposes, including a \$5.00 million swingline sub-facility. The agreement also provides the REIT with \$5.00 million in available letters of credit which bear interest at 2.25%. The facility matures on May 1, 2018, with an extension option of up to three years at the discretion of the lenders.

As at December 31, 2017 we had \$nil drawn from the facility, and posted letters of credit of \$nil.

c) Project specific financing

We use project financing to supplement our line of credit, or when certain projects allow us to access a lower cost of capital typically provided by project financing. This type of loan usually has floating rates of interest tied to prime.

The composition of our project specific financing is as follows:

As at (\$000s)	2017	2016
Project specific debt on investment properties under development, with interest rates between 3.50% and 3.70% (2016 - nil%)	12,217	—
Project specific debt on land, with interest rates between 4.58% and 5.70% (2016 - 3.20% to 4.08%)	8,709	5,213
	20,926	5,213
Weighted average effective interest rate	4.94%	3.63%

d) Secured vendor take back debt on land inventory

This debt is primarily comprised of loans on the acquisition of land that are held by the land vendor (fixed and variable rate financing with repayments over 3 to 5 years) or from financial institutions (variable rate financing with repayments over 3 to 5 years). Current debts mature from 2018 to 2021.

As at (\$000s)	2017	2016
Agreements payable with interest at the following contractual rates:		
Fixed rates of 3.00% - 6.00% (2016 - 3.00% to 6.00%)	64,891	65,408
Weighted average effective interest rate	5.04%	4.56%

As at December 31, 2017 \$10.62 million of debt was payable in US dollars (2016 - \$13.50 million).

e) Debt on investment properties and golf course assets

We use fixed rate, long-term mortgage financing on our investment property assets to raise capital. We are able to finance increased loan amounts from our existing portfolio of buildings as old mortgages renew and there is increased equity in our investment properties.

Debt on investment properties and golf course assets in the amount of \$444.81 million, excluding fair value adjustments and deferred finance fees, reflects financing placed on investment properties that have a carrying value of \$708.72 million.

Rates are negotiated at a pre-agreed benchmark bond rate plus a spread and are negotiated with different lenders to ensure competitive terms and multiple sources. New mortgage rates from Canadian lending institutions ranged from 3.11% to 3.75% in 2017.

The composition of our debt on investment properties and golf course assets is as follows:

As at (\$000s)	2017	2016
Canadian mortgages at fixed rates	345,709	348,021
Canadian mortgages at variable rates	49,816	52,033
US mortgages at fixed rates	44,576	48,763
US mortgages at variable rates	7,786	8,660
	447,887	457,477
Interest rate ranges	(2.48% - 6.16%)	(2.48% - 6.16%)
Weighted average effective interest rate	3.42%	3.54%

Loan maturity dates are spread out so as to reduce associated loan renewal risks. The following table represents cumulative loan amounts due for renewal over the next ten years:

Year	Loan renewal amount (\$000s)	Weighted average interest rate	Number of loans
2018	43,287	4.09%	9
2019	81,673	3.47%	10
2020	53,880	3.82%	8
2021	56,217	3.05%	8
2022	26,096	5.08%	5
2023	15,461	4.00%	2
2024	34,359	3.73%	4
2025	26,609	3.63%	6
2026	26,896	3.65%	5
2027	2,566	3.72%	1
2028	2,086	3.62%	1

As at December 31, 2017, \$52.36 million of debt was payable in US dollars (2016: \$57.42 million).

f) REIT - convertible debenture

On December 3, 2014, the REIT issued a 5.50% extendible convertible unsecured subordinated debenture ("REIT debenture") to the public for gross proceeds of \$34.50 million, including \$4.50 million issued pursuant to the exercise of an over-allotment option. The REIT debenture bears interest at an annual rate of 5.50% payable semi-annually in arrears on June 30 and December 31 in each year commencing June 30, 2015. The maturity date of the REIT debenture is December 31, 2019.

On December 21, 2017, the REIT issued a 5.25% extendible convertible unsecured subordinated debenture ("2017 Debenture") to the public for gross proceeds of \$23.00 million, including \$3.00 million issued pursuant to the exercise of an over-allotment option. Transaction costs related to the issuance were \$1.46 million for net proceeds of \$21.54 million. The 2017 Debenture bears interest at an annual rate of 5.25% payable semi-annually in arrears on June 30 and December 31 in each year commencing June 30, 2018. On completion of the Melcor Acquisition (refer to financial statements note 31), the maturity date of the 2017 Debenture was extended to December 31, 2022. The 2017 Debenture can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion rate of 86.9565 trust units per one thousand principal amount of convertible debenture.

These debentures were a source of financing and the funds were used to complete property acquisitions.

Liquidity & Capital Resources

The following table represents selected information as at December 31, 2017, compared to December 31, 2016.

<i>As at (\$000s except as noted)</i>	2017	2016
Cash & cash equivalents	42,505	39,892
Restricted cash	16,956	—
Accounts receivable	17,384	16,918
Agreements receivable	129,949	116,244
Revolving credit facilities	76,529	50,052
Accounts payable and accrued liabilities	51,979	35,274
Total assets	1,990,983	1,891,988
Total liabilities	982,393	897,267
Debt to equity ratio *	0.97	0.90

*See non-standard measures for definition

We employ a range of strategies to maintain operations and facilitate growth. Our principal liquidity needs are to:

- Fund recurring expenses;
- Meet debt service requirements;
- Make dividend payments;
- Make distributions to unitholders of the REIT;
- Fund land development; and
- Fund investing activities such as the discretionary purchase of land inventory and/or investment property purchases.

We are able to meet our capital needs through a number of sources, including cash generated from operations, long and short-term borrowings from our syndicated credit facility, mortgage financings, convertible debentures, and the issuance of common shares or trust units. Our primary use of capital includes paying operating expenses, sustaining capital requirements on land and property development projects, completing real estate acquisitions, debt principal and interest payments, paying distributions on the REIT units and paying dividends when declared by our board of directors.

We believe that internally generated cash flows, supplemented by borrowings through our credit facility and mortgage financings, where required, will be sufficient to cover our normal operating and capital expenditures. We regularly review our credit facility limits and manage our capital requirements accordingly.

On January 12, 2018, we sold the REIT five commercial properties for a total purchase price of \$80.88 million. The purchase price was settled through assumption of \$31.04 million in mortgages payable; issuance of 1,331,202 Class C LP Units, representing \$13.31

million in Retained Debt by Melcor; issuance of 283,447 Class B LP Units at a price of \$8.82, representing \$2.50 million; and cash of \$34.03 million. Concurrent with closing of this sale, the REIT issued 2,035,000 trust units in exchange for subscription receipts previously issued and outstanding and the maturity date of the 2017 Debentures was extended to December 31, 2022. Melcor's interest in the REIT on closing the Melcor Acquisition is approximately 53.0%.

We do not currently have any other plans to raise additional capital through the issuance of common shares, trust units, preferred shares or convertible debentures; however, under certain circumstances, we would consider these means to facilitate growth through acquisition or to reduce the utilized level on our credit facility.

Cash requirements

The following information about our contractual obligations and other commitments summarizes certain of our liquidity and capital resource requirements. The information presented includes legally committed capital expenditures.

Contractual obligations include:

	Total	Payments due by period			
		Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Debt on investment properties and golf course assets	447,887	58,876	161,606	97,043	130,362
Revolving credit facilities	76,529	76,529	—	—	—
Secured vendor take back debt on land inventory	64,891	22,678	32,798	559	8,856
Project specific financing	20,926	20,926	—	—	—
REIT debenture	55,500	—	32,500	23,000	—
Interest expense	52,597	13,903	19,192	11,062	8,440
Operating leases	930	156	356	372	46
Total contractual obligations	719,260	193,068	246,452	132,036	147,704

Sources and uses of cash

The following table summarizes our cash flows from (used in) operating, investing and financing activities, as reflected in our consolidated statement of cash flows:

	2017	2016
Cash flows from operating activities	7,406	68,997
Cash flows used in investing activities	(29,341)	(15,299)
Cash flows from financing activities	26,694	(61,363)

Cash from operations was \$61.59 million lower in 2017. During 2017 we purchased 771 acres of land inventory for \$42.58 million compared with 144 acres for \$9.75 million in 2016. Net cash from operating activities was also impacted by the increase in agreements receivable in our community development division. In response to market trends, terms on our agreements have increased in the past couple of years resulting in an increase in the balance at year end which was up \$13.71 million over 2016. We also incurred \$5.94 million in tenant incentives and direct leasing costs in 2017 to renew and secure new leases.

Cash used in investing activities was \$29.34 million, an increase of \$14.04 million over 2016. In 2016, we sold a residential property and residential units in the US for net proceeds of \$38.96 million. In the current year, the REIT disposed of an industrial property in Lethbridge, AB and Melcor disposed of a parking lot in Edmonton, AB for net proceeds of \$7.38 million. In the current year, we did not purchase any investment properties from third parties (2016 - \$38.72 million in purchases).

We continue to invest in improving our asset base through value enhancing projects. Additions to investment properties include development activities in Property Development and enhancements to properties held in the Investment Properties and REIT operating divisions. In 2017 we invested \$36.15 million in properties under development, property improvements and capitalized borrowing costs, compared with \$14.77 million in 2016.

Cash from financing activities increased by \$88.06 million over 2016 largely a result of a draw on our revolving credit facilities. In 2017, the revolving credit facilities made net draws of \$26.48 million compared to net repayments of \$54.02 million in 2016. General debt contributed to a net cash outflows of \$4.50 million through financings received and repayments made, compared to a net cash inflow of \$5.88 million in 2016. We also recognized \$21.54 million in cash inflows related to the issuance of the convertible debenture.

In 2017, we paid dividends of \$0.52 per share, for a total cash outflow of \$17.35 million. This compares to dividends of \$0.48 per share in 2016, for a cash outflow of \$15.97 million.

Share Data

Melcor has been a public company since 1968 and trades under the symbol “MRD” on the Toronto Stock Exchange. As at December 31, 2017 there were 33,389,451 common shares issued and outstanding and 978,447 options, each convertible to one common share upon exercise or exchange. There is only one class of shares issued.

Please refer to note 18 to the consolidated financial statements for information pertaining to our outstanding shares and options.

Off Balance Sheet Arrangements

In the normal course of operations, Melcor engages in transactions that, under IFRS, are either not recorded on our consolidated statements of financial position or are in amounts that differ from the full contract amounts. The main off-balance sheet arrangements we make include the issuance of guarantees and letters of credit.

A discussion of our letter of credit facility arrangement can be found in the Financing section. Refer to note 21 to the consolidated financial statements for information pertaining to our guarantees and letters of credit.

Quarterly Results

The following table presents a summary of our unaudited operating results for the past eight quarters. This information should be read in conjunction with the applicable year-end financial statements, notes to the financial statements and management’s discussion and analysis.

(\$000s)	2017				2016			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	109,633	62,795	46,955	38,567	106,391	63,432	42,084	30,554
Net income	32,084	11,517	3,927	(9,003)	24,109	16,260	1,778	(7,714)
<i>Per Share</i>								
Basic earnings	0.96	0.34	0.12	(0.27)	0.73	0.49	0.05	(0.23)
Diluted earnings	0.96	0.34	0.12	(0.27)	0.73	0.49	0.05	(0.23)
Book value *	30.21	29.39	29.30	29.41	29.83	29.19	28.80	28.86

*See non-standard measures for definition

We have historically experienced variability in our results of operations from quarter to quarter due to the seasonal nature of the development business and the timing of plan registrations with the municipalities. We typically experience the highest sales in our Community Development division in the fourth quarter, as this is when the majority of plans register. The fair value gains in our Property Development division are also seasonally affected, as the majority of construction in Alberta takes place during the spring and summer months.

Fourth Quarter

Three months ended December 31 (\$000s)	2017	2016
Revenue	109,633	106,391
Cost of sales	(61,753)	(63,333)
Gross profit	47,880	43,058
General and administrative expense	(7,229)	(6,083)
Fair value adjustment on investment properties	3,923	208
Adjustments related to REIT units	1,909	461
Loss on sale of assets	(18)	(1)
Operating earnings	46,465	37,643
Interest income	194	340
Foreign exchange loss	(26)	(412)
Finance costs	(5,938)	(3,375)
Net finance costs	(5,770)	(3,447)
Income before income taxes	40,695	34,196
Income tax expense	(8,611)	(10,087)
Net income for the period	32,084	24,109
Earnings per share attributable to Melcor's shareholders:		
Basic earnings per share	0.96	0.73
Diluted earnings per share	0.96	0.73

Highlights of the fourth quarter include:

- Our Property Development division completed and transferred 2 buildings (17,137 sf) to Investment Properties.
- Our Community Development division registered 11 plans in 7 communities, which added 796 lots to inventory with 864 lots sold in Q4-2017. This compares to 9 plan registrations in 6 communities adding 381 lots to inventory with 616 lots sold in Q4-2016.
- On December 4, 2017, we announced that we had entered into an agreement with the REIT to sell a portfolio of five commercial properties comprised of 172,629 sf GLA at ownership percentage for \$80.88 million. The sale closed on January 12, 2018. Through the REIT, we are able to monetize the value we create as we move land from raw inventory to completed commercial project. As majority owner of the REIT, we receive monthly distributions from the REIT. Growing the asset management side of our business helps to stabilize our overall revenue throughout the year.

Segmented information for the fourth quarter is as follows:

Three months ended December 31, 2017	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	85,776	5,765	8,910	16,263	693	—	117,407	(7,774)	109,633
Cost of sales	(51,118)	(5,600)	(3,456)	(6,733)	(980)	(119)	(68,006)	6,253	(61,753)
Gross profit	34,658	165	5,454	9,530	(287)	(119)	49,401	(1,521)	47,880
General and administrative expense	(2,381)	(577)	(1,244)	(780)	(317)	(2,649)	(7,948)	719	(7,229)
Fair value adjustment on investment properties	—	795	(1,503)	3,829	—	—	3,121	802	3,923
Loss on sale of assets	—	—	—	—	—	(18)	(18)	—	(18)
Interest income	87	2	27	22	—	56	194	—	194
Segment Earnings	32,364	385	2,734	12,601	(604)	(2,730)	44,750	—	44,750
Foreign exchange loss									(26)
Finance costs									(5,938)
Adjustments related to REIT units									1,909
Income before income taxes									40,695
Income tax expense									(8,611)
Net income for the period									32,084

Three months ended December 31, 2016	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	95,213	16,656	9,443	16,170	750	—	138,232	(31,841)	106,391
Cost of sales	(64,392)	(16,600)	(3,943)	(6,490)	(1,022)	(118)	(92,565)	29,232	(63,333)
Gross profit	30,821	56	5,500	9,680	(272)	(118)	45,667	(2,609)	43,058
General and administrative expense	(2,235)	(599)	(728)	(631)	(344)	(2,300)	(6,837)	754	(6,083)
Fair value adjustment on investment properties	—	50	1,903	(3,600)	—	—	(1,647)	1,855	208
Loss on sale of assets	—	—	—	—	(1)	—	(1)	—	(1)
Interest income	312	1	3	11	—	13	340	—	340
Segment Earnings	28,898	(492)	6,678	5,460	(617)	(2,405)	37,522	—	37,522
Foreign exchange gains									(412)
Finance costs									(3,375)
Adjustments related to REIT units									461
Income before income taxes									34,196
Income tax expense									(10,087)
Net income for the period									24,109

Outlook

Melcor owns a high quality portfolio of assets, including raw land, developed land inventory (residential lots and acres for multi-family and commercial development), income-producing properties and championship golf courses. Alberta, our largest market, has undergone dramatic changes throughout the past few years, primarily related to lower oil prices. We continue to execute on our strategic plan and achieved solid results in 2017. We are intentionally diversifying across asset class and geography, and continue to invest in the US with both raw land acquisitions and the launch of an 1,100-acre community with expansion capacity. This diversification will serve to ease reliance on the Alberta economy.

Market demand varies by asset class and region and we expect this to continue in 2018. On the residential side, we expect starter homes and lower priced options including duplexes, townhomes and new product types such as zero lot lines to continue to lead the market. On the commercial side, retail activity remains steady and we expect that trend to continue. Our US assets continue to deliver positive returns in economies that are growing and that are counter cyclical to our resource dependence in Alberta.

Our business model has adapted to changing times for 94 years. We will continue to take advantage of opportunities to diversify our asset base both geographically and by product type. We will maintain our disciplined, conservative approach to operations to ensure that we remain profitable while achieving our fundamental goals of protecting shareholder investment and sharing corporate profit with our shareholders.

With appropriate levels of serviced land inventory, high occupancy rates and capacity on our operating facility, we remain are positioned for the future.

Interest in the REIT

The REIT is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust dated January 25, 2013, which was subsequently amended and restated May 1, 2013.

The REIT began operations on May 1, 2013 when trust units were issued for cash pursuant to the initial public offering (Offering or IPO). Units of the REIT trade on the Toronto Stock Exchange under the symbol MR.UN. The REIT is externally managed, administered and operated by Melcor pursuant to the property management and asset management agreements entered into in conjunction with the IPO.

As of March 7, 2018, Melcor holds a 53.0% (December 31, 2016 and 2017 - 56.7%) effective interest in the REIT through ownership of all Class B LP units of the partnership through an affiliate and a corresponding number of special voting units of the REIT. The Class B LP units are economically equivalent to, and are exchangeable for, trust units. Melcor is the ultimate controlling party.

As we retain control over the REIT, we consolidate the REIT and record 100% of its revenues, expenses, assets and liabilities. We reflect the public's 47.0% interest (December 31, 2017 and 2016 - 43.3%) in the REIT as a financial liability.

Arrangements between Melcor and the REIT

Melcor continues to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. The following summarizes services to be provided to the REIT and the compensation to be paid to Melcor.

Asset management agreement - we receive a quarterly management fee which is comprised of the following:

- a. a base annual management fee calculated and payable on a quarterly basis, equal to 0.25% of the REIT's gross book value;
- b. a capital expenditures fee equal to 5.0% of all hard construction costs incurred on capital projects in excess of \$0.10 million;
- c. an acquisition fee equal to 0.5% - 1.0% of the purchase price;
- d. a financing fee equal to 0.25% of the debt and equity of all financing transactions completed for the REIT to a maximum of actual expenses incurred by Melcor.

Property management agreement - we receive a monthly fee which is comprised of the following:

- a. a base fee of 3.0% of gross property revenue;
- b. a leasing fee equal to 5.0% of aggregate base rent for new leases for the first 5 years and 2.5% thereafter, and 2.5% of aggregate base rent for lease renewals and expansions for the first 5 years.

Capital project funding - as part of the transaction, we agreed to pay approximately \$1.40 million in costs associated with certain maintenance and capital projects at nine of the Initial Properties.

IPO transaction costs - Costs incurred by Melcor in relation to the REIT's IPO were reimbursed by the REIT to the extent that these costs were eligible for capitalization against the unit issuance.

Upon consolidation we eliminate Class B LP Units, Class C LP Units, distributions on Class B LP Units, distributions on Class C Units, and fees earned under the asset management agreement and property management agreement.

Business Environment & Risks

A discussion of credit risk, liquidity risk and market risk can be found in note 29 to the consolidated financial statements.

The following is an overview of certain risk factors that could adversely impact our financial condition, results of operations, and the value of our common shares.

General Risks

We are exposed to the micro- and macro-economic conditions that affect the markets in which we operate and own assets. In general, a decline in economic conditions will result in downward pressure on Melcor's margins and asset values as a result of lower demand for the services and products we offer. Specifically, general inflation and interest rate fluctuations; population growth and migration; job creation and employment patterns; consumer confidence; government policies, regulations and taxation; and availability of credit and financing could pose a threat to our ongoing business operations.

International economic forces and conditions will impact our business as our investment into the US grows. We adapt our business plan to reflect current conditions and we believe that we have sufficient resources to carry our operations through uncertain times.

We participate in joint arrangements under the normal course of business that may have an effect on certain assets and businesses. These joint arrangements may involve risks that would not otherwise be present if the third parties were not involved, including the possibility that the partners have different economic or business interests or goals. Also, within these arrangements, Melcor may not have sole control of major decisions relating to these assets and businesses, such as: decisions relating to the sale of the assets and businesses; timing and amount of distributions of cash from such entities to Melcor and its joint arrangement partners; and capital expenditures.

Industry Risk

Real estate investments are generally subject to varying levels of risk. These risks include changes to general economic conditions, government and environmental regulations, local supply/demand, and competition from other real estate companies. Real estate assets are relatively illiquid in down markets, particularly raw land. As a result, Melcor may not be able to quickly re-balance its portfolio in response to changing economic or investment conditions.

Concentration of Assets Risk

The majority of our assets are located in Alberta. Adverse changes in economic conditions in Alberta may have a material adverse effect on our business, cash flows, financial condition and results of operations and ability to pay dividends. The Alberta economy is sensitive to the price of oil and gas. To mitigate against this risk, we endeavor to diversify our revenue mix by product and location.

Financing Risk

We use debt and other forms of leverage in the ordinary course of business to enhance returns to shareholders. Most leveraged debt within the business has recourse only to the assets being financed or margined and has no recourse to Melcor.

We are subject to general risks associated with debt financing. The following risks may adversely affect our financial condition and results of operations:

- Cash flow may be insufficient to meet required payments of principal and interest;
- Payments of principal and interest on borrowings may leave us with insufficient cash resources to pay operating expenses;
- We may not be able to refinance indebtedness on our assets at maturity due to company and market factors;
- The fair market value of our assets;
- Liquidity in the debt markets;
- Financial, competitive, business and other factors, including factors beyond our control;
- Refinancing terms that are not as favourable as the original terms of the related financing.

We attempt to mitigate these risks through the use of long-term debt and diversifying terms and maturity dates.

The terms of various credit agreements and other financing documents require that we comply with a number of financial and other covenants, such as maintaining debt service coverage and leverage ratios, and minimum insurance coverage. These covenants may limit our flexibility in our operations, and breaches of these covenants could result in defaults under the instruments governing the applicable indebtedness even if we had satisfied our payment obligations.

If we are unable to refinance assets/indebtedness on acceptable terms, or at all, we may need to utilize available liquidity, which would reduce our ability to pursue new investment opportunities, or require that we dispose of one or more of our assets on disadvantageous terms. In addition, unfavourable interest rates or other factors at the time of refinancing could increase interest expense.

A large proportion of our capital is invested in physical, long-lived assets, which can be difficult to liquidate, especially if local market conditions are poor. This circumstance could limit our ability to diversify our portfolio of assets promptly in response to changing economic or investment conditions.

We enter into financing commitments in the normal course of business and, as a result, may be required to fund these, particularly through joint arrangements. If we are unable to fulfill any of these commitments, damages could be pursued against Melcor.

Community Development

The Community Development division is subject to risks influenced by the demand for new housing in the regions where we operate. Demand is primarily impacted by interest rates, growth in employment, migration, general economic conditions, new family formations and the size of these families. The division's ability to bring new communities to the market is impacted by municipal regulatory requirements and environmental considerations that affect the planning, subdivision and use of land. The planning and approval process can take up to eighteen months. During this period, the market conditions in general and/or the market for lots in the size and price range in our developments may change dramatically.

The division manages our assets to ensure that we have adequate future land assets to develop by ensuring appropriate approvals are in place and by balancing our inventory of land between long, medium and short-term development horizons against the cost of acquiring and holding these lands.

Property Development

The Property Development division is subject to risks that would normally be associated with the construction industry (such as fluctuating labour, material and consulting costs), combined with the normal leasing risks that the Investment Property division faces (see below).

The division manages the overall costs of projects, project financing requirements, construction quality, and the suitability of projects in relation to the needs of the tenants who will occupy the completed building. The division is also subject to additional holding costs if an asset is not leased out on a timely basis.

Investment Properties and REIT

The Investment Properties and REIT divisions are subject to the market conditions in the geographic areas where we own and manage properties. Where strong market conditions prevail, we are able to achieve higher occupancy rates. Market conditions are influenced by outside factors such as government policies, demographics and employment patterns, the affordability of rental properties, competitive leasing rates and long-term interest and inflation rates. Refer to Business Environment & Risks section of the REIT's annual MD&A filed on SEDAR and incorporated by reference.

Recreational Properties

The results of golf course operations may be adversely affected by weather, which limits the number of playing days; competition from other courses; the level of disposable income available to customers to spend on recreational activities; the popularity of the sport; and the cost of providing desirable playing conditions on the course.

While weather is outside our control, we manage our golf courses to provide consistent playing conditions to support the popularity of our courses. We also focus on growing revenue related to food and beverage and event rentals.

Other Financial Information

Normal Course Issuer Bid

On March 29, 2017 we announced a Normal Course Issuer bid commencing March 31, 2017 and ending March 30, 2018. Under the bid, we could acquire up to 1,667,704 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 2,158 common shares.

During 2017, we did not buy back any shares (2016 - 12,231 common shares were purchased, canceled and returned to treasury).

Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with IFRS. In applying IFRS, we make estimates and assumptions that affect the carrying amounts of assets and liabilities, disclosure of contingent liabilities and the reported amount of income for the period. Actual results could differ from estimates previously reported. We have discussed the development, selection and application of our key accounting policies, and the critical accounting estimates and assumptions they involve, with the Audit Committee and the Board of Directors.

Our significant accounting policies and accounting estimates are contained in the consolidated financial statements. Please refer to note 3 to the consolidated financial statements for a description of our accounting policies and note 5 and 6 for a discussion of accounting estimates and judgments.

Changes in Accounting Policies and Adoption of IFRS

Refer to note 4 to the consolidated financial statements for information pertaining to accounting pronouncements that will be effective in future years.

Subsequent Events

Please refer to note 31 to the consolidated financial statements for information pertaining to subsequent events.

Joint Arrangement Activity

We record only our proportionate share of the assets, liabilities, revenue and expenses of our joint arrangements. Refer to note 25 to the consolidated financial statements for a listing of our current joint arrangements. The following table illustrates selected financial data related to joint arrangements at 100% as well as the net portion relevant to Melcor.

<i>Joint arrangement activity at 100% (\$000s)</i>	2017	2016
Revenue	169,505	139,282
Earnings	42,679	39,771
Assets	1,008,635	859,830
Liabilities	403,964	310,568

<i>Joint arrangement activity at Melcor's ownership % (\$000s) *</i>	2017	2016
Revenue	82,046	62,224
Earnings	22,280	18,881
Assets	444,378	401,410
Liabilities	169,740	140,399

* Ownership in joint arrangements varies from 7% - 80%.

Internal Control over Financial Reporting and Disclosure Controls

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant and material information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), in a timely manner. Under the supervision of the CEO and CFO, we carried out an evaluation of the effectiveness of our disclosure controls and procedures as defined in Canada by National Instrument 52-109 as of December 31, 2017. Based on this evaluation, our CEO and CFO concluded that the design and operation of our disclosure controls and procedures related to Melcor and its subsidiaries and joint arrangements were effective.

Internal control over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Management designed these controls based on the criteria set out in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013 Framework). The CEO and CFO have certified that the internal controls over financial reporting were properly designed and effective for the year ended December 31, 2017.

There has been no change to Melcor's disclosure controls and procedures or internal control over financial reporting during the year ended December 31, 2017, that materially affected, or is reasonably likely to materially affect, Melcor's internal control over financial reporting.

Notwithstanding the foregoing, no assurance can be made that the Melcor's controls over disclosure and financial reporting and related procedures will detect or prevent all failures of people to disclose material information otherwise required to be set forth in the Melcor's reports.

Non-standard Measures

Throughout this MD&A, we refer to terms that are not specifically defined in the CICA Handbook and do not have any standardized meaning prescribed by IFRS. These non-standard measures may not be comparable to similar measures presented by other companies. We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results. The non-standard terms that we refer to in this MD&A are defined below.

Net operating income (NOI): this is a measure of revenue less direct operating expenses.

Same asset NOI: this measure compares the NOI on assets that have been owned for the entire current and comparative year, excluding management fees earned on inter-divisional services and the effects of foreign currency translation.

Funds from operations (FFO): this measure is commonly used to measure the performance of real estate operations.

Calculations

We use the following calculations in measuring our performance.

Book value per share = (shareholders' equity) / (number of common shares outstanding)

Gross margin (%) = (gross profit) / (revenue) This measure indicates the relative efficiency with which we earn revenue

Net margin (%) = (net income) / (revenue) This measure indicates the relative efficiency with which we earn income

Debt to equity ratio = (total debt) / (total equity)

Net operating income (NOI) = (net income) +/- (fair value adjustments on investment properties) + (general and administrative expenses) – (interest income) + (amortization of operating lease incentives) +/- (straight-line rent adjustment). A reconciliation of NOI to the most comparable IFRS measure, net income, is as follows:

Investment Properties

(\$000s)	Year Ended	
	2017	2016
Segment earnings	15,084	30,615
Fair value adjustment on investment properties	2,668	(11,449)
General and administrative expenses	3,197	2,620
Interest income	(33)	(6)
Amortization of operating lease incentives	798	593
Straight-line rent adjustments	(663)	(1,439)
Divisional NOI	21,051	20,934

REIT

(\$000s)	Year Ended	
	2017	2016
Segment earnings	24,657	31,108
Fair value adjustment on investment properties	12,800	6,546
General and administrative expenses	2,718	2,653
Interest income	(62)	(35)
Amortization of operating lease incentives	3,062	3,216
Straight-line rent adjustments	(1,074)	(1,159)
Divisional NOI	42,101	42,329

Funds from operations (FFO) = (net income) + (amortization of operating lease incentives) +/- (fair value adjustment on investment properties) + (depreciation of property and equipment) + (stock based compensation expense) + (non-cash interest) +/- (gain (loss) on sale of asset) + (deferred income taxes) +/- (fair value adjustment on REIT Units). A reconciliation of FFO to the most comparable IFRS measure, net income, is as follows:

Consolidated

(\$000s)	Year Ended	
	2017	2016
Net income for the year	38,525	34,433
Amortization of operating lease incentives	6,304	6,344
Fair value adjustment on investment properties	8,828	(15,795)
Depreciation on property and equipment	1,436	1,571
Stock based compensation expense	408	302
Non-cash financing costs	414	1,179
Gain on sale of asset	(17)	(37)
Deferred income taxes	2,565	628
Fair value adjustment on REIT units	558	13,939
FFO *	59,021	42,564

Investment Properties

(\$000s)	Year Ended	
	2017	2016
Divisional income for the year	15,084	30,615
Fair value adjustment on investment properties	2,668	(11,449)
Amortization of operating lease incentives	798	593
Divisional FFO	18,550	19,759

REIT

(\$000s)	Year Ended	
	2017	2016
Divisional income for the year	24,657	31,108
Fair value adjustment on investment properties	12,800	6,546
Amortization of operating lease incentives	3,062	3,216
Divisional FFO	40,519	40,870

FFO per share = (FFO) / (basic weighted average common shares outstanding)