



Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2017

(Unaudited, in thousands of Canadian dollars)

Condensed Interim Consolidated Statement of Income

| Unaudited (\$000s) | For the three months ended | | For the nine months ended | |
|--|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Revenue | 62,795 | 63,432 | 148,317 | 136,070 |
| Cost of sales | (34,942) | (34,345) | (79,829) | (70,714) |
| Gross profit | 27,853 | 29,087 | 68,488 | 65,356 |
| General and administrative expense | (5,796) | (5,025) | (17,684) | (14,674) |
| Fair value adjustment on investment properties (note 5 and 10) | 106 | 14,170 | (12,751) | 15,587 |
| Adjustments related to REIT units (note 9) | (1,769) | (3,778) | (9,994) | (21,927) |
| Gain on sale of assets | 21 | 35 | 35 | 38 |
| Operating earnings | 20,415 | 34,489 | 28,094 | 44,380 |
| Interest income | 280 | 337 | 935 | 838 |
| Finance costs | (5,585) | (9,558) | (16,039) | (22,439) |
| Net finance costs | (5,305) | (9,221) | (15,104) | (21,601) |
| Income before income taxes | 15,110 | 25,268 | 12,990 | 22,779 |
| Income tax expense | (3,593) | (9,008) | (6,549) | (12,455) |
| Net income for the period | 11,517 | 16,260 | 6,441 | 10,324 |
| Income per share: | | | | |
| Basic earnings per share | 0.34 | 0.49 | 0.19 | 0.31 |
| Diluted earnings per share | 0.34 | 0.49 | 0.19 | 0.31 |

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Comprehensive Income

| Unaudited (\$000s) | For the three months ended | | For the nine months ended | |
|---|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Net income for the period | 11,517 | 16,260 | 6,441 | 10,324 |
| Other comprehensive income (loss) | | | | |
| Items that may be reclassified subsequently to net income (loss): | | | | |
| Currency translation differences | (4,134) | 979 | (8,085) | (6,037) |
| Comprehensive income | 7,383 | 17,239 | (1,644) | 4,287 |

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Financial Position

| Unaudited (\$000s) | September 30, 2017 | December 31, 2016 |
|---|--------------------|-------------------|
| ASSETS | | |
| Cash and cash equivalents | 41,932 | 39,892 |
| Accounts receivable | 14,040 | 16,918 |
| Income taxes recoverable | 6,495 | 1,909 |
| Agreements receivable | 99,170 | 116,244 |
| Land inventory (note 4) | 726,970 | 680,260 |
| Investment properties (note 5 and 10) | 965,188 | 970,693 |
| Property and equipment | 14,835 | 15,507 |
| Other assets | 50,175 | 50,565 |
| | 1,918,805 | 1,891,988 |
| LIABILITIES | | |
| Accounts payable and accrued liabilities | 44,646 | 35,274 |
| Provision for land development costs | 85,387 | 91,584 |
| General debt (note 6) | 643,589 | 608,611 |
| Deferred income tax liabilities | 65,846 | 67,458 |
| REIT units (note 9 and 10) | 98,689 | 94,340 |
| | 938,157 | 897,267 |
| SHAREHOLDERS' EQUITY | | |
| Share capital (note 7) | 72,446 | 72,137 |
| Contributed surplus | 2,867 | 2,594 |
| Accumulated other comprehensive income (AOCI) | 17,105 | 25,190 |
| Retained earnings | 888,230 | 894,800 |
| | 980,648 | 994,721 |
| | 1,918,805 | 1,891,988 |

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Cash Flows

| Unaudited (\$000's) | For the three months ended | | For the nine months ended | |
|---|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| CASH FLOWS FROM (USED IN) | | | | |
| OPERATING ACTIVITIES | | | | |
| Net income for the period | 11,517 | 16,260 | 6,441 | 10,324 |
| Non cash items: | | | | |
| Amortization of tenant incentives | 1,480 | 1,673 | 4,635 | 4,766 |
| Depreciation of property and equipment | 517 | 564 | 1,175 | 1,303 |
| Stock based compensation expense | 93 | 63 | 305 | 220 |
| Non-cash finance costs | (294) | 3,721 | (123) | 5,306 |
| Straight-line rent adjustment | (683) | (372) | (1,205) | (1,560) |
| Fair value adjustment on investment properties (note 5 and 10) | (106) | (14,170) | 12,751 | (15,587) |
| Fair value adjustment on REIT units (note 9 and 10) | (112) | 1,896 | 4,349 | 16,281 |
| Gain on sale of assets | (21) | (35) | (35) | (38) |
| Deferred income taxes | (287) | 253 | (1,327) | 228 |
| | 12,104 | 9,853 | 26,966 | 21,243 |
| Agreements receivable | (5,211) | 13,836 | 17,074 | 58,313 |
| Development activities | (10,857) | (1,049) | (12,209) | (9,176) |
| Purchase of land inventory (note 4) | (4,329) | (600) | (29,459) | (1,909) |
| Payment of tenant lease incentives and direct leasing costs | (1,438) | (1,738) | (3,836) | (4,308) |
| Operating assets and liabilities | 6,592 | 14,585 | 9,693 | (3,984) |
| | (3,139) | 34,887 | 8,229 | 60,179 |
| INVESTING ACTIVITIES | | | | |
| Purchase of investment properties | — | — | — | (33,738) |
| Additions to investment properties (note 5) | (14,056) | (2,455) | (23,471) | (11,523) |
| Disposal of investment properties (note 5) | 2,986 | 210 | 7,206 | 210 |
| Change in restricted cash | — | — | — | 1,041 |
| Purchase of property and equipment | (331) | (207) | (523) | (773) |
| Proceeds on disposal of property and equipment | 30 | 44 | 54 | 53 |
| | (11,371) | (2,408) | (16,734) | (44,730) |
| FINANCING ACTIVITIES | | | | |
| Revolving credit facilities | 31,543 | (14,055) | 38,645 | (27,092) |
| Proceeds from general debt | 31,091 | 16,518 | 41,251 | 72,116 |
| Repayment of general debt | (28,372) | (29,057) | (54,609) | (59,190) |
| Change in restricted cash | — | — | — | 1,247 |
| Dividends paid | (4,339) | (3,990) | (13,011) | (11,968) |
| Share capital issued | 199 | 101 | 277 | 263 |
| | 30,122 | (30,483) | 12,553 | (24,624) |
| FOREIGN EXCHANGE GAIN (LOSS) ON CASH HELD IN A FOREIGN CURRENCY | | | | |
| | (1,136) | 302 | (2,008) | (2,023) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE PERIOD | | | | |
| | 14,476 | 2,298 | 2,040 | (11,198) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD | | | | |
| | 27,456 | 35,178 | 39,892 | 48,674 |
| CASH AND CASH EQUIVALENTS, END OF THE PERIOD | | | | |
| | 41,932 | 37,476 | 41,932 | 37,476 |
| Total income taxes paid | 4,125 | 2,360 | 13,079 | 17,252 |
| Total interest paid | 6,935 | 6,870 | 18,639 | 20,141 |

See accompanying notes to these condensed interim consolidated financial statements.

1. CORPORATE INFORMATION

We are a real estate development company with community development, property development, investment properties, REIT and recreational property divisions. We develop, manage, and own mixed-use residential communities, business and industrial parks, office buildings, retail commercial centres, and golf courses.

The parent company is Melcor Developments Ltd. (“Melcor” or “we”) and is incorporated in Canada. The registered office is located at Suite 900, 10310 Jasper Avenue Edmonton, AB T5J 1Y8. We operate in Canada and the United States (“US”). Our shares are traded on the Toronto Stock Exchange under the symbol “MRD”. As at September 30, 2017 Melton Holdings Ltd. holds approximately 47.0% of the outstanding shares and pursuant to IAS 24, Related party disclosures, is the ultimate controlling shareholder of Melcor.

As at November 3, 2017, Melcor through an affiliate, holds an approximate 56.7% effective interest in Melcor REIT (“REIT” or “the REIT”) through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. Melcor continues to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. Trust units of the REIT are traded on the Toronto Stock Exchange under the symbol “MR.UN”.

Our quarterly results are impacted by the cyclical nature of our business environment. Income can fluctuate significantly from period to period due to the timing of plan registrations, the cyclical nature of real estate and construction markets, and the mix of lot sales and product types.

2. BASIS OF PRESENTATION

We prepare our condensed interim consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting.

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2016, which have been prepared in accordance with IFRS as issued by the IASB.

These condensed interim consolidated financial statements were approved for issue by the Board of Directors on November 3, 2017.

3. ACCOUNTING POLICIES

The accounting policies followed in these condensed interim consolidated financial statements are consistent with those of the previous financial year. We have adopted amendments to standards IAS 7, Statement of Cash Flows and IAS 12, Income Taxes, effective January 1, 2017. Adoption of these amended standards did not require any adjustment to the presentation or disclosures within these condensed interim consolidated financial statements.

4. LAND INVENTORY

| | September 30, 2017 | December 31, 2016 |
|------------------------|--------------------|-------------------|
| Raw land held | 376,129 | 333,854 |
| Land under development | 151,489 | 142,350 |
| Developed land | 199,352 | 204,056 |
| | 726,970 | 680,260 |

During the nine month period ended September 30, 2017, we purchased 449.04 acres and 294 lots of land at a cost of \$46,654 and received vendor financing of \$17,195.

During the comparative nine month period ended September 30, 2016, we purchased 94 acres of land at a cost of \$3,443 and received vendor financing of \$2,134. We had also acquired 22.94 acres of land at a cost of \$2,810, through an arrangement to buyout the interest of one of our joint venture partners. This purchase was satisfied with cash consideration of \$600 and a receivable settlement of \$2,210.

5. INVESTMENT PROPERTIES

Investment properties consists of the following:

| | September 30, 2017 | December 31, 2016 |
|------------------------------|--------------------|-------------------|
| Investment properties | 903,674 | 929,299 |
| Properties under development | 61,514 | 41,394 |
| Total | 965,188 | 970,693 |

The following table summarizes the change in investment properties during the period:

| | Nine months ended September 30, 2017 | | |
|--|---|---------------------------------|----------------|
| | Investment Properties | Properties under Development | Total |
| Balance - beginning of period | 929,299 | 41,394 | 970,693 |
| Additions | | | |
| Transfer from land inventory | — | 1,536 | 1,536 |
| Direct leasing costs | 851 | 248 | 1,099 |
| Property improvements | 3,038 | — | 3,038 |
| Development costs | 56 | 20,169 | 20,225 |
| Capitalized borrowing costs | — | 208 | 208 |
| Disposals | (10,746) | — | (10,746) |
| Transfers | 4,886 | (4,886) | — |
| Fair value adjustment on investment properties | (15,596) | 2,845 | (12,751) |
| Foreign currency translation (included in OCI) | (8,114) | — | (8,114) |
| Balance - end of period | 903,674 | 61,514 | 965,188 |

| | Year ended December 31, 2016 | | |
|--|---------------------------------|---------------------------------|----------------|
| | Investment Properties | Properties under Development | Total |
| Balance - beginning of year | 847,387 | 56,961 | 904,348 |
| Additions | | | |
| Direct acquisition | 64,186 | — | 64,186 |
| Transfer from land inventory | — | 12,140 | 12,140 |
| Direct leasing costs | 1,006 | 289 | 1,295 |
| Property improvements | 3,777 | — | 3,777 |
| Development costs | 1,939 | 8,949 | 10,888 |
| Capitalized borrowing costs | — | 103 | 103 |
| Disposals | (38,961) | — | (38,961) |
| Transfers | 44,967 | (44,967) | — |
| Fair value adjustment on investment properties | 7,876 | 7,919 | 15,795 |
| Foreign currency translation (included in OCI) | (2,878) | — | (2,878) |
| Balance - end of year | 929,299 | 41,394 | 970,693 |

In accordance with our policy we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized net operating income ("NOI"). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 10.

During the nine months ended September 30, 2017 we disposed of an industrial property in Lethbridge, Alberta for a sales price of \$7,760 (net of transaction costs). The sales price was settled through mortgage assumption of \$2,640, issuance of a vendor-take-back mortgage of \$900, and cash of \$4,220. The vendor take-back (VTB) mortgage bears interest at an annual rate of 6.00%, with

interest only payments payable monthly over a 36 month term. The VTB is open to prepayment in whole or in part without penalty. In the third quarter of 2017 we also disposed of a parking lot in Edmonton, Alberta for cash consideration of \$2,986 (net of transaction costs).

During the nine months ended September 30, 2016, we completed the acquisition of three suburban office properties in the greater Denver area:

- On February 26 - the Offices at Promenade for \$23,073 (US\$17,032) (including transaction costs). As part of the purchase Melcor also assumed a mortgage on the property with a carrying value of \$15,618 (US\$11,529). As a financial liability, we recorded the assumed mortgage at its fair value on initial recognition. The fair value of the mortgage was calculated using a market interest rate for an equivalent mortgage;
- On March 3 - the Offices at Inverness for \$13,067 (US\$9,746) (including transaction costs); and
- On March 31 - Syracuse Hill One for \$13,216 (US\$10,188) (including transaction costs).

These acquisitions were funded through available cash and were accounted for as direct acquisitions.

| 6. GENERAL DEBT | | |
|--|---------------------------|-------------------|
| | September 30, 2017 | December 31, 2016 |
| Melcor - revolving credit facilities | 75,254 | 32,728 |
| REIT - revolving credit facility | 13,444 | 17,324 |
| Project specific financing | 8,735 | 5,213 |
| Secured vendor take back debt on land inventory | 67,600 | 65,408 |
| Debt on investment properties and golf course assets | 445,403 | 455,189 |
| REIT - convertible debenture | 33,153 | 32,749 |
| | 643,589 | 608,611 |

7. SHARE CAPITAL

Issued and outstanding common shares at September 30, 2017 are 33,370,851 (December 31, 2016 – 33,350,898). During the three and nine months ended September 30, 2017, there were 14,400 and 19,953 options exercised (Q3-2016 – 7,900 and 20,750).

8. SEGMENTED INFORMATION

Geographic Analysis

A reconciliation of our revenues and assets by geographic location is as follows:

| External Revenues | For the three months ended | | For the nine months ended | |
|--------------------------|-----------------------------------|--------------------|----------------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| United States | 3,401 | 8,830 | 10,637 | 17,307 |
| Canada | 59,394 | 54,602 | 137,680 | 118,763 |
| Total | 62,795 | 63,432 | 148,317 | 136,070 |

Total Assets

| <i>As at</i> | September 30, 2017 | December 31, 2016 |
|---------------|---------------------------|-------------------|
| United States | 202,555 | 203,415 |
| Canada | 1,716,250 | 1,688,573 |
| Total | 1,918,805 | 1,891,988 |

8. SEGMENTED INFORMATION (continued)

Divisional Analysis

Our divisions reported the following results:

| For the three months ended September 30, 2017 | Community Development | Property Development | Investment Properties | REIT | Recreational Properties | Corporate | Subtotal | Intersegment Elimination | Total |
|---|--------------------------|-------------------------|--------------------------|---------|----------------------------|-----------|-----------------|-----------------------------|-----------------|
| Segment revenue | 35,673 | 5,120 | 8,464 | 16,791 | 4,093 | — | 70,141 | (7,346) | 62,795 |
| Cost of sales | (23,257) | (5,100) | (3,529) | (6,424) | (2,407) | (102) | (40,819) | 5,877 | (34,942) |
| Gross profit | 12,416 | 20 | 4,935 | 10,367 | 1,686 | (102) | 29,322 | (1,469) | 27,853 |
| General and administrative expense | (2,214) | (526) | (682) | (624) | (708) | (1,899) | (6,653) | 857 | (5,796) |
| Fair value adjustment on investment properties | — | (190) | (395) | 79 | — | — | (506) | 612 | 106 |
| Gain on sale of assets | — | — | — | — | 21 | — | 21 | — | 21 |
| Interest income | 236 | 1 | 4 | 20 | — | 19 | 280 | — | 280 |
| Segment Earnings (Loss) | 10,438 | (695) | 3,862 | 9,842 | 999 | (1,982) | 22,464 | — | 22,464 |
| Finance costs | | | | | | | | | (5,585) |
| Adjustments related to REIT units | | | | | | | | | (1,769) |
| Earnings before tax | | | | | | | | | 15,110 |
| Income tax expense | | | | | | | | | (3,593) |
| Net income for the period | | | | | | | | | 11,517 |

| For the three months ended September 30, 2016 | Community Development | Property Development | Investment Properties | REIT | Recreational Properties | Corporate | Subtotal | Intersegment Elimination | Total |
|---|--------------------------|-------------------------|--------------------------|---------|----------------------------|-----------|-----------------|-----------------------------|-----------------|
| Segment revenue | 35,458 | 25,763 | 9,558 | 16,439 | 3,952 | — | 91,170 | (27,738) | 63,432 |
| Cost of sales | (22,191) | (25,750) | (3,770) | (6,265) | (2,409) | (124) | (60,509) | 26,164 | (34,345) |
| Gross profit | 13,267 | 13 | 5,788 | 10,174 | 1,543 | (124) | 30,661 | (1,574) | 29,087 |
| General and administrative expense | (2,109) | (415) | (619) | (629) | (708) | (1,417) | (5,897) | 872 | (5,025) |
| Fair value adjustment on investment properties | — | 2,049 | 12,366 | (947) | — | — | 13,468 | 702 | 14,170 |
| Gain on sale of assets | — | — | — | — | 35 | — | 35 | — | 35 |
| Interest income | 328 | 1 | 1 | 7 | — | — | 337 | — | 337 |
| Segment Earnings (Loss) | 11,486 | 1,648 | 17,536 | 8,605 | 870 | (1,541) | 38,604 | — | 38,604 |
| Finance costs | | | | | | | | | (9,558) |
| Adjustments related to REIT units | | | | | | | | | (3,778) |
| Earnings before tax | | | | | | | | | 25,268 |
| Income tax expense | | | | | | | | | (9,008) |
| Net income for the period | | | | | | | | | 16,260 |

| For the nine months ended September 30, 2017 | Community Development | Property Development | Investment Properties | REIT | Recreational Properties | Corporate | Subtotal | Intersegment Elimination | Total |
|---|--------------------------|-------------------------|--------------------------|----------|----------------------------|-----------|-----------------|-----------------------------|-----------------|
| Segment revenue | 72,509 | 5,250 | 25,882 | 50,350 | 7,957 | — | 161,948 | (13,631) | 148,317 |
| Cost of sales | (47,996) | (5,100) | (10,420) | (19,767) | (4,909) | (321) | (88,513) | 8,684 | (79,829) |
| Gross profit | 24,513 | 150 | 15,462 | 30,583 | 3,048 | (321) | 73,435 | (4,947) | 68,488 |
| General and administrative expense | (6,527) | (1,488) | (1,953) | (1,938) | (1,866) | (6,329) | (20,101) | 2,417 | (17,684) |
| Fair value adjustment on investment properties | — | 2,513 | (1,165) | (16,629) | — | — | (15,281) | 2,530 | (12,751) |
| Gain on sale of assets | — | — | — | — | 35 | — | 35 | — | 35 |
| Interest income | 819 | 14 | 6 | 40 | — | 56 | 935 | — | 935 |
| Segment Earnings (Loss) | 18,805 | 1,189 | 12,350 | 12,056 | 1,217 | (6,594) | 39,023 | — | 39,023 |
| Finance costs | | | | | | | | | (16,039) |
| Adjustments related to REIT units | | | | | | | | | (9,994) |
| Income before tax | | | | | | | | | 12,990 |
| Income tax expense | | | | | | | | | (6,549) |
| Net income for the period | | | | | | | | | 6,441 |

| For the nine months ended September 30, 2016 | Community Development | Property Development | Investment Properties | REIT | Recreational Properties | Corporate | Subtotal | Intersegment Elimination | Total |
|---|--------------------------|-------------------------|--------------------------|----------|----------------------------|-----------|------------------|-----------------------------|-----------------|
| Segment revenue | 58,988 | 29,073 | 26,331 | 49,872 | 8,426 | — | 172,690 | (36,620) | 136,070 |
| Cost of sales | (38,116) | (29,050) | (10,051) | (19,280) | (5,158) | (394) | (102,049) | 31,335 | (70,714) |
| Gross profit | 20,872 | 23 | 16,280 | 30,592 | 3,268 | (394) | 70,641 | (5,285) | 65,356 |
| General and administrative expense | (6,302) | (1,259) | (1,892) | (2,022) | (1,931) | (3,646) | (17,052) | 2,378 | (14,674) |
| Fair value adjustment on investment properties | — | 6,080 | 9,546 | (2,946) | — | — | 12,680 | 2,907 | 15,587 |
| Gain on sale of assets | — | — | — | — | 38 | — | 38 | — | 38 |
| Interest income | 807 | 3 | 3 | 24 | — | 1 | 838 | — | 838 |
| Segment Earnings (Loss) | 15,377 | 4,847 | 23,937 | 25,648 | 1,375 | (4,039) | 67,145 | — | 67,145 |
| Finance costs | | | | | | | | | (22,439) |
| Adjustments related to REIT units | | | | | | | | | (21,927) |
| Income before tax | | | | | | | | | 22,779 |
| Income tax expense | | | | | | | | | (12,455) |
| Net income for the period | | | | | | | | | 10,324 |

9. NON-CONTROLLING INTEREST IN MELCOR REIT

In accordance with our policy, we account for the remaining 43.3% publicly held interest in the REIT as a financial liability measured at fair value through profit or loss (“FVTPL”). As at September 30, 2017 the REIT units had a fair value of \$98,689. We recorded adjustments related to REIT units for the three and nine months ended September 30, 2017 of \$1,769 and \$9,994 (Q3-2016 - \$3,778 and \$21,927).

As illustrated in the table below, the adjustment is comprised of:

| | For the three months ended | | For the nine months ended | |
|---|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Fair value adjustment on REIT units (note 10) | 112 | (1,896) | (4,349) | (16,281) |
| Distributions to REIT unitholders | (1,881) | (1,882) | (5,645) | (5,646) |
| Adjustments related to REIT units | (1,769) | (3,778) | (9,994) | (21,927) |

The following tables summarize the financial information relating to Melcor's subsidiary, the REIT, that has material non-controlling interest (NCI), before intra-group eliminations.

| As at | September 30, 2017 | December 31, 2016 |
|--------------------------|--------------------|-------------------|
| Assets | 644,090 | 663,724 |
| Liabilities | 351,130 | 359,828 |
| Net assets | 292,960 | 303,896 |
| Cost of NCI | 103,959 | 103,959 |
| Fair value of NCI | 98,689 | 94,340 |

| | For the three months ended | | For the nine months ended | |
|--|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Revenue | 16,791 | 16,439 | 50,350 | 49,872 |
| Net income (loss) and comprehensive income (loss) | 4,291 | 153 | (10,991) | (13,966) |
| Cash flows from operating activities | 4,751 | 3,688 | 10,279 | 9,234 |
| Cash flows from (used in) investing activities | (632) | (952) | 2,566 | (1,869) |
| Cash flows from (used in) financing activities, before distributions to REIT unitholders | (2,538) | 864 | (6,958) | 1,216 |
| Cash flows used in financing activities - cash distributions to REIT unitholders | (1,881) | (1,882) | (5,645) | (5,646) |
| Net increase (decrease) in cash and cash equivalents | (300) | 1,718 | 242 | 2,935 |

10. FAIR VALUE MEASUREMENT

Fair value is the price that market participants would be willing to pay for an asset or liability in an orderly transaction under current market conditions at the measurement date.

The fair value of Melcor's financial instruments were determined as follows:

- the carrying amounts of cash and cash equivalents, accounts receivables, agreements receivable and accounts payable and accrued liabilities approximate their fair values based on the short term maturities of these financial instruments.
- fair values of general debt are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 3).
- fair value of derivative financial liabilities, which is the conversion feature on the REIT convertible debenture, and our floating for fixed interest rate swap, are estimated based upon unobservable inputs, including volatility and credit spread (Level 3).

- fair value of REIT units are estimated based on the closing trading price of the REIT's trust units and the fair value of the convertible debenture is estimated based on the closing trading price of the REIT's debenture (Level 1).

In addition, Melcor carries its investment properties at fair value, which is determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows (Level 3).

The fair value hierarchy categorizes fair value measurement into three levels based upon the inputs to valuation technique, which are defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: unobservable inputs for the asset or liability.

There were no transfers between the levels of the fair value hierarchy during the period.

The following table summarizes Melcor's assets and liabilities carried at fair value and its financial assets and liabilities where carrying value does not approximate fair value.

| | September 30, 2017 | | | | | December 31, 2016 | |
|--|----------------------|------------|----------------|----------------------|------------------|----------------------|------------------|
| | Fair Value Hierarchy | Fair Value | Amortized Cost | Total Carrying Value | Total Fair Value | Total Carrying Value | Total Fair Value |
| Non-financial assets | | | | | | | |
| Investment properties | Level 3 | 965,188 | — | 965,188 | 965,188 | 970,693 | 970,693 |
| Financial liabilities | | | | | | | |
| General debt, excluding convertible debenture and derivative financial liability | Level 3 | — | 613,401 | 613,401 | 571,895 | 578,177 | 583,489 |
| Convertible debenture | Level 1 | — | 34,315 | 34,315 | 34,949 | 34,315 | 35,017 |
| Derivative financial liability | | | | | | | |
| Interest rate swaps | Level 3 | 922 | — | 922 | 922 | 27 | 27 |
| Conversion feature on convertible debenture | Level 3 | 61 | — | 61 | 61 | 61 | 61 |
| REIT units | Level 1 | 98,689 | — | 98,689 | 98,689 | 94,340 | 94,340 |

Investment properties

Investment properties are remeasured to fair value on a recurring basis, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows. The application of these valuation methods result in these measurements being classified as level 3 in the fair value hierarchy.

Under the discounted future cash flows method, fair values are determined by discounting the forecasted future cash flows over ten years plus a terminal value determined by applying a terminal capitalization rate to forecasted year eleven cash flows.

Under the direct income capitalization method, fair values are determined by dividing the stabilized net operating income of the property by a property specific capitalization rate.

The significant unobservable inputs in the Level 3 valuations are as follows:

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items;
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;
- Terminal capitalization rate - taking into account assumptions regarding vacancy rates and market rents; and

- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

An increase in the cash flows or stabilized net operating income results in an increase in fair value of investment property whereas an increase in the capitalization rate, discount rate or terminal capitalization rate decreases the fair value of the investment property.

In determining the fair value of our investment properties judgment is required in assessing the 'highest and best use' as required under IFRS 13, *Fair value measurement*. We have determined that the current uses of our investment properties are their 'highest and best use'.

Melcor's executive management team is responsible for determining fair value measurements on a quarterly basis, including verifying all major inputs included in the valuation and reviewing the results. Melcor's management, along with the Audit Committee, discuss the valuation process and key inputs on a quarterly basis. At least once every two years, the valuations are performed by qualified external valuers who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued.

Investment properties were valued by Melcor's internal valuation team as at September 30, 2017 of which 27 investment properties (of 47 legal phases) with a fair value of \$341,500 were valued by qualified independent external valuation professionals during the period. Valuations performed during the period resulted in fair value gains of \$106. As at December 31, 2016 Melcor's internal valuation team valued investment properties of which 45 investment properties (of 82 legal phases valued) with a fair value of \$430,312 were valued by qualified independent external valuation professionals during the year. Valuations performed during 2016 resulted in fair value gains of \$15,795.

The following table summarizes the valuation approach, significant unobservable inputs, and the relationship between the inputs and the fair value:

| Asset | Valuation approach | Significant unobservable inputs | Relationship between inputs and fair value |
|---|--|---|---|
| Investment properties | Direct capitalization or discounted cash flows | - Capitalization rate - Discount rate - Terminal rate - Stabilized NOI - Cash flows | Inverse relationship between capitalization, discount and terminal rates and fair value (higher rates result in decreased fair value); whereas higher stabilized NOI or cash flows results in increased fair value. |
| Properties under development | Direct capitalization less cost to complete | - Capitalization rate - Stabilized NOI - Costs to complete | Inverse relationship between capitalization rate and fair value (higher capitalization rate results in lower fair value); whereas higher stabilized NOI results in increased fair value. |
| Properties under development - undeveloped land | Direct comparison | - Comparison to market transactions for similar assets | Land value reflects market value. |

Weighted average annual stabilized net operating income for investment properties as at September 30, 2017 is \$1,465 (December 31, 2016 - \$1,477). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

| | Investment Properties | | | Properties under Development | | |
|------------------------------|-----------------------|-------|------------------|------------------------------|-------|------------------|
| | Min | Max | Weighted Average | Min | Max | Weighted Average |
| September 30, 2017 | | | | | | |
| Capitalization rate | 5.50% | 8.75% | 6.61% | 5.75% | 6.00% | 5.76% |
| Terminal capitalization rate | 5.75% | 9.00% | 6.77% | 6.00% | 6.25% | 6.01% |
| Discount rate | 6.00% | 9.75% | 7.69% | 7.00% | 7.25% | 7.03% |

| December 31, 2016 | Investment Properties | | | Properties under Development | | |
|------------------------------|-----------------------|-------|------------------|------------------------------|-------|------------------|
| | Min | Max | Weighted Average | Min | Max | Weighted Average |
| Capitalization rate | 5.50% | 8.75% | 6.58% | 6.00% | 6.00% | 6.00% |
| Terminal capitalization rate | 5.75% | 9.00% | 6.81% | 6.25% | 6.25% | 6.25% |
| Discount rate | 6.00% | 9.75% | 7.65% | 7.00% | 7.50% | 7.07% |

An increase in capitalization rates by 50 basis points would decrease the fair value and carrying amount of investment properties by \$55,988 (December 31, 2016 - \$57,485). A decrease in capitalization rates by 50 basis points would increase the fair value and carrying amount of investment properties by \$65,153 (December 31, 2016 - \$66,944).

General debt, excluding derivative financial liabilities

The fair value of revolving credit facilities approximates the carrying value excluding unamortized financing costs. The facilities bear interest, at our option, at a rate per annum equal to either the bank's prime lending rate plus 0.75% to 2.25% or at the bank's then prevailing banker's acceptance rate plus a stamping fee of 2.25% to 3.00%.

The fair value of project specific financing, secured vendor take back debt on land inventory and debt on investment properties and golf course assets and convertible debenture have been calculated by discounting the expected cash flows of each loan using a discount rate specific to each individual loan. The discount rate is determined using the bond yield for similar instruments of similar maturity adjusted for each individual project's specific credit risk. In determining the adjustment for credit risk, we consider current market conditions and other indicators of credit worthiness.

The fair value of convertible debenture is estimated based on the closing trading price of the REIT's debenture.

Derivative financial liabilities

Our derivative financial liabilities are comprised of floating for fixed interest rate swaps on mortgage levels and the conversion feature on the REIT convertible debenture.

The fair value of the interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date.

The significant unobservable inputs used in the fair value measurement of the conversion feature on the REIT convertible debenture as at September 30, 2017 are as follows:

- Volatility - expected volatility as at September 30, 2017 was derived from the historical prices of the REIT's trust units. As the REIT was formed on May 1, 2013, price history is limited and we have used the entire historical data up until September 30, 2017. Volatility was 16.73% (December 31, 2016 - 16.73%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at September 30, 2017. The credit spread used was 3.71% (December 31, 2016 - 3.71%).

REIT units

REIT units are remeasured to fair value on a recurring basis. The units are fair valued based on the trading price of the REIT units at the period end date. At September 30, 2017 the fair value of the REIT units was \$98,689, resulting in a fair value gain of \$112 during the quarter, and a year to date loss of \$4,349 (2016 - loss of \$1,896 and \$16,281) in the statement of income and comprehensive income during the three and nine months ended September 30, 2017 (note 9).

11. CREDIT RISK

Agreements receivable are collateralized by specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region. We manage credit risk by selling to certain qualified registered builders.

During the quarter, management was made aware that one of these builders is in receivership. Agreements receivable balances owing from this builder amount to \$6,180, of which \$920 are past due as at September 30, 2017. We hold title to the lots sold to this builder as specific security against this balance. Management has performed an assessment of the collectibility and of the underlying security for these agreements, and has concluded that no impairment is required as at September 30, 2017. We will continue to monitor our exposure to impairment as we work to settle the outstanding amounts.

12. EVENTS AFTER THE REPORTING PERIOD

Distributions on REIT trust units

On October 13, 2017 the REIT declared a distribution of \$0.05625 per unit for the months of October, November and December 2017. The distributions will be payable as follows:

| Month | Record Date | Distribution Date | Distribution Amount |
|---------------|--------------------|--------------------------|----------------------------|
| October 2017 | October 31, 2017 | November 15, 2017 | \$0.05625 per unit |
| November 2017 | November 30, 2017 | December 15, 2017 | \$0.05625 per unit |
| December 2017 | December 29, 2017 | January 15, 2018 | \$0.05625 per unit |

Dividends declared

On November 3, 2017 our board of directors declared a dividend of \$0.13 per share payable on December 29, 2017 to shareholders of record on December 15, 2017.