

# Management's Discussion & Analysis

March 11, 2020

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, 2019.

The financial statements underlying this MD&A, including 2018 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 11, 2020.

## 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](http://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 2020 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.

## TABLE OF CONTENTS

<b>Our Business</b>	2	<b>Financing</b>	29
<b>Strategy</b>	3	<b>Liquidity &amp; Capital Resources</b>	32
<b>Key Performance Drivers</b>	7	<b>Share Data</b>	34
<b>2019 Highlights</b>	13	<b>Normal Course Issuer Bid</b>	34
<b>Revenue &amp; Margins</b>	14	<b>Off Balance Sheet Arrangements</b>	34
<b>Funds from Operations</b>	15	<b>Quarterly Results</b>	35
<b>Divisional Results</b>	15	<b>Fourth Quarter</b>	36
Community Development	16	<b>Outlook</b>	38
Property Development	20	<b>Interest in Melcor REIT</b>	38
Investment Properties	22	<b>Business Environment &amp; Risks</b>	39
REIT	25	<b>Other Financial Information</b>	42
Recreational Properties	27	<b>Internal Control over Financial Reporting and Disclosure Controls</b>	43
<b>General &amp; Administrative Expense</b>	28	<b>Non-standard Measures</b>	44
<b>Income Tax Expense</b>	28		

# 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.

Since 1923, our focus has been the business of real estate. We've built over 140 communities across western Canada since the 1950s and have helped to shape much of Alberta's landscape. We manage 4.59 million square feet (sf) in commercial real estate assets and 608 residential rental units. We have been a public company since 1968 (TSX:MRD).

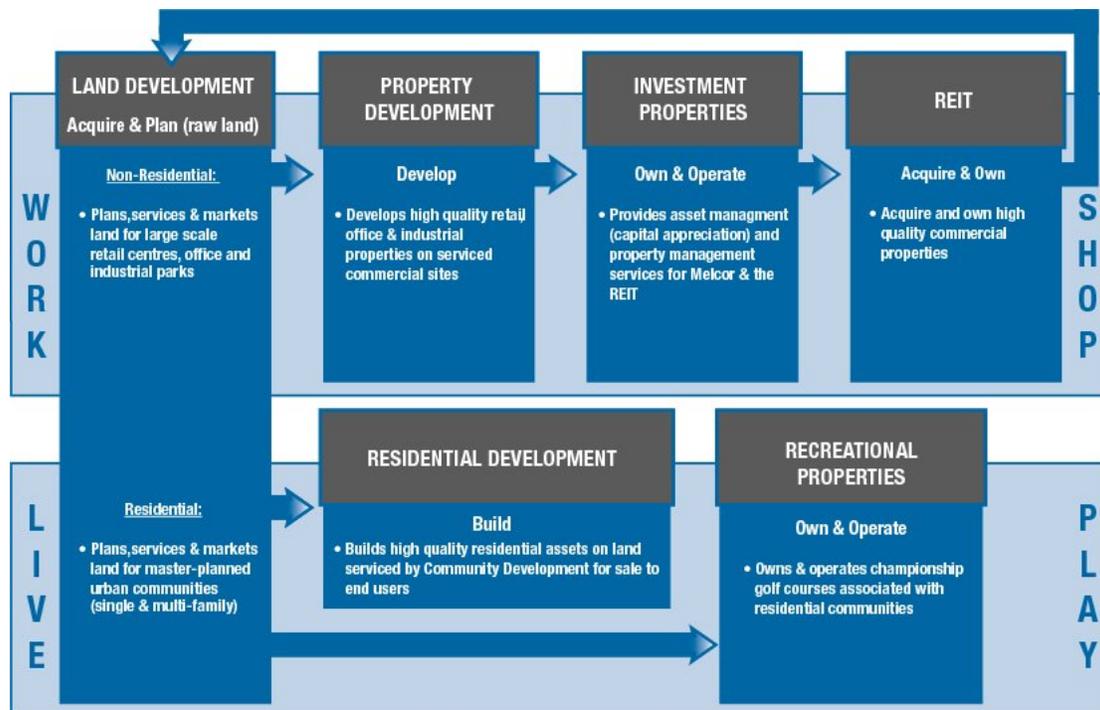
**We are committed to building communities that enrich quality of life - communities where people live, work, shop and play.**

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 office, retail, industrial and residential assets (Melcor Real Estate Investment Trust or the REIT, formed May 1, 2013 through an IPO. We retain a controlling 55.1% 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.)

In addition, we own and operate championship golf courses associated with our residential communities in our fifth division, Recreation Properties. Melcor has \$2.10 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 authentic values of a family-run organization, practicing the golden rule and building deep relationships with our clients, our business partners and our employees.

## Strategy

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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 commercial properties, managing our income-producing portfolio and operating championship golf courses.

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

In 2019, we continued our disciplined approach to new community development in Canada and focused on reducing overall lot inventory in existing communities. We launched two new communities adjacent to popular current communities that are running out of inventory - Lanark Landing adjacent King's Heights in Airdrie, AB and Rosewood at Secord adjacent Rosenthal in west Edmonton, AB. Throughout the past few years, we have shifted the product type in our residential developments to meet trending changes in market demand. More stringent mortgage qualifications came into effect in early 2019, which, combined with the continued soft economy, made cost effective homes — townhomes, duplex, zero lot line or traditional single family with secondary suites to assist with mortgage qualifications — the preferred products.

Our major US community of Harmony, outside of Denver, CO, operates on a different scale than our Canadian developments with volume builders taking on a significantly higher number of lots than typical in our Canadian markets. Sales velocity has been ramping up and we are planning to bring on a new phase of 181 lots in 2020.

Commercial property development, particularly neighbourhood shopping centres, continues at a solid pace as pre-lease thresholds are met. With a focus on local services — grocer, gas, coffee, pharmacy, dental, restaurant, daycare — these retail hubs are largely Amazon-proof.

Our geographic and revenue source diversification strategies have served to offset the softness in Canadian residential development. Our commercial property divisions now manage 4.59 million sf of income-generating assets, providing stable results throughout the year to smooth out the seasonal nature of construction related divisions.

We have over 95 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.

The following diagram illustrates the pillars of our strategy, which are to **grow** by acquiring strategic land and property and exploring strategic opportunities to increase capital resources; to **sustain** by remaining disciplined in monitoring and managing our key performance drivers and our reputation; to **diversify** by developing real estate assets for revenue, earnings and cash flow growth and by increasing our presence in the United States. **People** are the heart of our strategy, and we commit to protecting our culture and values and taking care of our exceptional team.



## 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.

Division	Assets	Strategy
Community Development	10,632 acres of raw land inventory in strategic growth corridors	<p>Reduce older inventory.</p> <p>Maintain right mix of inventory, available at the right time to meet market needs</p> <p>Increase market share by maintaining best in class design and community amenities</p>
Property Development	<p>Prospects for over 5.5 million sf of new development based on existing plans</p> <p>Completed and transferred 99,794 sf (8 buildings) in 2019</p> <p>96,797 sf is currently under construction, while a further 47,688 sf is completed and awaiting lease-up and/or transfer.</p>	<p>Plan, build and lease retail, office, industrial and multi-family residential real estate projects</p> <p>Maintain 3-5 year inventory of developable assets</p> <p>Maximize value of existing assets through vertical development or re-development</p>
Investment Properties & REIT	<p>4.59 million sf of commercial property and 608 residential units under management, diversified across 4 asset classes in 3 provinces and 2 states</p> <p>As Property Development projects are completed, our GLA continues to grow.</p>	<p>Improve existing assets with value-added investments to achieve higher occupancy rates and increase rent per square foot</p> <p>Be the landlord of choice by providing consistent, high-quality service</p>
Recreational Properties	4 championship golf courses	<p>Maintain strong reputation through consistent course quality and player experience</p> <p>Grow revenue from food and beverage operations</p>

## Diversification

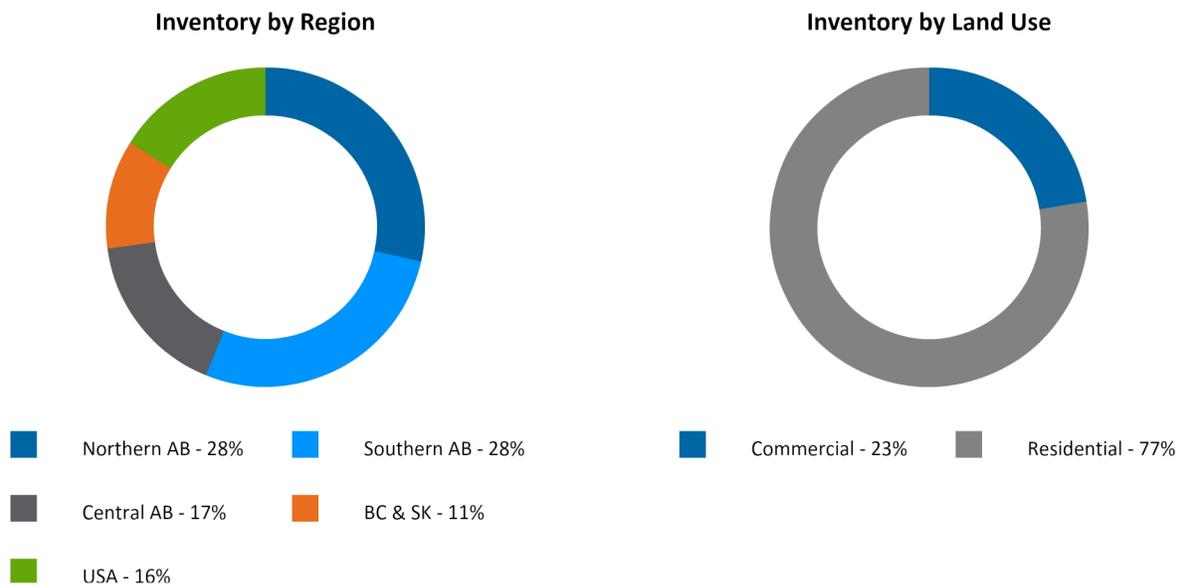
Our operating divisions diversify our revenue streams in a number of ways:

- 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 diverse divisions and invests in Canada and the US to build inventory for future development. This division holds land for future residential or commercial development in strategic growth corridors. It is 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 140 communities across Alberta, BC and the United States.

### LAND INVENTORY

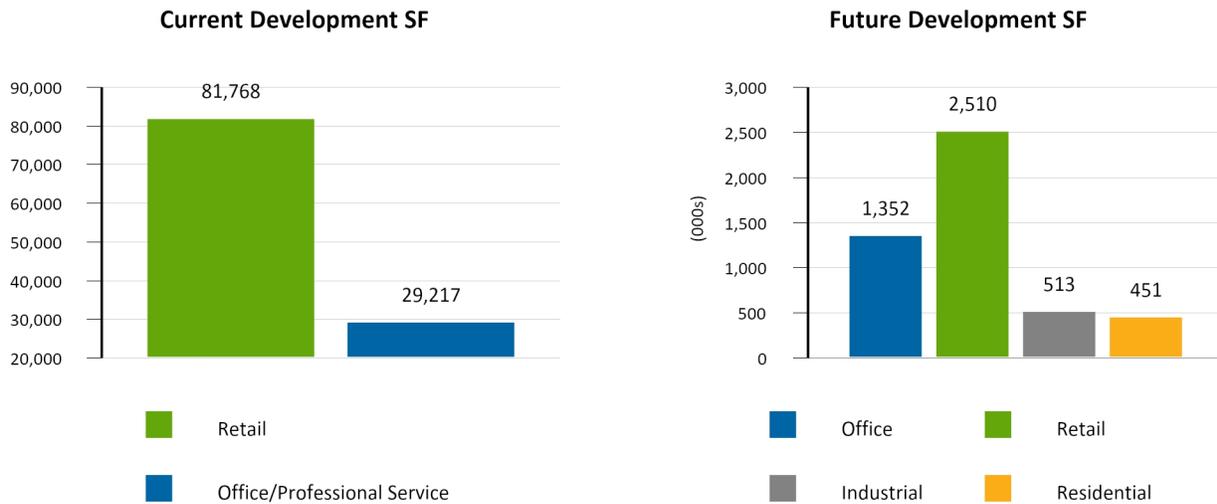


**Property Development** adds value to raw land by developing retail, office, industrial and multi-family residential properties in Alberta.

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 the 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.

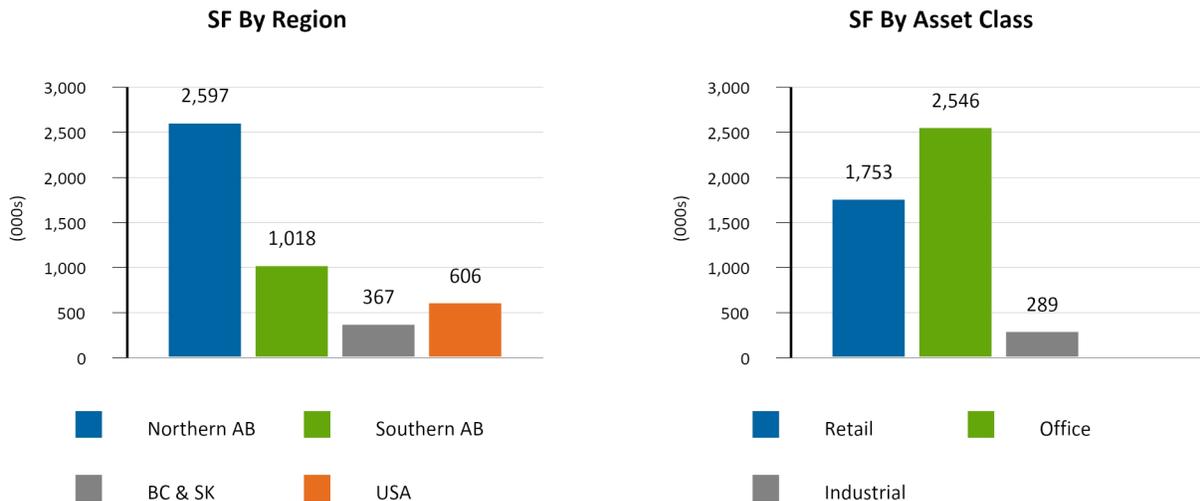
Melcor has been developing commercial properties since the 1970s and has built over 2.5 million sf. Our future development pipeline is 5.5 million sf based on current development plans.

## PROPERTY DEVELOPMENT



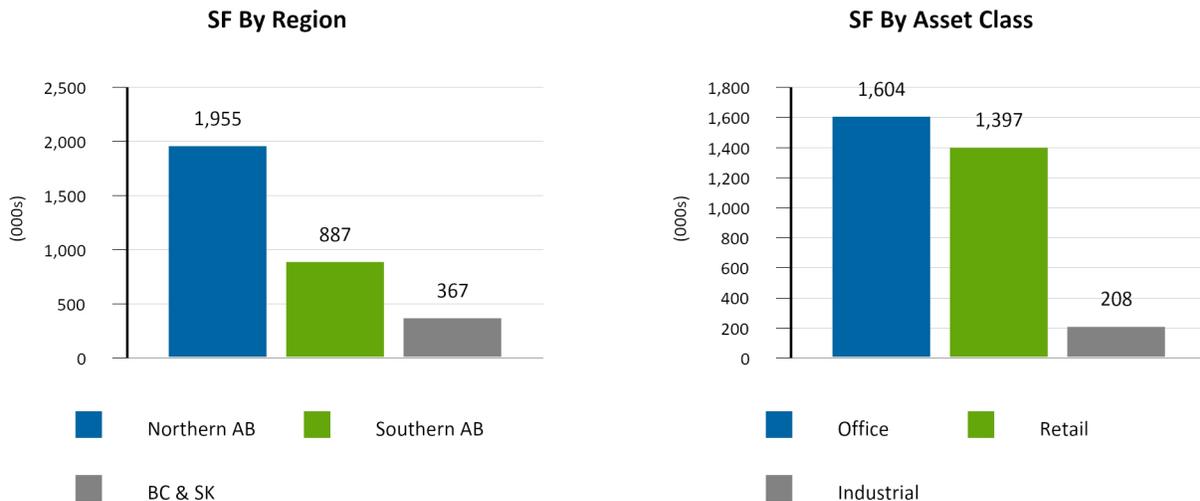
**Investment Properties** manages 4.59 million sf of geographically diverse income-producing assets (including those owned by the REIT) to provide consistent annuity income and cash flow. Our total portfolio under management is diversified across asset class, property mix and region. The regional asset mix is primarily commercial in western Canada, with the majority of these assets owned by the REIT. Our US portfolio is a blend of residential and commercial properties. The goal of the Investment Properties division is to be the landlord of choice by providing exceptional customer care. We 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 GLA MANAGED



**The REIT** owns 3.21 million sf of income-producing assets that are managed by the Investment Properties division. 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. To date, the REIT has acquired over 1.0 million sf from Melcor and 745,000 sf from third parties.

## TOTAL GLA OWNED BY THE REIT



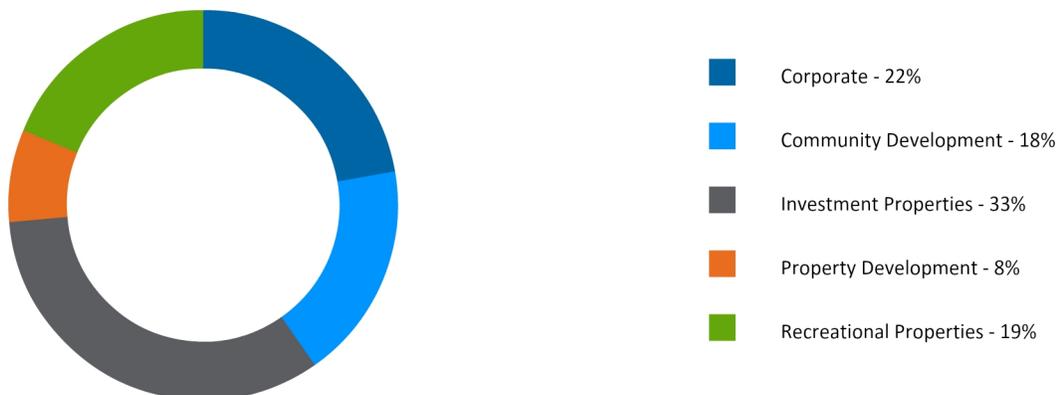
## Key Performance Drivers

### 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 development, 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 7.53 years and we have 22 team members (7 active) on Melcor's Quarter Century Club.

In 2019, two long-service employees retired. We also lost a current and core employee unexpectedly - which further solidified our team culture as we worked together to fill the void.

### Employees by Division



Our culture is based on over nine decades of strong core values. We offer rewarding career development opportunities, competitive compensation and benefits, and employer-matched RRSP and employee share purchase programs (ESPP). Managers and the executive team also receive restricted share units (RSUs) and stock options.

## Real Estate Inventory

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

- 10,632 acres of developable land
- 4,588,003 sf of leasable commercial property and 608 residential units under management in 3 provinces and 2 states
- Potential to develop over 5.5 million sf of new commercial 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:

(including joint arrangements at 100%)	December 31, 2019				December 31, 2018			
	CANADA			USA	CANADA			USA
	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)
Open	1,112	59.00	130.44	136	987	68.56	136.13	294
Transfers	—	—	—	—	—	—	2.50	—
New developments	515	17.22	36.39	—	1,198	13.99	9.17	309
Internal sales	—	—	(36.93)	—	—	—	(5.25)	—
Sales	(668)	(17.22)	(3.81)	(72)	(1,073)	(23.55)	(12.11)	(467)
Year end	959	59.00	126.09	64	1,112	59.00	130.44	136

Residential development in Canada remained moderated in 2019 to align with market demand. New lot development was down by 57% and single-family lot sales were down by 38% compared to 2018, with ending single-family lot inventory down 14%.

We sold 72 single-family lots in Harmony, our community outside of Denver, CO. We have planned for continued future development in Harmony to meet strong market demand.

Our markets have changed and we recognize this. We have been proactively managing our cash position and ensuring that our development coincides with demand for several years now. We are well placed to respond to stronger market conditions when they return and continue to focus on clearing out existing inventory held by Melcor and by our builders using active marketing programs to support this objective. We remain committed to managing our risk in uncertain markets by ensuring that market demand is in place prior to proceeding with development.

### 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 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:

<i>Land purchases (in acres, net of joint arrangement interests)</i>	2019	2018	Total Land Holdings
Edmonton & Region	80.00	134.63	<b>3,024</b>
Red Deer & Region	158.03	0.45	<b>1,782</b>
Calgary & Region	—	2.50	<b>2,202</b>
Lethbridge	160.00	—	<b>737</b>
British Columbia	—	0.63	<b>554</b>
Saskatchewan	—	—	<b>616</b>
United States	72.57	62.00	<b>1,717</b>
	470.60	200.21	<b>10,632</b>

We acquired 470.60 acres of land in strategic growth corridors in 2019 and continue to seek investment opportunities. Land acquisitions in the US and in the Edmonton region are adjacent to land that is either currently in inventory or has already sold to builders, in order to build strategic positioning. Land acquisitions in Red Deer and Lethbridge were also highly strategic - adjacent to planned community facilities or new infill land that was previously unavailable. As a relationship focused company, Melcor invested the time and energy to develop relationships with these original land owners and ensure that they received fair value for their land.

## Financial Resources

Land and property development are capital-intensive activities. We require access to sufficient capital to continue to grow, develop new land and commercial property 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 primarily 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 2019, Melcor had project specific financings on three residential and four commercial projects totaling \$68.44 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.

Our operations are supported by a syndicated operating line of credit with total availability of \$196.13 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 2019, Melcor is well positioned to take advantage of acquisition and growth opportunities.

On October 29, 2019 the REIT announced the successful issue and sale of the 5.10% unsecured convertible debenture for gross proceeds of \$46.00 million, including \$6.00 million for the exercise of the over-allotment option in full.

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

# Corporate Sustainability

We are committed to corporate sustainability - in environmental practice, social responsibility, governance of our company and as stewards of the areas where we operate. Attaining best practice in all aspects of our business is our constant aspiration. Our history and our culture form our strong foundation: the authentic values of a family-run organization, practicing the golden rule and building deep relationships with our clients, our business partners and our employees.

## Environmental Commitment

### Land Development

We consider the impact of land development on the natural environment. Our goal is to create a habitat where people, plants, birds and wildlife can flourish together. Here are a few examples of our practices and some notable developments:

- low impact development techniques to reduce and absorb runoff (smaller driveways, more greenspace)
- unique naturalized storm water management ponds that mimic the natural environment - these first of a kind proved that we can re-create a very natural environment that attracts wildlife
- use natural land features as design features of the community
- partner of Edmonton Area Land Trust, committed to preserving natural treasures like the Larch Sanctuary
- use mature trees and native species in landscaping and require individual homeowners to do the same to not only beautify the community, but to increase natural absorption of rain water and snow melt
- our communities are filled with community gathering spaces - parks, playgrounds, community gardens and orchards

In 2010 we commenced development of the environmentally intelligent subdivision of Larch Park, which featured LED street-lighting before it was commonplace, narrower roads, bio-swales, soil preservation and a construction waste management program. Amenities include a community garden, an orchard, trails with plaques about local wildlife and plant species throughout and a truly natural storm pond. The homes meet BuiltGreen Gold, LEED for Homes Gold or R2000 with a minimum Energuide rating of 80. It borders the Larch Sanctuary, a protected natural area reserve.

### Property Development

We focus on efficient buildings in our commercial property development. Knowing that we are going to manage for the long-term, we strive to construct buildings that are as energy efficient as possible. Our neighbourhood shopping centres use xeriscaping, which is landscaping designed to reduce or eliminate the need for supplemental water by using native plants and trees.

The majority of our current development projects are neighbourhood shopping centres built for the convenience of our communities, with a quick walk, you can satisfy all your basic needs.

The Fountain Tire building, completed in 2014, recently received the ENERGY STAR designation, which is given to most energy efficient office buildings by Natural Resources Canada.

### Property Management

Our property management practices are designed to improve operating efficiency and reduce cost while at the same time increasing client satisfaction and thus retention rates. Our capital spending strategy focuses on equipment upgrades and maintenance initiatives that will reduce energy consumption in our properties.

Examples of our commitment to environmental best practices include:

- All properties have LED lights
- 80% of our buildings have motion-sensing lights that turn off when no one is present
- We have active recycling programs in all buildings
- We engage specialists to monitor and analyze our energy usage and identify potential improvements. Of 12 properties benchmarked from 2012 - 2019 we realized:
  - reduced electricity consumption of 15.5%
  - decrease in natural gas consumption of 0.3%
  - reduced equivalent greenhouse gases by 30%

- One building achieved ENERGY STAR certification in early 2020, recognizing the top 25% most efficient office buildings in Canada. We are tracking other office buildings in our portfolio for this certification.

## Recreational Properties

We clear walking trails and cross country ski tracks through our golf courses to make them a year-round attraction and a benefit to the surrounding neighbourhoods that many residents enjoy.

## Social Responsibility

Melcor has been built on relationships since 1923. The golden rule - treating others as you would like to be treated - has always been our core value. We cultivate and greatly value our relationships with tenants, clients, contractors, shareholders and the communities where we operate.

Our goal is to build places where people **want** to live, work, shop and play. That means amenities that help to build a sense of community for neighbourhood residents and neighbourhood shopping centres with public space for gathering.

We demonstrate social responsibility through our relationships with all stakeholders and the communities where we operate. Our commitment to being the landlord of choice is much more than a slogan. It is lived by every team member, as demonstrated by the results of our recent tenant survey. We surveyed 16 office buildings in November 2019 and both our property managers and building operators achieved a 92% approval rate.

We are committed to fostering a diverse, inclusive and safe work environment. Our people are at the heart of our strategy and one of three core values is to "empower and care for our exceptional team."

Our human capital strategy emphasizes health and wellness and recently doubled the benefit available for psychological services to support the mental well-being of staff. Food for Thought lunch and learn sessions are offered periodically to encourage learning on a variety of topics, including food waste, the benefits of proper sleep and meditation.

In addition, our social committee plans multiple events throughout the year to encourage staff interaction outside of the workday. The focus on a positive, empowering work environment creates an engaged and dedicated workforce with 22 employees having served the company for 25+ years. The average tenure of our employees is 7.53.

Our employees also make meaningful contributions to local charities through fundraising activities and by volunteering their time and talent. 2019 marked Melcor's 50th year of supporting the Capital Region United Way campaign.

Women make up 29% of Melcor's management committee, 38% of management and 43% of our overall team.

Being invested in the communities where we do business is an important part of who we are. As we pursue excellence in our business, we also want the communities where we do business to be the best they can be. We give where we live to build strong communities. Our giving and involvement focuses on key pillars of strong communities: education, health, youth, sports, public gathering places such as libraries, and social programs that lend a helping hand to those in need.

This commitment goes beyond financial and volunteer support. We take pride in the way our properties look. Entrances to office buildings have seasonal floral arrangements, beautifying the street. We have public art installations in, on and around a number of our properties.

Our focus on relationships extends to our service providers as well. The majority of our service providers are local and many are small businesses that support our local economies.

As the COVID-19 pandemic spreads, we have implemented programs and policies to educate and protect our staff. We have also implemented building practices to protect our tenants and minimize the spread of COVID-19, including hand sanitation stands at every entrance and on every floor in the elevator lobby. We continue to monitor the situation.

## ***Effective Governance***

We are committed to effective corporate governance practices as a core component of our operating philosophy. Strong governance practice form the foundation of a sustainable company and long-term value creation for share- and unit-holders. The board reviews our corporate governance practices annually to better align with industry best practices.

Melcor's Management Committee, which reviews and approves the projects we undertake, is 29% female.

Examples of our commitment to effective corporate governance practices include:

- a board of directors comprised of a majority of independent directors
- as the chair is related to the company, we have appointed a lead director
- 22% of directors are female; 40% of independent directors
- 33% of our executive team is female

# 2019 Highlights

<i>(\$000s except as noted)</i>	2019	2018	Change
Revenue	207,971	267,434	(22.2)%
Gross margin (%) *	46.5%	46.8%	(0.6)%
Fair value adjustment on investment properties	12,234	863	1,317.6 %
Net income	37,741	64,273	(41.3)%
Net margin (%) *	18.1%	24.0%	(24.6)%
Funds from operations *	38,265	56,127	(31.8)%
Shareholders' equity	1,080,257	1,067,565	1.2 %
Total assets	2,096,047	2,023,076	3.6 %
<b>Per Share Data</b>			
Basic earnings	1.13	1.92	(41.1)%
Diluted earnings	1.13	1.92	(41.1)%
Funds from operations *	1.15	1.68	(31.5)%
Book value *	32.51	32.01	1.6 %

\* See non-standard measures for definitions and calculations.

Our diversification strategy continues to have a positive impact on results to offset the softness in the Alberta and BC residential markets that has existed over the past five years. Our portfolio of income properties has grown 11% to 4.59 million sf via third-party acquisitions and properties constructed and transferred internally. The Property Development team transferred 8 buildings (99,794 sf) to Investment Properties in 2019. Investment Properties and the REIT had a combined revenue growth of 8% and represent 39% of revenue. The majority of GLA growth took place in the latter half of the year and will contribute to revenue growth in 2020. Recent GLA growth will be partially offset by the sale of a US office property with a total of 63,112 sf late in the year.

2019 results were also positively impacted by our geographic diversification strategy as we continued to sell lots in our new community of Harmony outside of Denver, CO. US revenue, which includes both investment properties and residential development, made up 14% of total revenue.

Softness continued in the our Canadian residential markets in 2019, with single-family lot sales down 38% compared to 2018 leading to a 27% decline in Community Development revenue. With a strategic focus on managing inventory, we developed 57% fewer lots than 2018. Promotions were in place throughout 2019 in various communities to move inventory. We began development on two new communities adjacent to popular communities that had run out of inventory, one in Airdrie, AB and one in west Edmonton, AB. We expect showhomes to open in these new communities this spring. Diversity in the Community Development division's product types and geographic focus contributed to steady activity in spite of market challenges. Community Development contributed \$32.51 million to earnings. However, FFO decreased by 32% due to the decline in Community Development revenue. Our income-producing properties remain a steady source of FFO and help to stabilize overall income.

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

## Investing for growth

We continued to invest in land inventory and increased our land holdings by 470.60 acres in strategic growth corridors. The acquired land is primarily allocated to residential development and includes 72.57 acres acquired in the US. While active development has slowed, we continue to move land use approvals through the municipal approval process to increase our supply of shovel ready assets.

Our Property Development division completed and transferred 8 buildings (99,794 sf) in 2019 with a further 96,797 sf under development and 47,688 sf completed and awaiting lease up at year end. Revenue was up 38% over 2018 as 51% more GLA was completed and transferred compared to last year. Revenue from the Property Development division is eliminated on consolidation. 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 15 buildings in 6 projects expected to be completed and transferred to Investment Properties in 2020.

The REIT completed the following third-party acquisitions during the year:

- a 56,084 sf single tenant retail building with warehouse space in Calgary, AB for \$12.45 million on April 24, 2019
- a 283,235 sf power shopping centre in Grande Prairie, AB for \$54.8 million on November 12, 2019.

We completed the following dispositions of US assets during the year:

- a residential unit in Phoenix, AZ was sold for \$0.31 million (US\$0.24 million) net of transaction costs on March 12, 2019.
- an office property in Denver, CO was sold for \$8.76 million (US\$6.32 million) net of transaction costs on December 31, 2019.

## Return to Shareholders

We continue to distribute profits to our shareholders. In 2019, we paid dividends of \$0.50 per share.

We declared a dividend of \$0.10 per share on March 11, 2020 payable on March 31, 2020 to shareholders of record on March 20, 2020. The dividend is an eligible dividend for Canadian tax purposes.

We have been paying dividends since 1969.

## Revenue & Margins

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Revenue was down 22% to \$207.97 million in 2019. The primary contributor to this decrease in revenue was continuing softness in the western Canadian residential market, leading to a 27% decrease in Community Development division revenue. We sold 38% fewer single-family lots in Canada and 85% fewer in the US compared to 2018. Lots sales in the US will remain irregular due to the nature of development activity.

Overall revenue generated from single-family lot sales was down 47% to \$67.70 million while the average price per lot was down 2%. Average price per lot has been negatively impacted by two factors over the past several year: the trend to smaller lots (more affordable product type) and the predominance of joint ventures in our active communities. The number of lots sold is at 100%, whereas the average price is at our JV%.

The decline in revenue from single-family lots was partially offset by growth in commercial and multi-family land sales in Community Developments, which generated \$34.65 million in revenue compared to \$24.13 million in 2018.

Revenue from our income-producing portfolio (including REIT properties) was up 8% over 2018. Property Development transfer revenue (up 38%) is eliminated on consolidation; however, these properties will contribute to future revenue for our income-producing portfolio.

Gross margin remained stable at 47% in 2019. This stability was led by our higher margin income-producing portfolio (including REIT properties), which contributed 39% of total revenues in 2019 at a gross margin of 59%. Margins earned in our Community Development division were down 9%. Margins in this division are affected by a number of factors, including types of lots, 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. Gross margin on income properties is more stable in nature and serves to neutralize volatility in Community Development margin.

Net margin declined to 18% from 24% in 2018. Net margin is impacted by swings in fair value adjustments recorded on our investment properties and REIT units. Net income was \$37.74 million, down from \$64.27 million in 2018, largely as a result of adjustments related to the REIT which had a negative impact of \$17.56 million in 2019. These adjustments are a result of market forces that are out of management's control.

Fair value gains of \$12.23 million were recorded in 2019 compared to fair value gains of \$0.86 million in 2018. The following contributed to this swing:

- 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 \$4.02 million (2018: \$1.02 million), and
- leasing activity and completion of construction on Property Development projects resulting in fair value gains of \$6.89 million (2018: \$7.36 million).

## 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 REIT units.

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	
	2019	2018
Net income for the year	37,741	64,273
Amortization of operating lease incentives	7,867	6,710
Fair value adjustment on investment properties	(12,234)	(863)
Depreciation on property and equipment	1,381	1,417
Stock based compensation expense	717	450
Non-cash financing costs	3,442	1,466
Gain on sale of asset	(83)	(6)
Deferred income taxes	(9,241)	(3,493)
Fair value adjustment on REIT units	8,675	(13,827)
<b>FFO *</b>	<b>38,265</b>	<b>56,127</b>
<i>Per Share Data</i>		
<b>FFO per share *</b>	<b>1.15</b>	<b>1.68</b>

\* See non-standard measures for definitions and calculations.

FFO decreased 32% to \$38.27 million from \$56.13 million in 2018 as a result of the overall decline in revenue and net income. Softer residential real estate markets led to the 27% decline in Community Development revenue and the overall 22% decline in revenue and 41% reduction in net income compared to 2018. 2019 FFO was also negatively impacted by \$9.24 million in deferred tax adjustments related to the reduced Alberta corporate tax rate. Our income properties (Investment Properties and REIT divisions, excluding fair value adjustments) remain a steady source of FFO and help to stabilize overall income.

## 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, industrial and multi-family residential revenue-producing properties on serviced commercial sites developed by Community Development or purchased from third parties;
- Investment Properties, which manages and leases the commercial properties developed 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 39 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, marketing, administration, legal and human resources.

The following table summarizes operating division results:

	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	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
<i>(\$000s except as noted)</i>										
Revenue	<b>123,207</b>	168,336	<b>42,507</b>	30,751	<b>39,494</b>	32,545	<b>71,159</b>	70,173	<b>8,466</b>	8,391
Portion of total revenue	<b>43%</b>	54%	<b>15%</b>	10%	<b>14%</b>	10%	<b>25%</b>	23%	<b>3%</b>	3%
Cost of sales	<b>(83,747)</b>	(99,765)	<b>(42,300)</b>	(30,350)	<b>(16,276)</b>	(13,236)	<b>(28,772)</b>	(28,097)	<b>(6,189)</b>	(6,013)
Gross profit	<b>39,460</b>	68,571	<b>207</b>	401	<b>23,218</b>	19,309	<b>42,387</b>	42,076	<b>2,277</b>	2,378
Gross margin (%)	<b>32%</b>	41%	<b>—%</b>	1%	<b>59%</b>	59%	<b>60%</b>	60%	<b>27%</b>	28%
Portion of total gross profit	<b>37.0%</b>	52%	<b>—%</b>	—%	<b>22%</b>	15%	<b>39%</b>	32%	<b>2%</b>	2%
General and administrative expense	<b>(7,914)</b>	(9,501)	<b>(2,307)</b>	(2,406)	<b>(2,381)</b>	(2,439)	<b>(2,868)</b>	(2,884)	<b>(2,298)</b>	(2,298)
Fair value adjustment on investment properties	—	—	<b>6,888</b>	7,356	<b>(809)</b>	447	<b>(1,622)</b>	(11,385)	—	—
Gain on sale of assets	—	—	—	—	—	—	—	—	<b>83</b>	14
Interest income	<b>960</b>	905	<b>28</b>	27	<b>42</b>	8	<b>117</b>	137	—	—
Segment Earnings	<b>32,506</b>	59,975	<b>4,816</b>	5,378	<b>20,070</b>	17,325	<b>38,014</b>	27,944	<b>62</b>	94

*Divisional results are shown before intersegment eliminations and exclude the corporate division.*

## 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 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.

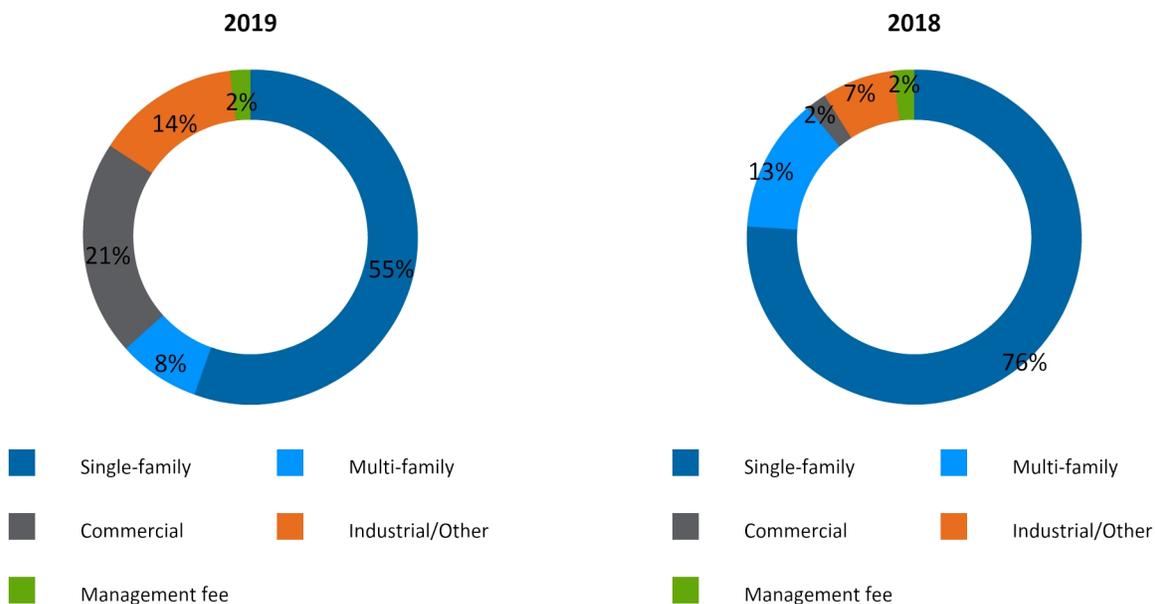
As at December 31, 2019 we held 10,632 acres of raw land for future development, which positions the division well for future growth. Our developed land inventory at December 31, 2019 included 959 single-family lots in Canada and 64 single-family lots in the US, 59 acres for multi-family development, and 126 commercial and industrial 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.

We expect to continue our focus on clearing out existing inventory held by Melcor (lots) and by our builders (spec homes) in 2020 and have active marketing programs in place to support this objective.

### REVENUE BY TYPE



The following table summarizes our activity:

Consolidated	2019	2018
<i>Canada Sales data: (including joint ventures at 100%)</i>		
Single-family sales (number of lots)	668	1,073
Gross average revenue per single family lot (\$)	128,993	131,700
Multi-family sales (acres)	17.22	23.55
Gross average revenue per multi-family acre (\$)	1,080,180	922,700
Commercial sales (acres)	36.93	5.25
Gross average revenue per commercial land acre (\$)	771,591	978,100
Other land sales - Industrial, Other (acres)	3.84	18.10
Gross average revenue per other land acre (\$)	319,422	674,000
Raw land sales to municipalities (acres)	84.33	—
Gross average revenue per raw land acre (\$)	214,144	—
<i>US Sales data: (including joint ventures at 100%)</i>		
Single-family sales (number of lots)	72	467
Gross average revenue per single family lot (\$)	120,400	74,600
Other land sales - Industrial, Other (acres)	2.98	—
Gross average revenue per other land acre (\$)	763,673	—
<i>Financial results: (including joint ventures at Melcor's interest)</i>		
Revenue (\$000s)	123,207	168,336
Earnings (\$000s)	32,506	59,975

## Regional Highlights

Edmonton & Region	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	480	599
Multi-family sales (acres)	17.22	11.62
Commercial sales (acres)	14.55	4.10
Other land sales - Industrial & Other (acres)	3.84	7.47
Raw land sales to municipalities (acres)	15.88	—
<i>Financial results:</i>		
Revenue (\$000s)	69,538	70,929
Earnings (\$000s)	19,688	27,321

The market for residential homes in the Edmonton region remained soft in 2019 and the average selling price of single-family lots in the region decreased by 15%. This decrease is a reflection of the trend towards smaller lots and less expensive product type, particularly townhomes, further exacerbated by the predominance of joint ventures in our active projects. Joint ventures reduce our risk, but also have a significant impact on the average selling price as the number of lots sold is at 100% while revenue is at JV%. Only 4% of single-family lot sales revenue came from 100% Melcor-owned communities in 2019 compared to 26% in 2018.

We continued to offer lower priced options in all neighbourhoods, including duplexes, townhomes, detached garage homes, homes with secondary or garage suites and zero lot-line homes. Throughout 2019, we actively marketed and sold lots to the public, which helped to maintain momentum in an otherwise lagging market.

Revenue for the region was relatively flat, with the 20% decline in single-family lot sales offset by the sale of developed and raw acres. Multi-family sales were up at 17.22 acres, contributing revenue of \$9.63 million at JV%. We also sold 14.55 acres of commercial land to Property Development for \$10.50 million for the development of a gas station. The Edmonton region sold an additional 3.84 acres of raw and industrial land during the year to third parties, and 15.88 acres of raw land to municipalities, contributing an additional \$3.74 million.

Red Deer & Region	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	34	164
Commercial sales (acres)	10.53	—
<i>Financial results:</i>		
Revenue (\$000s)	4,040	11,485
Earnings (\$000s)	1,078	3,751

The central Alberta residential market continued to be constrained by the economic conditions impacting the province, with a 79% decrease in the number of single-family lots sold. Sales are expected to partially recover in 2020 as we continue selling the first phase of Evergreen and begin selling phase two of the community.

We used a variety of incentives and rebate programs to support the sale of spec inventory for our builders and are comfortable that we have appropriate inventory levels heading into 2020. While the market, in terms of permits issued, contracted in Red Deer in 2019 - Melcor's market share increased to close to 70%.

Calgary & Region	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	127	274
Multi-family sales (acres)	—	3.59
Commercial sales (acres)	11.85	1.15
Other land sales - Industrial & Other (acres)	—	10.63
Raw land sales to municipalities (acres)	64.40	—
<i>Financial results:</i>		
Revenue(\$000s)	30,474	43,284
Earnings (\$000s)	8,728	15,078

Home sales in the Calgary Metropolitan Area remained soft in 2019, reflected in the 54% decrease in single-family lot sales. The decline in single-family revenue was partially offset by 64.40 acres of raw land sold to municipalities, which generated \$9.13 million in revenues. We also sold a total 11.85 acres of commercial land to our Property Development division through internal transfer, including 5.29 acres in Greenwich for the Calgary Farmers' Market West and other commercial retail units, 1.97 acres in Kingsview Market and 4.59 acres in The District.

The new community of Lanark Landing made up 69% of single-family lots sold in the Calgary region. The first phase of this community is comprised of duplex, townhome and laned homes, with the first showhomes anticipated to open this spring.

We anticipate slightly stronger sales activity in 2020 and have sufficient land with various levels of approval to meet market demand in the short and medium term.

Lethbridge	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	19	31
Multi-family sales (acres)	—	8.34
<i>Financial results:</i>		
Revenue (\$000s)	2,619	8,847
Earnings (\$000s)	611	3,635

Lethbridge saw a decline in single-family lot sales of 39% resulting in a decline in revenues of \$6.23 million. Although the market continued to be softer in 2019 as a result of oversupply, we anticipate that the construction of a central park amenity in Garry Station to continue to drive momentum in that neighbourhood through lot sales.

Kelowna	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	8	5
Raw land sales to municipalities (acres)	4.05	—
<i>Financial results:</i>		
Revenue (\$000s)	5,321	1,775
Earnings (loss) (\$000s)	1,203	(268)

The Kelowna market remained soft in 2019 as a result of a combination of provincial and federal policy announcements made in the prior year. Single-family lot sales increased over 2018 with a total of 8 lots sold. Revenue was also positively impacted by 4.05 acres of raw land sold to municipalities, contributing \$1.85 million in revenues in 2019. We continued to focus on inventory management and preparation for market improvements by advancing construction at both BlueSky and North Clifton Estates. Inventory will be ready to bring on quickly at BlueSky once market activity resumes.

North Clifton Estates is a new Okanagan lake-front neighbourhood that has received a significant amount of interest and we anticipate that it will be absorbed at a quicker pace. We have seen early evidence of this as lots became available for sale in early 2020. North Clifton is a joint venture project.

United States	2019	2018
<i>Sales data:</i>		
Single-family sales (number of lots)	72	467
Other land sales - Industrial & Other (acres)	2.98	—
<i>Financial results:</i>		
Revenue (\$000s)	11,215	31,516
Earnings (\$000s)	1,113	10,030

Melcor's development activity slowed in Harmony (Aurora, CO) in 2019, resulting in a 64% decrease in revenue. This is not so much an indication of the market as it points to the difference in the scale of development in the US, where larger blocks of lots are sold to a few volume builders. With the original sale of 173 lots to the builders completed in 2018 and the model home parade grand opening in September 2019, we were prudently awaiting signs of positive sales velocity before continuing to develop additional phases.

With recent approval to begin phase two, we are now working to deliver an additional 181 serviced lots to our builders, who are quickly selling out of their inventory. We also received final approvals on the third phase of Harmony which will contain 100 lots.

We also continue to progress development on our Arizona land holdings and received final plan approvals on Paseo Place, a 120 acre land holding in Goodyear, AZ. We also received pre-approval on La Privada, a 198 acre land holding in Goodyear, AZ (adjacent to Paseo Place) which resulted in a lot yield increase of 24 lots to the overall project (602 total lots).

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, industrial and multi-family residential 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, 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 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>	2019	2018
Total revenue	42,507	30,751
Revenue from property transfers	42,300	30,350
Management fees	207	401
Margin (%) on property transfers	8%	20%
Square footage transferred (sf, at 100%)	99,794	65,990
Number of buildings transferred	8	5
Fair value gains on investment properties	6,888	7,356

Property Development completed and transferred 8 buildings (99,794 sf) to Investment Properties in the last half of 2019 and has another 47,688 sf completed and awaiting lease up and/or transfer. A further 96,797 sf remains under development and we continue to move new projects through the planning and development approval process. We anticipate another active construction season in 2020 and anticipate commencing construction on an additional 169,900 sf.

## Regional Highlights

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

<i>(\$000s)</i>	2019	2018
Northern Alberta	3,357	7,289
Southern Alberta	3,531	67
	6,888	7,356

**Northern Alberta** transferred 93,249 sf (7 buildings) to Investment Properties. Notable activity during 2019 includes:

- Jensen Lakes Crossing: we completed construction and transferred 4 buildings (26,000 sf), including a gas station. These buildings generated fair value gains of \$2.34 million. We also completed construction on an additional CRU (10,200 sf) in 2019 which will transfer when it meets transfer criteria.
- Woodbend Market: we completed construction and transferred a gas station (3,130 sf) in Woodbend Market to our investment properties division. This CRU generated fair value gains of \$1.91 million during 2019.
- Village at Blackmud Creek: we transferred a 56,524 sf office building that was completed in 2018 but did not meet transfer criteria. The building generated a fair value loss of \$1.88 million due to occupancy of 63%.

**Southern Alberta** transferred 6,545 sf (1 building) to Investment Properties. Notable activity during 2019 includes:

- The District: we completed construction and transferred the Tim Hortons CRU for fair value gains of \$0.71 million in 2019.
- Kingsview Market: two CRUs (18,471 sf) in Kingsview Market are near completion and awaiting lease up. These buildings are expected to transfer in 2020 and resulted in fair value gains of \$2.07 million in 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 and transferred to IP or sold*	SF under development or developed and awaiting lease up
The Village at Blackmud Creek	South Edmonton	Regional business park	725,000	113,905	—
Telford Industrial	Leduc	Industrial Park	500,000	143,118	—
West Henday Promenade	West Edmonton	Regional mixed use centre	665,000	116,300	—
Kingsview Market	Airdrie	Regional shopping centre	331,000	181,900	18,471
Kingsview Commercial	Airdrie	Regional shopping centre	33,500	—	33,500
Chestermere Station	Chestermere	Neighbourhood shopping centre	278,100	241,600	—
Clearview Market 2	Red Deer	Neighbourhood shopping centre	80,000	—	7,965
The District at North Deerfoot	North Calgary	Regional business / industrial park	1,585,000	535,295	50,525
Campsite Industrial	Spruce Grove	Industrial Park	170,000	13,700	—
The Shoppes at Jagare Ridge	South Edmonton	Neighbourhood shopping centre	105,000	27,900	29,217
Jensen Lakes Crossing	St. Albert	Neighbourhood shopping centre	150,000	85,918	4,807
Woodbend Market	Leduc	Neighbourhood shopping centre	140,000	3,000	—

Expected Future Projects					
Project	Location	Type	Total SF *	Ownership Interest	Expected Start (year)
Greenwich	West Calgary	Regional mixed use centre	325,000	100%	2020
Vista Ridge	Sylvan Lake	Neighbourhood shopping centre	15,000	50%	2021
Laredo	Red Deer	Neighbourhood shopping centre	10,000	100%	2022
Secord	Edmonton	Neighbourhood shopping centre	75,000	60%	2022
Mattson	Edmonton	Neighbourhood shopping centre	75,000	50%	2022
Rollyview	Leduc	Neighbourhood shopping centre	75,000	100%	2022
Keystone Common	North Calgary	Regional power centre	700,000	100%	2023
The Shoppes at Canyons	Lethbridge	Neighbourhood shopping centre	105,000	100%	2022+
Rosenthal	Edmonton	Neighbourhood mixed use	30,000	50%	2023+
West Pointe Marketplace	Lethbridge	Regional power centre	750,000	100%	2023+
Westview Commercial	West Calgary	Neighbourhood shopping centre	150,000	100%	2023+
Sora	South Calgary	Neighbourhood shopping centre	60,000	50%	2023+

## 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 4.59 million sf of income-producing commercial GLA and 608 residential units.

Our commercial property portfolio is primarily comprised of properties developed and transferred from our Property Development division in Alberta and acquired from third parties elsewhere. Our goal is to improve the operating efficiency of each property for stable and growing cash flow, 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 economy. We also own 10 parking lots and other assets which are held for the long-term, providing current stable income and future re-development potential.

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

## Operating Results

<i>(\$000s except as noted)</i>	2019	2018
Commercial properties GLA under management (sf, total)	<b>4,588,003</b>	4,128,914
Properties owned and managed (sf)	<b>994,176</b>	880,779
Properties managed (sf)	<b>3,593,827</b>	3,248,135
Revenue (total)	<b>39,494</b>	32,545
Canadian properties	<b>13,673</b>	11,327
US properties	<b>18,590</b>	14,807
Management fees	<b>5,940</b>	5,083
Parking lots and other assets	<b>1,291</b>	1,328
Net operating income (NOI) *	<b>23,432</b>	19,295
Funds from operations *	<b>22,699</b>	18,016
Funds from operations per share *	<b>0.68</b>	0.54

\* 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

Our Canadian property portfolio grew in 2019 via our Property Development activities. Over the past twelve months, the Property Development division completed and transferred eight buildings, adding 99,794 sf to owned and managed GLA and generating an increase in commercial property revenue and NOI over 2018. In 2018, five buildings were transferred from Property Development, adding 65,990 sf of GLA. With 96,797 sf of GLA under active development in the Property Development division, and another 47,688 sf completed and awaiting lease up, we expect our Canadian property portfolio to continue to grow.

Revenue generated on assets acquired from Property Development and held through the period was \$4.79 million in 2019 (2018 - \$2.55 million).

Occupancy on properties owned by Investment Properties was 84% at December 31, 2019 (2018 - 96%). The decrease in occupancy was due to new properties transferred from the Property Development division with lower in-place occupancy. Committed occupancy is 87%. Weighted average base rent rate was \$30.40 (2018 - \$23.36), up \$7.04 due to new properties transferred from the PD division which have higher in-place rents.

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

(\$000s except as noted)	2019	2018
Same asset NOI *	6,747	6,221
Third party acquisition	111	12
Properties transferred from PD	2,805	1,274
Properties transferred to REIT	—	213
NOI	9,663	7,720
Amortization of operating lease incentives	(662)	(330)
Straight-line rent adjustment	568	1,056
Gross profit	9,569	8,446

\* See non-standard measures for definition.

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 measurement most directly comparable to NOI and same asset NOI is segment earnings.

Gross profit was \$9.57 million up 13% from 2018 as a result of properties transferred from the Property Development Division over the past 12 months.

Same asset NOI was up 8% over 2018 at \$6.75 million due to higher average occupancy in 2019, fewer tenants on rent-free periods and increasing rents on leases with multiple rent escalations.

#### US properties

In the fourth quarter, we sold a 63,112 sf office property (Centennial Airport Plaza) in Denver, CO for \$8.76 million (US\$6.32 million). This property was our first commercial investment in Colorado, acquired in April 2015 for \$6.14 million (US\$4.88 million). Our portfolio is concentrated in the Phoenix and Denver areas; regions we view as a hedge to our Canadian resource derived economic exposure. Revenues from this asset was \$1.27 million (US\$0.96 million) (2018 - \$1.22 million (US\$0.94 million).

Revenue increased 26% over 2018, primarily due to a third party acquisition made in Arizona during Q3-2018 as well as increased occupancy across the portfolio. Same asset NOI was up 5% over 2018 due to new leasing across our commercial portfolio and higher residential occupancy.

Occupancy on commercial US properties was 88% (2018 - 84%). The increase is primarily a result of new leasing in our Arizona portfolio. Rental rates on commercial US properties were \$20.53 (2018 - \$19.64) up 5%. The increase in rental rates is primarily due to the sale of Centennial Airport Plaza which had a lower average rental rate.

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

(\$000s except as noted)	2019	2018
Same asset NOI *	4,774	4,548
Third party acquisitions	1,338	364
Third party disposals	376	409
NOI	6,488	5,321
Foreign currency translation	2,118	1,575
Amortization of operating lease incentives	(1,158)	(808)
Straight-line rent adjustment	1,038	97
Gross profit	8,486	6,185

\* See non-standard measures for definition.

#### 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 up \$0.86 million or 17% compared to 2018,

due to acquisition fees earned on REIT purchases in 2019 as well as internalization of management on one of our joint venture assets.

During 2019 we recognized \$1.29 million in revenues on our parking stalls and other assets, down 3% from 2018 revenue of \$1.33 million. These revenues fluctuate from period to period.

### Funds from Operations

Funds from operations (FFO) increased by \$4.68 million or 26% over 2018 as a result of higher NOI from both our US and Canadian properties.

### Fair Value of Investment Portfolio

The fair value of our portfolio increased by \$25.81 million over 2018. The increase in fair value was the result of \$39.46 million in transfers of completed properties from Property Development and \$3.55 million in property improvements. Other changes included fair value gains of \$0.81 million, disposals of \$8.39 million, foreign currency translation loss of \$6.57 million, and changes to tenant improvements and straight line rent.

For the year ended December 31, 2019, Melcor's internal valuation team performed the valuation assessment. Of 35 legal phases assessed, 12 investment properties with a fair value of \$148.51 million were valued by qualified independent external valuation professionals. In 2018, 8 investment properties of 32 legal phases with a fair value of \$52.59 million were valued by qualified independent external valuation professionals.

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

(\$000s)	2019	2018
Alberta - all assets	1,132	(554)
US - residential	(555)	225
US - commercial	(1,386)	776
	(809)	447

We recognized fair value losses on our US portfolio as a result of capital and tenant spending which did not result in a significant increase in fair value and a decrease in stabilized NOI in our US residential portfolio. Gains on our Alberta assets were primarily due to appreciation in land prices on a downtown Edmonton development site as well as gains on our Clearview Market Square property in Red Deer, AB and Stoneycreek Shopping Centre in Fort McMurray, AB due to an uptick in stabilized NOI. Refer to note 28 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

### REIT

The REIT owned 39 income-producing office, retail and industrial properties, representing 3,208,950 sf in GLA and a land lease community at December 31, 2019. The REIT's portfolio has a diversified tenant profile, with a mix of national, regional and local tenants operating in a variety of industries.

We held a controlling 55.1% effective interest in the REIT through ownership of all Class B LP Units at December 31, 2019 (December 31, 2018 - 53.0%). 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)	2019	2018
Rental revenue	<b>71,159</b>	70,173
Net operating income (NOI) *	<b>45,300</b>	43,983
Same asset NOI (see calculation following)	<b>38,792</b>	38,962
Fair value adjustments	<b>(1,622)</b>	(11,385)
Occupancy	<b>88%</b>	90%
Funds from operations *	<b>43,177</b>	42,426
Funds from operations per share *	<b>1.30</b>	1.27

\* See non-standard measures for definition and calculation.

Rental revenue increased \$0.99 million or 1% over 2018 as a result of acquisitions completed over the past two years: Melcor Crossing (Nov-2019), Staples Centre (Apr-2019), LFS Building (Dec-2018) and the Melcor Acquisition (Jan-2018), and partially offset by two retail property sales in 2018. Rental revenue from acquired properties was \$9.43 million in 2019 (2018 -\$6.99 million). During 2018 we also recognized \$0.38 million of rental revenue from sold properties. Higher amortization of tenant incentives due to increasing tenant inducement costs, and lower straight-line rent adjustments resulted in a slight decrease in same-asset revenues over 2018.

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 2019 we completed 148,268 sf of lease renewals (including holdovers) and had 74,116 sf in new leases commence for occupancy of 88.0%. Our retention rate was significantly impacted by the departure of a major tenant, RBC, representing 47,088 sf or approximately 1.5% of our portfolio. RBC's lease expired September 30, 2019. Excluding this tenant we retained 73.6% of expiring leases (representing 55 leases) in spite of challenging market conditions in many of our operating regions.

Weighted average base rent was \$16.79, up \$0.28 compared to December 31, 2018 due to the acquisition of Melcor Crossing which had a weighted average base rate of \$17.81. The increase was partially offset by lower rates on new and renewed leasing completed during the year.

Direct operating expenses were up 2% over 2018. On a same-asset basis, property taxes and utilities increased by 1% due to higher utility riders and fees as well as increases in property taxes, primarily on our retail assets. Same-asset operating expenses were stable in 2019. As a cornerstone of our property management strategy, we are committed to efficient and cost effective maintenance of our buildings to ensure maximum value to our tenants and unitholders.

(\$000s except as noted)	2019	2018
Same asset NOI *	<b>38,792</b>	38,962
Acquisitions	<b>6,508</b>	4,740
Disposals	<b>—</b>	281
NOI before adjustments	<b>45,300</b>	43,983
Amortization of operating lease incentives	<b>(3,541)</b>	(3,097)
Straight-line rent adjustment	<b>628</b>	1,190
Net rental income	<b>42,387</b>	42,076

\* See non-standard measures for definition and calculation.

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.

Portfolio growth over the past year contributed to a 3% increase in NOI (before adjustments). On a same-asset basis, NOI was stable.

## Funds from Operations

FFO within this division increased by 2% over 2018 as a result of third party acquisition completed in 2019. Stability in FFO demonstrates the REIT's consistency in stabilizing Melcor's overall operating results.

## Fair Value of REIT Portfolio

	2019	2018
Number of properties	39	37
Total GLA (sf)	3,339,030	2,998,938
GLA (REIT owned %) (sf)	3,208,950	2,868,901
Fair value of portfolio (\$000s)	776,212	704,339
Weighted average capitalization rate	6.82%	6.69%
Weighted average terminal cap rate	6.87%	6.75%
Weighted average discount rate	7.76%	7.70%

For the year ended December 31, 2019, Melcor's internal valuation team performed the valuation assessment. In 2019, 32 phases of 53 legal phases with a fair value of \$444.70 million were valued by qualified independent external valuation professionals. Valuations performed during the year resulted in fair value losses of \$1.62 million. In 2018, 24 phases of 50 legal phases with a fair value of \$367.55 million were valued by qualified independent external valuation professionals, resulting in a fair value loss of \$11.39 million. Refer to note 28 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

Phases are a result of the property development process when a larger project is developed over an extended period of time and subdivided into legal phases for increased flexibility.

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

(\$000s)	2019	2018
Northern Alberta	2,431	(12,816)
Southern Alberta	(1,469)	33
Saskatchewan & British Columbia	(2,584)	1,398
	(1,622)	(11,385)

Fair value gains in Northern Alberta were due to new leasing on certain Edmonton office properties as well as rent escalations on select Edmonton area properties. Fair value losses in Southern Alberta were due to increased vacancy at one of our Calgary, AB office properties. Fair value losses in Saskatchewan & British Columbia were due to tenant rollover at two of our Regina, SK retail properties and a decline in market rental rates. 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 less than 1% 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

(\$000s except as noted)	2019	2018
Revenue	8,466	8,391
Gross profit	2,277	2,378
Gross margin (%)	26.9%	28.3%
Earnings	62	94

The financial performance of our golf courses is greatly influenced by the weather conditions during the golf season. Favourable weather conditions in Alberta early in the season allowed for courses to open earlier and contributed to a 1% increase in revenue in 2019. The number of rounds played at all four courses was up 5% to 101,357 rounds.

We continue to focus on food and beverage initiatives as part of our strategy for attracting tournaments and stabilizing revenue. In 2019, food and beverage contributed revenue of \$2.64 million compared to \$2.74 million in 2018.

	Ownership interest	2019		
		Season opened	Season closed	Rounds of golf *
<b>Managed by Melcor:</b>				
Lewis Estates (Edmonton)	60%	April 12	October 28	24,670
The Links (Spruce Grove)	100%	April 13	October 28	22,129
Black Mountain (Kelowna)	100%	April 3	November 11	32,358
<b>Managed by a Third Party:</b>				
Jagare Ridge (Edmonton)	50%	April 19	October 20	22,200
		2018		
	Ownership interest	Season opened	Season closed	Rounds of golf *
<b>Managed by Melcor:</b>				
Lewis Estates (Edmonton)	60%	April 27	October 30	24,158
The Links (Spruce Grove)	100%	April 27	October 30	21,179
Black Mountain (Kelowna)	100%	April 6	November 8	29,663
<b>Managed by a Third Party:</b>				
Jagare Ridge (Edmonton)	50%	May 1	October 21	21,930

\* Rounds of golf indicated at 100%.

## General and Administrative Expense

General and administrative expenses decreased by 4% over 2018, primarily due to decreased activity in our Community Development division and careful monitoring of expenses. Management continues to prudently monitor our administrative expenses.

## Income Tax Expense

The statutory tax rate for the year ended December 31, 2019 is 26.5% (2018 - 27%). Significant adjustments that impacted the 2019 effective tax 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. In addition, a reduction in the statutory tax rate resulted in a deferred income tax recovery.

# Financing

As at December 31, 2019, our total general debt outstanding was \$751.35 million compared to \$659.56 million in 2018. The financing function is managed by our corporate division and decisions on how to deploy operating and acquisition funds are 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)		2019	2018
Melcor - revolving credit facilities	a	70,451	46,529
REIT - revolving credit facility	b	22,864	—
Project specific financing	c	68,436	62,639
Secured vendor take back debt on land inventory	d	39,005	40,842
Debt on investment properties and golf course assets	e	484,413	454,342
REIT - convertible debentures	f	66,184	55,204
		<b>751,353</b>	<b>659,556</b>

## 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 the 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 that mature on July 31, 2021 are renewable one year in advance of expiry and may be modified.

A summary of the credit facilities is as follows:

As at (\$000s)		2019	2018
Credit limit approved	i)	196,133	200,103
Supportable credit limit	ii)	148,992	164,980
Credit used		(70,451)	(46,529)
Credit available		<b>78,541</b>	<b>118,451</b>

i) The portion of these loan limits that relate solely to Melcor Developments Ltd. is \$120.00 million (2018 - \$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)		2019	2018
Total letter of credit facility		72,660	72,170
Letters of credit issued		(26,886)	(31,784)
Available for issue		<b>45,774</b>	<b>40,386</b>

## 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. An additional \$10.00 million is available by way of an accordion feature, subject to lender approval. Depending on the form under which the facility is accessed, rates of interest will vary between prime plus 1.25% or bankers' acceptance plus 2.25% stamping fee. The agreement also provides the REIT with \$5.00 million in available letters of credit which bear interest at 2.25%. The facility matures June 1, 2021.

As at December 31, 2019 we had \$22.86 million (December 31, 2018 - \$nil) drawn from the facility; and posted letters of credit of \$0.15 million (December 31, 2018 - \$0.15 million).

## 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)	2019	2018
Project specific debt on investment properties under development, with interest rates between 4.25% and 4.45% (2018 - 4.25% to 4.45%)	38,329	30,811
Project specific debt on land, with interest rates between 4.95% and 9.48% (2018 - 4.95% to 9.48%)	30,107	31,828
	68,436	62,639
Weighted average effective interest rate	5.43%	6.67%

As at December 31, 2019 \$19.09 million (2018 - \$19.79 million) of debt was payable in US dollars (2019 - US \$14.70 million and 2018 - US \$14.51 million).

## 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 2020 to 2023.

As at (\$000s)	2019	2018
Agreements payable with interest at the following contractual rates:		
Fixed rates of 4.00% - 5.00% (2018 - 3.00% to 5.95%)	31,947	36,460
Variable rate of 5.95% (2018 - 5.95%)	7,058	4,382
	39,005	40,842
Weighted average effective interest rate	4.34%	4.69%

As at December 31, 2019 no debt was payable in US dollars (2018 - \$nil).

## 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 \$484.41 million, excluding fair value adjustments and deferred finance fees, reflects financing placed on investment properties that have a carrying value of \$869.79 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 3.24% to 3.83% in 2019.

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

As at (\$000s)	2019	2018
Canadian mortgages at fixed rates	374,106	338,549
Canadian mortgages at variable rates	45,414	47,658
US mortgages at fixed rates	54,310	63,316
US mortgages at variable rates	13,029	7,931
	486,859	457,454
Interest rate ranges	(2.54% - 5.55%)	(2.54% - 5.57%)
Weighted average effective interest rate	3.48%	3.47%

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
2020	53,956	3.34%	7
2021	61,982	3.00%	10
2022	26,096	3.43%	4
2023	66,749	4.10%	6
2024	55,553	4.04%	9
2025	35,886	4.02%	6
2026	33,670	3.60%	5
2027	—	—%	—
2028	17,102	4.07%	3
2029	49,491	3.36%	5

As at December 31, 2019, \$67.34 million of debt was payable in US dollars (2018: \$71.25 million).

#### f) REIT - convertible debentures

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.

These debentures were redeemed on December 19, 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. 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. The maturity date of the 2017 Debenture is 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.

On October 29, 2019, the REIT issued a 5.10% extendible convertible unsecured subordinated debenture ("2019 Debenture") to the public for gross proceeds of \$46.00 million, including \$6.00 million issued pursuant to the exercise of an over-allotment option. The 2019 Debenture bears interest at an annual rate of 5.10% payable semi-annually in arrears on June 30 and December 31 in each year commencing December 31, 2019. The maturity date of the 2019 Debenture is December 31, 2024. The 2019 Debenture can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion rate of 112.3596 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, 2019, compared to December 31, 2018.

<i>As at (\$000s except as noted)</i>	2019	2018
Cash & cash equivalents	<b>36,980</b>	26,727
Accounts receivable	<b>9,783</b>	10,849
Agreements receivable	<b>76,406</b>	126,490
Revolving credit facilities	<b>93,315</b>	46,529
Accounts payable and accrued liabilities	<b>43,582</b>	44,825
Total assets	<b>2,096,047</b>	2,023,076
Total liabilities	<b>1,015,790</b>	955,511
Debt to equity ratio *	<b>0.94</b>	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 November 12, 2019 the REIT purchased a 283,235 sf regional shopping centre in Grande Prairie, Alberta ("Grande Prairie Acquisition") for \$55,570 (including transaction costs). The acquisition was satisfied with cash raised through the issuance of 1,225,822 Class B LP Units to Melcor Developments Ltd. for total consideration of \$10,000 and through the issuance of the 2019 Debentures.

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:

	<i>Payments due by period</i>				
	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Debt on investment properties and golf course assets	486,859	72,691	119,280	148,282	146,606
Revolving credit facilities	93,315	93,315	—	—	—
Secured vendor take back debt on land inventory	39,005	20,832	15,973	2,200	—
Project specific financing	68,436	68,436	—	—	—
REIT debenture	69,000	—	23,000	46,000	—
Interest expense	179,525	30,418	43,000	30,862	75,245
Operating leases	589	179	364	46	—
<b>Total contractual obligations</b>	<b>936,729</b>	<b>285,871</b>	<b>201,617</b>	<b>227,390</b>	<b>221,851</b>

We also have a contractual obligation of \$106.64 million on the non-controlling interest portion of REIT units as they are redeemable at the option of the holder.

## 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:

	2019	2018
Cash flows from operating activities	<b>31,226</b>	30,827
Cash flows used in investing activities	<b>(80,529)</b>	(38,826)
Cash flows from (used in) financing activities	<b>59,858</b>	(8,909)

Cash from operations was \$0.40 million higher in 2019. Net income, adjusted for non-cash items, contributed \$36.58 million to cash from operations compared to \$54.07 million in 2018. In 2019 we purchased 471 acres of land inventory for \$12.50 million compared with 200 acres for \$7.82 million in 2018 (net of vendor financing). Development activities resulted in \$14.30 million in cash outflows in 2019 compared to \$22.64 million in 2018.

Collections on agreements receivables were \$50.08 million compared \$3.46 million in 2018. We also incurred \$10.16 million in tenant incentives and direct leasing costs in 2019 to renew and secure new leases.

Cash used in investing activities was \$80.53 million, an increase of \$41.70 million over 2018. During 2019 the REIT purchased a retail investment property in Calgary, Alberta for a purchase price of \$12.48 million and a 283,235 sf regional shopping centre in Grand Prairie, Alberta for \$55.02 million, this contributed \$67.50 million to the total cash outflows of \$68.55 million for purchases of investment property in 2019 compared to \$33.54 million in 2018.

Cash used in investing activities was partially offset by dispositions made during the year. On December 31, 2019 we disposed of a commercial building in Denver, CO as well as one residential unit in Arizona for total proceeds of \$9.07 million.

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 2019 we invested \$20.27 million in properties under development, property improvements and capitalized borrowing costs, compared with \$21.42 million in 2018.

Cash from financing activities was up \$68.77 million over 2018 largely a result of our use of revolving credit facilities and the issuance of the 2019 debentures in the REIT. In 2019, the revolving credit facilities made net draws of \$46.79 million compared to net repayments of \$30.00 million in 2018. In October of 2019, the REIT issued convertible debentures for proceeds of \$44.28 million.

These activities were partially offset by the redemption of the 2014 debentures resulting in cash outflows of \$34.5 million. General debt contributed to a net cash inflow of \$21.86 million through financings received and repayments made, compared to \$21.72 million in 2018.

During the year, we repurchased 121,252 shares which were canceled and returned to treasury for \$1.53 million.

In 2019, we paid dividends of \$0.50 per share (2018 - \$0.52 per share), for a total cash outflow of \$16.63 million, compared to \$17.36 million paid in 2018.

## Share Data

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Melcor has been a public company since 1968 and trades under the symbol "MRD" on the Toronto Stock Exchange. As at December 31, 2019 there were 33,225,265 common shares issued and outstanding, 997,400 stock options, and 145,422 restricted share units. Each stock option and restricted share unit is convertible to one common share upon exercise or exchange. There is only one class of shares issued. As at March 11, 2020 there were 33,220,677 common shares issued and outstanding, 980,600 stock options, and 144,793 restricted share units.

Please refer to note 16 to the consolidated financial statements for information pertaining to our outstanding shares and options.

## Normal Course Issuer Bid

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On March 29, 2018 we announced a Normal Course Issuer Bid ("NCIB") that commenced March 31, 2018 and ended March 30, 2019. Under this bid, we could have acquired up to 1,669,782 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,262 common shares. Under this now expired NCIB, we purchased a total of 64,352 shares for cancellation during Q1-2019.

On March 28, 2019 we announced an NCIB commencing April 1, 2019 and ending March 31, 2020. Under the bid, we may acquire up to 1,665,080 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,000 common shares. As of March 11, 2020, 69,100 shares were purchased and cancelled.

In connection with the commencement of the NCIB, we entered into an automatic share purchase plan agreement with a broker to allow for the purchase of common shares under the NCIB at times when we ordinarily would not be active in the market due to regulatory restrictions or self-imposed trading blackout periods.

Also on March 28, 2019 the REIT announced an NCIB commencing April 1, 2019 and ending March 31, 2020. Under the bid, we may acquire up to 659,339 trust units in total (approximately 5% of our issued and outstanding trust units) with a daily repurchase restriction of 2,908 trust units. As of March 11, 2020, 53,504 units have been purchased and cancelled.

In connection with the commencement of the REIT NCIB, we entered into an automatic share purchase plan agreement with a broker to allow for the purchase of trust units under the NCIB at times when we ordinarily would not be active in the market due to regulatory restrictions or self-imposed trading blackout periods.

## Off Balance Sheet Arrangements

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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 19 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)	2019				2018			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	78,056	53,946	41,085	34,884	119,982	60,245	42,793	44,414
Net income	16,946	16,068	3,137	1,590	36,526	11,469	1,631	14,647
FFO	13,917	10,696	7,975	5,677	30,671	12,841	7,695	4,920
<i>Per Share</i>								
Basic earnings	0.51	0.48	0.09	0.05	1.09	0.34	0.05	0.44
Diluted earnings	0.51	0.48	0.09	0.05	1.09	0.34	0.05	0.44
FFO basic	0.42	0.32	0.24	0.17	0.92	0.38	0.23	0.15
FFO diluted	0.45	0.32	0.21	0.17	0.92	0.38	0.23	0.15
Book value *	32.51	32.20	31.76	31.88	32.01	29.39	29.30	29.41

*\*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)	2019	2018
Revenue	78,056	119,982
Cost of sales	(45,565)	(66,510)
Gross profit	32,491	53,472
General and administrative expense	(5,947)	(5,674)
Fair value adjustment on investment properties	10,875	605
Adjustments related to REIT units	(7,206)	6,216
Loss on sale of assets	—	—
Operating earnings	30,213	54,619
Interest income	254	241
Foreign exchange (loss) gain	(38)	166
Finance costs	(6,391)	(6,129)
Net finance costs	(6,175)	(5,722)
Income before income taxes	24,038	48,897
Income tax expense	(7,092)	(12,371)
Net income for the period	16,946	36,526
Earnings per share attributable to Melcor's shareholders:		
Basic earnings per share	0.51	1.09
Diluted earnings per share	0.51	1.09

Highlights of the fourth quarter include:

- Our Property Development division completed and transferred 5 buildings (78,962 sf) to Investment Properties.
- Our Community Development division registered 9 plans in 8 communities, which added 481 lots to inventory with 465 lots sold in Q4-2019. This compares to 16 plan registrations in 12 communities adding 637 lots to inventory with 710 lots sold in Q4-2018.
- On November 12, 2019 the REIT purchased a 283,235 sf regional shopping centre from a third party for \$55.0 million in Grande Prairie, Alberta.
- Melcor purchased 1,225,822 Class B LP units at \$8.16 or \$10,000 from the REIT. The funds from this transaction were used as partial consideration towards the purchase of the regional shopping centre.
- On December 31, 2019 an office property in Denver, CO was sold for \$8.76 million (US\$6.32 million) net of transaction costs.
- During the fourth quarter, under our NCIB, we purchased 34,000 shares at a cost of \$0.42 million. These shares have been canceled and returned to treasury.

Segmented information for the fourth quarter is as follows:

Three months ended December 31, 2019	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	62,966	28,912	10,509	18,273	610	—	121,270	(43,214)	<b>78,056</b>
Cost of sales	(42,186)	(28,800)	(4,179)	(7,544)	(979)	—	(83,688)	38,123	<b>(45,565)</b>
Gross profit	20,780	112	6,330	10,729	(369)	—	37,582	(5,091)	<b>32,491</b>
General and administrative expense	(1,826)	(542)	(654)	(707)	(385)	(2,576)	(6,690)	743	<b>(5,947)</b>
Fair value adjustment on investment properties	—	3,347	4,544	(1,364)	—	—	6,527	4,348	<b>10,875</b>
Interest income	178	7	14	28	—	27	254	—	<b>254</b>
Segment Earnings (loss)	19,132	2,924	10,234	8,686	(754)	(2,549)	37,673	—	<b>37,673</b>
Foreign exchange gain									<b>(38)</b>
Finance costs									<b>(6,391)</b>
Adjustments related to REIT units									<b>(7,206)</b>
Income before income taxes									<b>24,038</b>
Income tax expense									<b>(7,092)</b>
Net income for the period									<b>16,946</b>

Three months ended December 31, 2018	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	95,426	10,577	8,913	17,336	677	—	132,929	(12,947)	119,982
Cost of sales	(55,486)	(10,500)	(3,706)	(6,980)	(1,018)	—	(77,690)	11,180	(66,510)
Gross profit	39,940	77	5,207	10,356	(341)	—	55,239	(1,767)	53,472
General and administrative expense	(2,492)	(622)	(620)	(727)	(351)	(1,577)	(6,389)	715	(5,674)
Fair value adjustment on investment properties	—	986	4,791	(6,224)	—	—	(447)	1,052	605
Loss on sale of assets	—	—	—	—	—	—	—	—	—
Interest income	147	8	2	33	—	51	241	—	241
Segment Earnings (loss)	37,595	449	9,380	3,438	(692)	(1,526)	48,644	—	48,644
Foreign exchange loss									166
Finance costs									(6,129)
Adjustments related to REIT units									6,216
Income before income taxes									<b>48,897</b>
Income tax expense									<b>(12,371)</b>
Net income for the period									<b>36,526</b>

# Outlook

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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 and policy changes related to the governing political bodies both provincially and federally. We continue to intentionally diversify our business across asset class and geography, including investment in the US with raw land and commercial property acquisitions and the continued development of our 1,100-acre community in Aurora. We anticipate that these diversification strategies will continue to ease our reliance on the Alberta economy going forward.

We expect continued softness in the residential market in Alberta in 2020 and are focused on reducing existing lot inventory held by both Melcor and our builders. On the commercial side, retail activity remains steady and we expect that to continue in 2020. Our US assets delivered positive results in economies that are growing and that are counter cyclical to our resource dependence in Alberta.

Our business model has adapted to changing times and economic cycles for over 95 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, movement of residential and commercial land through the municipal approvals process, steady occupancy rates and capacity on our operating facility, we remain well-positioned for the future.

## Interest in the REIT

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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 11, 2020, Melcor holds a 55.1% (December 31, 2018 - 53.0% and 2019 - 55.1%) 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 44.9% interest (December 31, 2019 - 44.9%) 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

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A discussion of credit risk, liquidity risk and market risk can be found in note 27 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.

## Environmental Risk

Our development activities are subject to various requirements (including federal, provincial and municipal laws) relating to the protection of the environment. For example, environmental laws or local bylaws may apply to a development site based on its environmental condition, present and former uses, and its adjoining properties. Environmental laws and conditions may result in delays, cause Melcor to incur significant compliance and other costs, and can severely restrict or prevent development in environmentally sensitive regions or areas.

Under these requirements, we could be, or become, liable for environmental or other harm, damage or costs, including with respect to the release of hazardous, toxic or other regulated substances into the environment and/or affecting persons, and the removal or other remediation of hazardous, toxic or other regulated substances that may be present at or under our properties (including commercial buildings, land inventory and development sites).

Such requirements often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release or presence of such substances. Additional liability may be incurred by Melcor with respect to the release of such substances from our properties to properties owned by third parties, including properties adjacent to our properties or with respect to the exposure of persons to such substances. The failure to remove or otherwise address such substances may materially adversely affect our ability to sell such property, maximize the value of such property or borrow using such property as collateral security, and could potentially result in claims or other proceedings against Melcor.

We employ a rigorous due diligence process prior to acquiring raw land, development sites or investment properties to mitigate our exposure to these potential issues. It is our operating policy to obtain, or be entitled to rely on, a Phase I environmental site assessment prior to acquiring property or land. Where a Phase I environmental site assessment warrants further investigation, it is our operating policy to conduct further environmental investigations. Although such environmental assessments provide Melcor with some level of assurance about the condition of the property, we may become subject to liability for undetected contamination or other environmental conditions of its properties against which it cannot insure, or against which we may elect not to insure where insurance premium costs are considered to be disproportionate to the assessed risk, which could have a material adverse effect on our business, cash flows, financial condition and results of operations and ability to make distributions to unitholders.

Environmental laws and other requirements can change and we may become subject to more stringent environmental laws or other requirements in the future. Compliance with more stringent environmental laws or requirements, the identification of currently

unknown environmental issues or an increase in the costs required to address a currently known condition may have a material adverse effect on our business, cash flows, financial condition and results of operations and ability to pay dividends to shareholders.

Melcor bears the risk of assessment, remediation or removal of such contamination, hazardous substances or other residual pollution. The discovery of any such residual pollution on the sites and/or in the buildings, particularly in connection with the lease or sale of properties or borrowing using the real estate as security, could trigger claims for rent reductions or termination of leases for cause, for damages and other breach of warranty claims against Melcor. The remediation of any contamination and the related additional measures we would have to undertake could have a materially adverse effect and could involve considerable additional costs that we may have to bear. Melcor will also be exposed to the risk that recourse against the polluter or the previous owners or occupants of the properties might not be possible, for example, because they cannot be identified, no longer exist or have become insolvent. Moreover, the existence or even the mere suspicion of the existence of contamination, hazardous materials or other residual pollution can materially adversely affect the value of a property and our ability to lease or sell such a property.

We employ a rigorous due diligence process, including obtaining a Phase I environmental site assessment, prior to acquiring property to mitigate our exposure to these potential issues.

## Pandemics, Natural Disasters or Other Unanticipated Events

The occurrence of pandemics, natural disasters, or other unanticipated events, in any of the areas where we or our partners and suppliers operate could disrupt operations. In addition, pandemics, natural disasters or other unanticipated events could have a material adverse effect on our business, financial condition, results of operations and cash flows. To mitigate these risks, we have developed a comprehensive health and safety program and are currently expanding it to include pandemics in response to Coronavirus (COVID-19). We have introduced new policies and practices both internally and at the properties that we manage to reduce the spread of COVID-19 through education and plentiful access to hand sanitizer, etc. We are currently reviewing additional measures and will continue to transparently communicate with our staff, tenants and stakeholders.

## Cyber Security Risk

Cyber security has become an increasingly problematic issue for issuers and businesses in Canada and around the world, including for Melcor and the real estate industry in general. Cyber attacks may focus on financial fraud, obtaining sensitive data for inappropriate use or to disrupt business operations. A cyber incident is any adverse event that threatens the confidentiality, integrity or availability of our information resources, including intentional or unintentional events to gain unauthorized access to information systems to disrupt operations, corrupt data or steal confidential information.

As our reliance on technology has increased, so has our risk of a cyber security breach. The primary risks that could directly result from the occurrence of a cyber incident include operational interruption, damage to our reputation, damage to our business relationships with tenants and suppliers, disclosure of confidential information regarding our tenants, employees and third parties with whom we do business, and may result in negative consequences, including remediation costs, loss of revenue, additional regulatory scrutiny and litigation.

We completed a cyber security assessment with a third party consultant which resulted in an action plan that we are working through. Progress is reported to the Audit Committee quarterly. Some of the actions we have implemented to remain resilient include processes, procedures and controls to help mitigate these risks, including installing firewalls and antivirus programs on our networks, servers and computers, staff training, and cyber security insurance. However, these measures, as well as our increased awareness of the potential risk of a cyber incident, does not provide assurance that our efforts will be effective or that attempted security breaches or disruptions will not be successful or damaging.

## 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

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## 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 29 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 23 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>	2019	2018
Revenue	180,039	193,250
Earnings	51,365	57,627
Assets	1,015,191	1,033,828
Liabilities	364,569	402,526

<i>Joint arrangement activity at Melcor's ownership % (\$000s) *</i>	2019	2018
Revenue	73,436	82,811
Earnings	22,847	27,126
Assets	456,373	455,808
Liabilities	160,567	169,308

\* Ownership in joint arrangements varies from 7% - 60%.

## 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, 2019. 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, 2019.

There has been no change to Melcor's disclosure controls and procedures or internal control over financial reporting during the year ended December 31, 2019, 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 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	
	2019	2018
<b>Segment earnings *</b>	<b>20,070</b>	17,325
Fair value adjustment on investment properties	<b>809</b>	(447)
General and administrative expenses	<b>2,381</b>	2,439
Interest income	<b>(42)</b>	(8)
Amortization of operating lease incentives	<b>1,820</b>	1,138
Straight-line rent adjustments	<b>(1,606)</b>	(1,152)
<b>Divisional NOI</b>	<b>23,432</b>	19,295

\*Refer to note 24 to the consolidated financial statements

### REIT

(\$000s)	Year Ended	
	2019	2018
<b>Segment earnings *</b>	<b>38,014</b>	27,944
Fair value adjustment on investment properties	<b>1,622</b>	11,385
General and administrative expenses	<b>2,868</b>	2,884
Interest income	<b>(117)</b>	(137)
Amortization of operating lease incentives	<b>3,541</b>	3,097
Straight-line rent adjustments	<b>(628)</b>	(1,190)
<b>Divisional NOI</b>	<b>45,300</b>	43,983

\*Refer to note 24 to the consolidated financial statements

**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	
	2019	2018
Net income for the year	37,741	64,273
Amortization of operating lease incentives	7,867	6,710
Fair value adjustment on investment properties	(12,234)	(863)
Depreciation on property and equipment	1,381	1,417
Stock based compensation expense	717	450
Non-cash financing costs	3,442	1,466
Gain on sale of asset	(83)	(6)
Deferred income taxes	(9,241)	(3,493)
Fair value adjustment on REIT units	8,675	(13,827)
<b>FFO</b>	<b>38,265</b>	<b>56,127</b>

Investment Properties

(\$000s)	Year Ended	
	2019	2018
Divisional income for the year *	20,070	17,325
Fair value adjustment on investment properties	809	(447)
Amortization of operating lease incentives	1,820	1,138
<b>Divisional FFO</b>	<b>22,699</b>	<b>18,016</b>

\*Refer to note 24 to the consolidated financial statements

REIT

(\$000s)	Year Ended	
	2019	2018
Divisional income for the year *	38,014	27,944
Fair value adjustment on investment properties	1,622	11,385
Amortization of operating lease incentives	3,541	3,097
<b>Divisional FFO</b>	<b>43,177</b>	<b>42,426</b>

\*Refer to note 24 to the consolidated financial statements

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