



## **Builders Capital Mortgage Corp.**

Management's Discussion and Analysis  
Quarter Ended September 30, 2020

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) has been prepared by Builders Capital Mortgage Corp. (Builders Capital or the company) as of November 23, 2020. It should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2019, available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website at [www.builderscapital.ca](http://www.builderscapital.ca). The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). All financial information is presented in Canadian dollars.

### Notice Regarding Forward-Looking Information

Certain information included in this MD&A contains forward-looking statements within the meaning of applicable securities legislation, including statements with respect to management's beliefs, estimates and intentions, and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "expect", "intent", "estimate", "anticipate", "believe", "should", "plans", "continue" or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. These statements are not guarantees of future performance and are based on our estimates and assumptions, which are subject to risks and uncertainties, and could cause our actual results to differ materially from the forward-looking statements contained in this MD&A. These risks and uncertainties include, among other things, risks associated with mortgage lending, competition for mortgage lending, real estate values, interest rate fluctuations, environmental matters and the general economic environment. We caution that the foregoing list is not exhaustive, as other factors could adversely affect our results, performance or achievements. Readers are also cautioned against undue reliance on any forward-looking statements. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

### Background and Overview

Builders Capital is a mortgage lender providing short-term course of construction financing, primarily to residential builders. The company was formed on March 28, 2013 and commenced active operations on December 12, 2013 on the closing of our initial public offering and our listing on the TSX Venture Exchange under the symbol BCF. The company is a mortgage investment corporation (MIC) within the meaning of Section 130.2(6) of the *Income Tax Act* (Canada) and is governed by the laws of the Province of Alberta.

As an MIC, Builders Capital is not subject to income tax provided that we distribute all of our taxable income as dividends to shareholders within 90 days of our December 31<sup>st</sup> year-end. For income tax purposes, such dividends are treated by shareholders as interest income, so that each shareholder is in the same tax position as if their proportionate share of mortgage investments made by the company had been made directly by the shareholder.

The company is structured with two classes of shares: Class A Non-Voting Shares, held by the public, and Class B Non-Voting Shares, held by management and private investors. This two-tier share structure grants dividend priority to the Class A Non-Voting Shares, providing additional security of both principal and dividends to our public shareholders, as detailed under the section entitled Distributions later in this MD&A.

In addition to the Non-Voting Shares, Builders Capital has a limited number of Voting Shares, which are held by the company's principal shareholders.

## **Investment Strategy**

In order to deliver above average risk-weighted returns, our strategy is to invest primarily in short-term construction mortgages that are secured by development stage residential real property. Lending on development property is limited, with mortgages generally provided only in circumstances where a borrower intends to complete the development and build on the land.

Investments in our portfolio are strategically concentrated on:

- First or subordinate mortgages on real estate with a target of up to 75% of property value;
- Mortgages on residential wood frame construction projects; and
- Mortgages on properties located in typically more liquid and less volatile urban markets and their surrounding areas, with a geographic focus on Western Canada.

## **Investment Restrictions**

Our share terms provide for a number of investment restrictions that can only be changed by a vote of all of the shareholders:

- Builders Capital will not make any investment or conduct any activity that would result in the company failing to qualify as a "mortgage investment corporation" within the meaning of the Tax Act.
- We will not invest in asset-backed commercial paper or in securitized pools of mortgage loans, including securitized pools of sub-prime mortgages.
- We will not invest in securities other than first and subordinate mortgages secured by real property and, on a temporary basis only, interim investments consisting of cash and cash equivalents, Government of Canada treasury bills and Government of Canada bonds with a term to maturity of three years or less (although the company shall not be precluded from owning securities of our subsidiaries or affiliates).
- Builders Capital will not engage in securities lending.
- The company will not engage in derivative transactions for speculative purposes and will only take part in derivative transactions in order to hedge interest rate or exchange rate risk.

## **Operations**

Builders Capital provides short-term, course of construction financing to builders of residential, wood-frame construction projects in Western Canada. We believe that staying focused on this niche market reduces overall risk and increases the potential return on our mortgage portfolio. All of our mortgages are tailored to the specific needs of residential builders, giving Builders Capital a competitive advantage in this sector of the construction market.

Our mortgage portfolio and operations are managed by Builders Capital Management Corp. (the manager) under a management agreement. The manager sources and services mortgage loans and directs the company's business operations. Under the terms of the management agreement, the manager provides staff, office space and equipment, as well as the expertise required to operate the business of the company. The manager maintains extensive experience in all aspects of residential construction and in-depth, up-to-date residential real estate industry knowledge in order to make prudent mortgage underwriting decisions and efficiently manage potential mortgage defaults. The manager has the ability to complete any unfinished development projects that Builders Capital may acquire through enforcement proceedings or otherwise in a timely and cost-effective manner. All such actions are conducted by the manager on behalf of the company.

All investments are subject to a rigorous underwriting review. When sourcing investment opportunities, the manager will conduct an initial review to confirm that a mortgage prospect satisfies our lending criteria and Asset Allocation Model (AAM). The AAM dictates the allocation of the aggregate funded and committed assets, based on geographical, economic sector, term, borrower and loan-to-appraised value criteria.

The manager is then required to perform comprehensive due diligence of the underlying assets. The due diligence process revolves around the manager's system of underwriting loans and evaluating projects and borrowers. This process includes a detailed re-costing of each project based on the assumption that we are going to build it ourselves and an analysis of what the completed project will be worth. This assessment gives us the information we need to ascertain the value proposition inherent in the project. We only lend on projects that we believe are economically sound and for which we have the capability, through the manager, to complete and sell if necessary.

All of the loans we make to borrowers consist of promissory notes secured by collateral mortgages over real property. None of the mortgages are originally written for terms longer than one year. Subject to the satisfaction of Builders Capital's rigorous lending requirements, any or all of our mortgages may be, or may become, revolving in nature.

In some cases, the mortgage is intended to be repaid on or before the end of its original one-year term, which would typically coincide with the building project being completed and sold. In cases where the project has not been completed and/or sold by the end of the term, assuming that the manager is comfortable with the marketing efforts and security position, we will generally renew the mortgage to give additional time for completion and marketing. In these cases, no cash is usually received on the renewal, although we will sometimes require a payment or additional security on the loan.

In other cases, the intention is to continue financing the ongoing construction of projects for a borrower on a revolving basis. In these situations, each time a project is completed and sold, cash is received to pay down the loan balance, in some cases to zero. As the loan balance is reduced, new projects can be added to the mortgage. At term-end, as builders will often have a number of projects under construction at varying stages of completion, the mortgages are typically renewed and the builder draws down on the renewed mortgage to continue to fund their projects. In these cases, there is a revolving aspect to the loan but, again, no cash is expressly due upon the renewal.

Payments of principal, interest and fees are generally only required on the sale or refinancing of the property forming the security for our loan. However, our loan terms stipulate that we can expect

payments after substantial completion of a project. Further, all of our mortgages are demand loans, which can be called at our discretion.

While our mortgages often revolve, and can continue to be renewed for multiple years, our goal is to keep the terms short on any one project and to have borrowers repay advances against each project on its completion, either through the sale of the property or by refinancing with another institution.

At inception, we target a loan-to-value ratio not exceeding 75%. However, calculating a loan-to-value ratio requires estimates of value, which are subject to uncertainty. For various reasons, including accruing interest, delays in completion of projects and changing market values, this target ratio is sometimes exceeded. We generally become concerned about collectability when any loan exceeds an estimated 85% loan to value ratio.

## **Q3 2020 Summary**

### **Performance Highlights**

- Earnings exceeded the amount required to pay planned Class A Non-Voting Share dividends by 1.3 times
- Consistent with our targeted distribution, dividends paid to Class A public shareholders in the third quarter were \$0.2016 per share, representing an 8% annual return on the original \$10.00 issue price for the 27<sup>th</sup> consecutive quarter since inception
- Mortgage portfolio grew 13.7% year-over-year to represent 95% of shareholders' equity
- We reduced assets held for sale by 17.9% year-over-year. By quarter end, assets held for sale represented 11% of shareholders' equity
- We achieved a weighted average loan-to-value ratio of our mortgage portfolio of approximately 75%, in line with our target level

### **Business Environment and COVID-19 Update**

- Residential construction in our markets has continued with little interruption through the COVID-19 pandemic; fully all of the builders we work with continue to actively progress their projects
- Housing market conditions in our core western Canadian markets have held up well, and in some cases improved, despite early headwinds generated by the COVID-19 pandemic. The positive housing market conditions are supported by low interest rates and continued strong employment levels in the higher-income brackets
- Our strategy will continue to concentrate on shifting assets from Alberta to the BC market as we receive repayments on older mortgages. We will also consider entering new markets where we see positive economic fundamentals and opportunities for productive portfolio growth, but will continue to bring a conservative approach to making new loans
- While it is difficult to predict the longer-term economic impact of the COVID-19 pandemic on the housing markets we serve, we are moving forward with a healthy weighted average loan-to-value ratio on our portfolio, which provides significant stability

## Financial Overview

	<b>Three months ended September 30, 2020 \$</b>	<b>Three months ended September 30, 2019 \$</b>	<b>Three months ended September 30, 2018 \$</b>
Revenues	837,084	648,104	870,441
Total comprehensive income	496,407	261,441	563,880
Total assets	28,680,936	27,660,737	29,898,420
Shareholders' equity	27,131,174	27,028,481	26,768,731
Basic and diluted earnings per share	0.17	0.09	0.20
Cash dividends declared	590,293	491,261	542,343
Cash dividends declared per Class A share	0.2019	0.2016	0.2016
Cash dividends declared per Class B share	0.1995	0.0997	0.189

## Investment Portfolio

At September 30, 2020

Property Type	Mortgage Portfolio (No.)	Outstanding Balance (\$)	Total Committed Mortgage Principal (\$)	%	AAM Allocation*
<b>Residential</b>					
Single family – Detached	23	15,791,944	20,502,000	61%	100%
Single family – Attached	11	10,266,028	13,340,000	39%	100%
<b>Total:</b>	<b>34</b>	<b>26,057,972</b>	<b>33,842,000</b>	<b>100%</b>	<b>N/A</b>
<b>Geographic Location of Property</b>					
Calgary and Area	17	14,721,284	21,852,000	56%	100%
Edmonton and Area	5	2,751,052	2,830,000	11%	100%
Other Alberta	5	2,263,609	2,265,000	9%	100%
British Columbia	7	6,322,027	6,895,000	24%	50%
<b>Total:</b>	<b>34</b>	<b>26,057,972</b>	<b>33,842,000</b>	<b>100%</b>	<b>N/A</b>
<b>Interest Rate (excluding fees)</b>					
Less than 10%	1	2,030,493	1,950,000	7%	N/A
10%-10.99%	12	10,663,241	15,652,000	41%	N/A
11%-11.99%	14	9,820,852	12,730,000	39%	N/A
12%-12.99%	5	2,149,195	2,060,000	8%	N/A
Greater than 13%	2	1,394,191	1,450,000	5%	N/A
<b>Total:</b>	<b>34</b>	<b>26,057,972</b>	<b>33,842,000</b>	<b>100%</b>	<b>N/A</b>
<b>Original Funding Date **</b>					
Calendar 2020	9	5,064,863	8,292,000	19%	N/A
Calendar 2019	15	13,703,708	16,785,000	53%	N/A
Calendar 2018	1	97,959	75,000	1%	N/A
Calendar 2017	3	2,018,005	1,650,000	7%	N/A
Calendar 2016	1	714,126	750,000	3%	N/A
Calendar 2015 or earlier	5	4,459,311	6,290,000	17%	N/A
<b>Total:</b>	<b>34</b>	<b>26,057,972</b>	<b>33,842,000</b>	<b>100%</b>	<b>N/A</b>

\*Indicates the maximum percentage of the portfolio allowable under Builders Capital's Asset Allocation Model.

\*\*Loans are originally written for terms of up to one year, but are renewed in cases where a builder continues to roll new security onto the loan facility or if the project has not been sold but is still progressing or being actively marketed.

## Introduction

Our financial performance improved through the first three quarters of 2020 as market conditions remained largely stable, as our strategies to strengthen the resilience of our mortgage portfolio began to pay off, and as our capital utilization continued to increase.

While building activity in Canada dropped substantially in April of this year due to the emergence of the COVID-19 pandemic, it recovered through the second quarter and has held relatively steady since. The builders we work with have continued to actively progress all of their projects. Real estate prices have also remained generally stable, supported by historically low interest rates, continued strong levels of employment in the higher income brackets, and significant resiliency among consumers in pursuing home purchases.

While we remain cautious about the potential for pandemic-related impacts on future market activity, we are encouraged by the progress we have made in strengthening our mortgage portfolio in the first three quarters of 2020. A key metric of the stability of our portfolio is the average loan-to-value (LTV) ratio of our mortgages, as this is a key predictor of how likely we are to experience a loss on any given loan if future real estate markets weaken. While the LTV calculation can be subject to uncertainties, particularly given fluctuating values, our weighted average LTV stands at approximately 75%, substantially improved from the 80% range we experienced throughout 2018 and also better than the 76% LTV we reported as at December 31, 2019.

Our capital utilization ratio, as measured by net mortgages receivable as a percentage of shareholders' equity balance, also improved in the first three quarters of 2020. As at September 30, 2020, our capital utilization ratio increased to 95%, up from 84% as at December 31, 2019. This improvement reflects our success in reducing our portfolio of foreclosed properties and making fuller use of our capital and line of credit to pursue more builders' loans. By quarter-end, our portfolio of assets held for sale had been reduced to less than \$3 million and has since been reduced to \$2.3 million with the sale of another property subsequent to the quarter-end. We have not had to foreclose on any properties in the past 18 months.

We emphasize that through the challenging market conditions of recent years, our first priority has been to preserve the capital with which we have been entrusted and we have focused on effectively managing problem loans and foreclosures to reduce our risk. We have also underwritten new loans more conservatively than we would in healthier markets. Going forward, we believe our conservative approach will help us navigate market and economic uncertainties that arise from the COVID-19 pandemic and we will remain cautious in our approach to lending in the near-term.

## Operating Results for the Three and Nine Months Ended September 30, 2020

Our mortgage portfolio increased by \$3.4 million, or 15.1%, in the first nine months of 2020 and as at September 30, 2020 was \$3.1 million or 13.7% larger than it was at September 30, 2019. The nine-month increase was achieved through the addition of \$434,000 in share capital, increased borrowing on our line of credit, and a \$640,000 net reduction in assets held for sale. At quarter-end, our ratio of net mortgages to shareholders' equity stood at 95%, a 13.3% improvement over Q3 2019. While this was still below the 120% utilization rate achieved in our strongest quarters when we held no assets for resale, it is a marked improvement from December 31, 2019 when we were at a low of 84%.

We carried out no foreclosures in the third quarter of 2020, consistent with Q3 2019. During the quarter we completed and listed for sale a property in Edmonton, AB and also entered into a contract to sell a completed home in Saskatoon, SK which subsequently closed on November 6, 2020. At September 30, assets held for sale included: i) a completed home in Saskatoon, SK which has been subsequently sold; ii) a townhouse unit in Calgary, AB which is listed for sale, and iii) the above-mentioned home in Edmonton, AB, which is also listed for sale.

The foreclosures and write-downs during fiscal 2019 reflect the difficult and lengthy five-year downturn for the Alberta economy, during which time, housing prices fell by approximately 9%. Towards the end of 2019, the market finally began to stabilize and with loans being repaid, we began to redeploy capital into new mortgages. Our turnover rate, which for us is an important metric for profitability, has improved substantially as a result. Cash advances and invoiced interest totaled \$5.0 million in Q3, as compared to \$5.2 million in the third quarter of 2020, but on a year-to-date basis were up 51% to \$20.7 million, from \$13.7 million in the first nine months of 2019. The cash advances were offset by repayments in the amount of \$6.9 million for the third quarter and \$17.6 million in the first nine months of the year, as compared to \$6.9 million and \$16.7 million, respectively, in 2019.

In tandem with underwriting mortgages, we regularly engage in the purchase and sale of mortgages to help ensure full cash utilization and create liquidity as required. During the first nine months of 2020, we purchased a single mortgage for \$426,000 and sold none. This contrasts to the same period in 2019 when we bought one mortgage for \$1.9 million and sold none. The purchase transactions were conducted with Builders Capital (2014) Ltd., a privately held corporation owned by certain directors of the company.

We are pleased that the approximate weighted average loan-to-value ratio ("LTV") of our mortgage portfolio has held reasonably steady at slightly below 75%, almost two years after peaking at the end of 2017 and staying elevated throughout 2018. The improvement in and the ability to maintain our weighted average loan-to-value ratio provides important stability as we negotiate the economic uncertainties arising from the COVID-19 pandemic.

Further reducing shareholder risk as we move forward is our minimal use of leverage. Generally, the only debt that we employ is our line of credit, which is used primarily as a cash flow tool to facilitate making advances to borrowers. As difficult market conditions persisted through the latter half of 2019, we remained cautious in our lending and worked to reduce our line of credit balance. During the first three quarters of 2020, we returned to using our loan facility to fund additional mortgages, and accordingly our debt-to-equity ratio, while still conservative, has risen to 5.7% from 2.3% at December 31, 2019.

As at the end of the third quarter, the total value of our mortgage portfolio, before taking into account our \$339,000 allowance for mortgage losses, was \$26.1 million. This compares to \$23.1 million at the end of fiscal 2019 and \$22.9 million at the end of Q3 2019. The \$3.2 million, or 13.8%, year-over-year improvement reflects a redeployment of assets that had been held for sale into productive mortgages, increased use of our line of credit, as well as an additional \$319,000 in net capital investment during the period. As at September 30, 2020, our loan portfolio was made up of 34 mortgages with an average outstanding balance of \$766,000, compared to 29 mortgages averaging \$881,000 each at the end of Q3 2019.

## Revenue

For the three months ended September 30, 2020, mortgage revenue increased 17.1% to \$837,000, from \$648,000 in Q3 2019, reflecting growth in the size of our mortgage portfolio. For the nine months ended September 30, 2020, mortgage revenue increased 9.5% to \$2.4 million, from \$2.2 million in the same period in 2019.

Third quarter 2020 revenue consisted of \$763,000 in interest and \$74,000 in lender fees charged to borrowers. This equates to annualized gross revenue of 11.3% of the weighted average gross share capital, up from 8.9% in Q3 2019. Nine-month revenue was comprised of \$2.2 million in interest and \$219,000 in lender fees, representing annualized gross revenue of 10.9% of the weighted average gross share capital, as compared to 10.2% in 2019.

Lender fees are tied to the negotiation of new mortgages, generally at 1% of the approved loan amount, and are charged for an annual term to borrowers when new loans are made or existing loans are renewed. Lender fees are maximized when turnover in the portfolio is highest. During the third quarter, lender fees were \$74,000, 48.4% higher than in Q3 2019. Lender fees earned exceeded management fees paid in the quarter by a very modest \$263, however as our goal has always been to keep lender fee revenue above management fee expense, we are pleased that this goal was achieved.

## Expenses

Excluding funds set aside to provide for loan losses and interest expense, third quarter 2020 operating expenses were consistent with the prior year at \$102,000. Because revenues increased, this represents 12.2% of revenue as compared to 15.7% in Q3 2019. Our goal is to keep operating expenses within 10% of revenues and we believe the key to achieving this ratio will be continuing to increase revenues while holding expenses steady.

In the third quarter of 2020, we recorded a provision for mortgage losses of \$213,782 which is 24.9% lower than the provision taken in the same period of 2019. Year-to-date, the provision of \$424,000 is 13.6% less than that deemed necessary in the same period in the prior year. The provision is based on our ongoing assessment of our portfolio and our assessment of current market conditions. It is intended to help ensure that the carrying value of our mortgages receivable and our assets held for sale reflect true fair values, particularly in challenging markets. The lower provisions in the 2020 periods reflect that our markets are now stabilizing, our portfolio of mortgages has largely turned over, and our underwriting criteria reflect more current, lower valuations. Given the improved LTV ratios in our portfolio, our success in reducing the balance of assets held for sale, and the fact that home prices in recent months have been holding firm, we are optimistic that we can return to more historically typical provisions for mortgage losses going forward.

Management fees were \$74,000 in the third quarter and \$221,000 year-to-date (1.2% and 3.2% higher than 2019 respectively), calculated on the total gross amount of Class A and Class B Non-Voting Shares outstanding. Our intention is to continue to grow our capital base, resulting in these fees increasing, but our expectation is that this impact will be more than offset by higher revenues.

Interest expense applies to our operating line of credit, which we use as a cash flow tool to fund mortgage draws. A higher utilization rate for our capital will provide better returns in the form of additional interest income, but will also necessitate increased use of our line of credit for funding draws

when our own funds are fully employed. As at September 30, 2020, our line of credit had a balance of \$1.0 million as compared to a zero balance at December 31, 2019. Interest expense of \$24,000 was incurred in the quarter, compared to no interest expense in Q3 2019.

### **Total Comprehensive Income**

Total comprehensive income grew to \$496,000 in the third quarter, an increase of 89.9% from \$261,000 in Q3 2019. Year-to-date comprehensive income of \$1.6 million was up 20.7% from the same period in 2019 and represents our best nine-month result since September 30, 2018. Earnings per share increased by 88.9% to \$0.17 in Q3 2020, from \$0.09 in the third quarter of 2019.

The year-over-year improvement in our third quarter earnings performance reflects the success of our strategies for strengthening our mortgage portfolio, as well as stabilization in our core real estate markets. Real estate conditions in Alberta and British Columbia improved in early 2020 and, despite concerns related to the COVID-19 pandemic have, to date, not worsened substantially. While the potential impact of the COVID-19 pandemic and fluctuations in world oil prices on our business is still unclear at this time, we believe we are well positioned to continue to improve our results.

Our share terms call for annual dividends of \$0.80 per Class A Non-Voting Share per year, or approximately \$0.20 per quarter, prior to any other dividends being paid. Earnings in the quarter were \$0.17 per share overall, but were \$0.25 per Class A Non-Voting Share. These earnings exceeded the amount required to satisfy the dividend committed to the Class A Non-Voting shareholders by 1.3 times. With Class B Non-Voting shareholders bearing a much greater proportion of the risk of income fluctuations, even if earnings had been only 82% of their actual figure, the company would still have been in a position to pay Class A shareholders their full, planned quarterly dividend. Given this margin, we anticipate that potential continued fluctuations in our comprehensive income will not affect the payment of our Class A Non-Voting Share dividends just as such fluctuations through difficult market conditions has not affected it in any previous quarter.

In order to maintain distributions on the Class B Non-Voting Shares, we have been actively working to raise capital from the sale of additional Class A Non-Voting Shares. Increasing the number of Class A Non-Voting Shares in relation to the Class B Non-Voting Shares will improve the Class B Non-Voting share returns in any period during which our net earnings exceed an 8% overall return on capital. On January 2, 2020 we issued 45,000 Class A Non-Voting Shares for \$10.00 per share. Our ratio of Class A to Class B Non-Voting shares now stands at 2.2:1, up from 1.4:1 after our initial public offering. Our share terms limit the ratio to no greater than 3:1.

### **Share Issuance Costs**

As no new shares were issued, no share issuance costs were incurred in Q3 2020. For the year-to-date period, share issue costs relating to the additional capital raised in Q1 2020 were \$17,000. Total share issue costs since inception now stand at \$2.4 million, including professional fees for offering document preparation; offering, agent and brokerage fees and commissions; and other marketing and offering costs. In accordance with IFRS, these share issue costs are accounted for as a reduction in the value of the equity of the company. These costs are, however, deductible for tax purposes over a five-year amortization period.

Our intent is to restrict shareholder distributions to less than 100% of net income in order to utilize the tax deductibility of these payments. This distribution policy will, over time, have the result of retaining income equal to the offering costs within Builders Capital, which will increase the Net Asset Value of the company while ensuring that no corporate taxes are paid. Because of the two-tier share structure, and the priority on distributions that the Class A Non-Voting Shares hold over the Class B Non-Voting Shares, we expect the restriction in distributions to come primarily from the portion of income otherwise available for distribution to the Class B Non-Voting shareholders.

#### **Statement of Financial Position**

At September 30, 2020 total assets were \$28.7 million (December 31, 2019 – \$27.2 million), \$2.9 million (10.2%) of which was assets held for sale and the balance of which was primarily funded mortgages. The \$1.5 million increase in total assets since December 31, 2019 reflects approximately \$1 million in borrowing on our line of credit and \$434,000 in net additional share capital.

Assets held for sale are comprised of properties which we have obtained in foreclosure actions. In most cases, these properties are unfinished at the time, and we need to expend resources to complete them and prepare them for sale. As discussed above, at September 30, 2020 our assets held for sale included completed single family homes in Saskatoon, Saskatchewan and Edmonton, Alberta, and a completed townhouse unit in Calgary, Alberta.

Liabilities at quarter-end totaled \$1.5 million (December 31, 2019 – \$600 000) and were comprised of a line of credit balance of \$1.0 million, dividends relating to the fiscal quarter paid on November 2, 2020, our trade payables, the balance due to Builders Capital Management Corp., and deferred lender fees.

Throughout the quarter we were in compliance with all bank covenants relating to the line of credit, and we had no off-balance sheet arrangements during the year.

## Quarterly Financial Information

	Quarter ended September 30 2020 \$	Quarter ended June 30 2020 \$	Quarter ended March 31, 2020 \$	Quarter ended December 31, 2019 \$	Quarter ended September 30, 2019 \$	Quarter ended June 30, 2019 \$	Quarter ended March 31, 2019 \$	Quarter ended December 31, 2018 \$
Revenues	837,084	860,036	703,638	729,749	648,104	698,111	845,714	884,185
Total comprehensive earnings	496,407	629,545	475,731	118,775	261,441	472,190	593,228	292,116
Total assets	28,680,936	30,813,268	31,725,932	27,152,829	27,660,737	27,789,720	30,146,336	28,918,136
Shareholders' equity	27,131,174	27,225,059	26,997,126	26,554,715	27,028,481	27,258,301	26,653,051	26,250,889
Earnings per share	0.21	0.21	0.16	0.04	0.09	0.16	0.21	0.10
Cash dividends declared	590,293	401,612	466,880	489,960	491,261	588,715	491,066	552,658
Cash dividends declared per Class A share	0.1995	0.1995	0.1972	0.2016	0.2016	0.1995	0.1973	0.2016
Cash dividends declared per Class B share	0.1995	-	0.0756	0.1008	0.0997	0.2096	0.1247	0.1890

## Distributions

Under our two-tiered share structure, Class A Non-Voting shareholders are entitled to receive annual dividends of 8% in preference to all other shareholder distributions. Once these dividends have been paid, Class B Non-Voting shareholders are entitled to receive total annual dividends of up to 16%. At our fiscal year-end, any remaining income intended for distribution after these dividends are paid is allocated pro-rata between the classes of shares, including the Voting Shares.

On September 22, 2020, based on income for the third quarter of 2020, our Board of Directors declared a dividend of \$0.2016 per Class A Non-Voting Share to shareholders of record on September 30, 2020. This distribution was paid on November 2, 2020 and is recorded as payable in the accompanying condensed consolidated interim financial statements. The dividend amount was calculated to provide an annualized 8% return on the \$10.00 initial Class A Non-Voting Share price.

Subsequent to the quarter-end, on October 26, 2020, again based on income for the third quarter of 2020, the Board declared a dividend of \$0.2016 per share to Class B Non-Voting shareholders of record on that date. This distribution was also paid on November 2, 2020. This dividend is not recorded in these consolidated financial statements as it was declared subsequent to the quarter-end.

## Liquidity and Capital Resources

Cash flow and liquidity are critical to our success. We monitor both daily to ensure we can meet the expectations of our borrowers.

In the second quarter of 2020, we closed a sale of one property in Richmond, BC that we had been holding, bringing in approximately \$1.0 million. Other than this, our regular turnover of loans paying out and new loans being funded has been fairly typical for our operations. As at September 30, 2020, our line of credit balance stood at 19% of its limit, leaving us with a reasonable balance available for cash-flow requirements.

During the three months ended September 30, 2020, mortgages were funded in the amount of \$4.2 million, down from \$4.5 million funded in Q3 2019. Third quarter repayments were similar to the prior year at \$7.0 million, as compared to \$6.9 million in Q3 2019. Year-to-date, funded mortgages increased to \$18.3 million and repayments totaled \$17.6 million, as compared to \$11.5 million and \$16.7 million, respectively, in the same period in 2019. The 59% increase in year-to-date funded mortgages reflects our success in reducing assets held for sale and our sourcing of additional mortgages as older loans turned over.

As our mortgages are predominantly short-term in nature, the continual repayment by borrowers of existing mortgage investments creates liquidity for ongoing mortgage investments and funding commitments.

Our mortgage portfolio turns over approximately annually. We expect that borrower repayments will remain at a reasonably consistent level through 2020 and plan to continue funding mortgages in amounts approximately equal to mortgage repayments received. It is likely that a number of our mortgages will be renewed as they come due, as discussed earlier under Operations.

Liquidity risk for the company arises primarily from the prospect of committing to a mortgage for which sufficient funds are not available to make draws as requested by the borrower. As noted in the Investment Portfolio table above, we have mortgage commitments to borrowers totaling \$33.8 million, which exceed the current amounts funded by \$7.8 million. We anticipate funding these commitments through the repayment of existing mortgages. Should mortgage repayments fall short of our commitments, we have a number of tools to manage liquidity and to ensure that commitments can be met. These tools include our \$5.5 million line of credit, detailed cash flow planning procedures, and Builders Capital's well-established network of affiliates and mortgage industry contacts, through which mortgages can be sold or syndicated as required for cash flow purposes. In addition, our mortgage documents include language whereby a borrower cannot compel the company to advance funds. Our primary goal is to minimize unused cash balances, while ensuring that borrower needs and other commitments can always be met.

Since inception, almost all of the sales and purchases of mortgages, which have both helped keep the mortgage book full and been a source of liquidity as required, have been to and from related parties, in particular Builders Capital (2014) Ltd. ("BCL"). BCL is a privately held corporation, of which Builders Capital directors Sandy Loutitt and John Strangway are also both directors. The company has often been reliant on BCL as a vendor and purchaser of mortgages and as a source for liquidity, including at certain times of low cash flow, for payment of dividends. This reliance means that if BCL was unwilling, or unable, to act as a purchaser or vendor of mortgages, the company would have to leave a larger margin for error in our cash management practices, which could reduce profitability. The company expects to continue to be able to rely on BCL as a source of liquidity in the future. It is unlikely we could find another party that could provide liquidity as quickly or as efficiently.

We are prepared to increase our issued capital and regularly make solicitations for investments in Class A Common non-voting shares. Should such shares be issued, the proceeds will be used for general cash flow and for expansion of our mortgage portfolio. Builders Capital is financed, and will continue to be financed, primarily by the issuance of common shares.

According to our share terms, Class A Non-voting shareholders have an annual right to redeem their shares on October 31st each year at 95% of Net Asset Value. Payment for the redemptions is to be made on November 30th each year. During the quarter, we received redemption requests for 15,800 Class A Non-voting common shares and 11,740 Class B Non-voting common shares. These shares will be redeemed for \$139,609, and \$109,194 respectively. While we would prefer to continue to grow our capital stock, we are pleased to be able to provide liquidity to our shareholders as envisioned by our share terms.

### **Related-Party Transactions**

Our manager is a company controlled by Sandy Loutitt and John Strangway, both of whom are also directors of Builders Capital. The manager receives a management fee calculated as 1% per annum of the book value of the share capital of the company. Management fees amounted to \$74,000 in the third quarter of 2020 (2019 - \$73,000) and \$221,000 for the nine-month period (2019 - \$214,000).

In addition to the management fee, the manager charges lender fees directly to borrowers both on loan originations and on loan renewals, with 28.6% of these fees being paid to the company and the remaining 71.4% going to the manager. The company collects these fees from the borrower, both on our own behalf and on behalf of the manager, by adding them to the principal amount of the mortgage,

generally on the first advance to the borrower. The company then pays the manager's share of the fees to the manager, regardless of whether or not any payments have been received on the mortgage. Such payments to the manager are generally made within 30 days of having been charged to the borrower. Renewal fees are also charged to the borrower and paid to the manager during the term of the mortgage. During the third quarter, the amount of these fees collected on behalf of the manager totaled \$89,000 (2019 – \$127,000) and \$366,000 for the nine-month period (2019 - \$344,000).

In general, mortgages are purchased when the company has excess cash on hand, quality mortgages are available to purchase, and opportunities to immediately fund additional mortgages are not available. The acquisition of mortgages helps us to minimize excess balances and maximize interest revenue. Mortgages are sold when, despite the line of credit being fully drawn, additional cash is required, or is forecast to be required, to fund mortgage draws and commitments. Often, mortgages purchased are subsequently sold back and vice versa. The purchase and sale of mortgages sometimes results in balances due to or from related parties being outstanding for short periods of time. These balances are unsecured and non-interest bearing. No mortgages were purchased or sold in either the first or third quarters, and a single mortgage was purchased for \$426,000 in Q2.

## **Market Outlook**

The following discussion is qualified in its entirety by the Notice Regarding Forward-Looking Information at the beginning of this MD&A and by the section entitled Risks and Uncertainties that follows this Outlook section.

Despite early concerns about the impact of COVID-19 on housing markets, prices and sales activity have risen in many Canadian markets in the months since the COVID-19 pandemic emerged.

RBC Economics in its November 4, 2020 report stated that “Canada’s largest housing markets remained piping hot last month—at, or near record highs,” while in August, 2020, RBC Economics commented that, “early reports from local real estate boards point to strong year-on-year increases in resales for most regions including Toronto, Vancouver and Calgary in July,” and that, “exceptionally low interest rates are likely helping to support near-term housing demand.” The August report points out that while labour markets have suffered during the pandemic, employment in the higher-income brackets (defined as wages of \$1,200 or more per week) has actually grown by 7% compared to the previous year. This fact has positive implications for real estate markets. The report concludes that, “there are still plenty of downside risks for the housing markets...but, for now, both new building activity and home resales have shown stronger trends than feared.” RBC Economics also predicted a trend towards owners looking for “more spacious properties in less crowded settings” which will in turn “sustain strong demand in smaller markets, putting intense pressure on their housing stock.”

As a short-term lender with the ability to reasonably quickly redeploy capital between markets, we are confident in our ability to derive an advantage from this changing landscape. In the near term, our strategy will continue to concentrate on shifting assets from Alberta to the BC market and from inner city to suburbs as we receive repayments. Our increasing emphasis on BC reflects that market's stronger fundamentals.

We will also actively seek new markets where we see positive economic fundamentals and opportunities for productive portfolio growth. We will generally adopt a conservative approach to

making new loans, paying close attention to evolving market conditions and ensuring that the borrowers to whom we lend have sufficient equity invested in the project to adequately minimize our downside risk.

Going forward we also expect to further reduce our portfolio of foreclosed properties. Over the past 24 months, we have foreclosed on nine properties and sold seven of them. We have also reduced the approximate weighted average loan-to-value ratio on our portfolio to below 75% and believe that there is sufficient equity in the majority of the loans in our portfolio to minimize the risk of further loan losses. As always, however, it remains possible that we will need to take additional steps to collect on some of our mortgage assets over the coming months. That said, we believe that the necessary safeguards are in place to assure our ability to maintain the Class A Non-Voting Share dividend at 8% per annum.

These safeguards include maintaining a prudent debt-to-equity ratio, generally restricting our lending to 75% of what we believe to be the fair market value of a property at any given time, and taking adequate allowances for expected credit losses allowing us to build a cushion of funds to further protect investors. In addition, by investing only in short-term mortgages, we maintain the liquidity necessary to preserve capital. In the event that we believe a market has become too risky, we will work on converting our investments to cash, and will forego returns in order to protect the capital with which we've been entrusted.

Finally, safeguards built into our share structure give Builders Capital's public Class A Non-Voting shareholders priority on all capital and income distributions over our Class B Non-Voting shareholders. In the event of a serious decline in the earning potential or value of our portfolio, Class B shareholders would forego all distributions until the Class A shareholders have received both their 8% return and, in the case of a dissolution, their capital. As demonstrated during recent quarters, with the impact of both our increased allocation of funds against potential loan losses and unproductive assets, borne entirely by Class B Non-Voting shareholders, this structure is functioning as intended.

## **Financial Instruments**

Our primary business purpose is to invest in mortgages which accordingly are the only significant financial instrument that we carry and are the source of virtually all of our revenues. These financial instruments expose us to risks which are managed as follows:

### **Credit Risk**

Credit risk is the risk of loss associated with the counterparty's inability to fulfill its payment obligations. Credit risk arises principally from our lending activities. Any instability in the real estate sector and an adverse change in economic conditions in Canada could result in declines in the value of real property securing our mortgages. We mitigate this risk by adhering to our investment and operating policies.

All mortgages to which we commit are individually evaluated by our underwriters using credit risk assessment tools and are assigned risk ratings in accordance with the level of credit risk attributed to each loan. Each new mortgage is approved independently and in accordance with the authorization structure set out in our policies. Our underwriting approach places a strong emphasis on the value of the mortgage security and an assessment of the financial viability of the construction project being financed.

We have clearly defined underwriting policies and procedures that we adhere to in our mortgage approval process. These include a maximum projected loan-to-value ratio, standards with regard to the asset quality and marketability, geographic market restrictions and requirements regarding the overall credit quality and integrity of borrowers. We also actively analyze external market conditions including prevailing real estate values and employment conditions in the markets in which we lend. In all cases, our mortgages receivable are secured by registered charges over real property.

We utilize an internal risk rating system to categorize each mortgage in the portfolio on the basis of the perceived risk of a potential credit loss. The risk assessment of each mortgage assigned at the underwriting stage is subsequently revised based on changes in market conditions and on factors specific to the mortgage and the borrower. One of the main factors in considering whether the credit risk of a mortgage has increased significantly is the estimated loan-to-value ratio. Loan-to-value ratios can change due to declining property values, as well as other factors such as the inability of the borrower to continue to inject equity into the project. Mortgages are considered to be impaired when the expectation is that full collection of principal and interest is no longer likely.

Our lending is for construction purposes, and all loans are made only on the strength of mortgage security over real property. The value of the underlying security is subject to change for a variety of factors, including the degree of completion of the construction, possible deterioration in structures left incomplete and market forces which can cause values to either increase or decrease.

In the case of mortgage impairment, probable recovery is determined using a combination of updated property-specific information, historical loss experience and management judgement to determine the impairment provision that may be required. The primary factor in assessing a mortgage as low risk would be a loan to value ratio which is low enough to make a potential credit loss extremely unlikely.

Although we write mortgages for periods of one year or less, the mortgages are often renewed based either on the borrower's ongoing requirement for capital for additional projects, or because the project which was originally financed has not been completed and sold. In each case, prior to renewal, we assess the mortgage for impairment.

Mortgages which were funded prior to the end of the previous fiscal year, and which have been renewed due to delays in completing the construction or the sale of the underlying security rather than due to a revolving arrangement for ongoing construction having been made, and for which no specific allowance has been recognized, can be considered to be past due, but not impaired as management considers collection to be reasonably assured due largely to the estimated value of the mortgage security held.

### **Market Risk**

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates.

#### **i) Interest Rate Risk**

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will vary as a result of changes in market interest rates. We manage our financial instruments with the objective of mitigating any potential interest rate risks. The interest rates on the company's mortgages receivable are fixed for the term. Therefore, we are not exposed to significant cash flow interest rate risk. As at September 30, 2020, our mortgages receivable are subject to fair value interest rate risk as a decrease or increase in market interest rates will

decrease or increase the fair value of the fixed rate financial asset. Any change in market interest rates will, however, have no impact on our cash flows or comprehensive income for the year as mortgages receivable carry a fixed rate of interest.

We are exposed to interest rate risk on our line of credit and loan payable as they carry a variable rate of interest.

**ii) Foreign Currency Risk**

We do not have assets or liabilities denominated in foreign currency.

**Liquidity Risk**

Liquidity risk arises from the possibility of not having sufficient ability to obtain debt financing or equity capital to fund future growth or meet our obligations as they arise and become due. Furthermore, liquidity risk also arises if we are not able to obtain financing on favorable terms.

Our main liquidity requirements will arise from mortgage acquisitions, manager fees and distributions to shareholders. All of the aforementioned liquidity requirements, except for mortgage acquisitions, are generally funded from cash flows earned on mortgage interest and fees. Mortgage acquisitions are generally funded through equity issuances. Our financial condition and results of operations would be adversely affected if it were unable to obtain additional funds through equity issuances or financing, or if we were unable to meet our other liquidity requirements from ongoing operating activities.

Our approach to managing liquidity is to ensure that we will have sufficient financial resources available to meet our liabilities as they become due. This includes monitoring of cash, line of credit, loan payable and accounts payables and accrued liabilities. We intend to mitigate our liquidity risk by not entering into property acquisitions unless we have secured or are confident that we can secure the appropriate capital (debt and/or equity) to fund the particular acquisition. Liquidity risk is also mitigated by the terms offered to investors, which state that all redemptions are at the discretion of management and are dependent on the circumstances, and to borrowers, which state that the company is never obligated to advance additional mortgages or funding.

**Capital Management**

Our capital consists of shareholders' equity. Our objectives when managing capital are, with a focus on capital preservation, to acquire, originate and maintain a portfolio consisting primarily of construction mortgages that generates attractive returns relative to risk in order to permit us to pay quarterly distributions to our shareholders.

We set the amount of capital in relation to risk and manage the capital structure and make adjustments to it in light of changes to economic conditions and the risk characteristics of the underlying assets.

Our objectives when managing capital are:

- i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and,
- ii) to maintain investor, creditor and market confidence in order to sustain the future development of the business.

Our company is subject to externally imposed capital requirements. The credit facility contains certain financial covenants that must be maintained. During the period, we were in compliance with all financial covenants.

## **Critical Accounting Estimates**

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the condensed consolidated interim financial statements and reported amounts of revenues and expenses during the reporting year. Estimates, assumptions and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual outcomes can differ from these estimates. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the amounts recognized in the condensed consolidated interim financial statements are:

### **Measurement of fair values**

Our accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities.

Fair value represents the price at which a financial instrument could be exchanged in an orderly market, in an arm's length transaction between knowledgeable and willing parties who are under no compulsion to act. We classify the fair value of the financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1: Fair value measurements are those derived from quoted prices (unadjusted) in the active market for identical assets or liabilities.
- Level 2: Fair value measurements are those derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (derived from prices).
- Level 3: Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

We review significant unobservable inputs and valuation adjustments. If third party information is used to measure fair values, we will assess the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

### **Measurement of expected credit loss**

We are required to make estimates and assumptions that relate to the expected credit losses. These judgements include changes in circumstances that may cause future assessments of credit risk to be materially different from current assessments which would require an increase or decrease in the allowance for credit losses.

### **Classification of non-voting shares with redemption feature**

Under IFRS, IAS 32 requires that shares of an entity which include a contractual obligation for the issuer to repurchase or redeem them for cash or another financial asset be classified as financial liabilities. Our Class A and Class B non-voting shares contain a redemption feature whereby the holders can request redemption of the shares during a specified period during the year. The redemption feature is subject to certain restrictions which give Management the ability to effectively defer redemption indefinitely. Accordingly, management has applied judgment in assessing whether the redemption feature would

create a contractual obligation to repurchase or redeem shares for cash or another financial asset and has determined that it would not and that the shares should be classified as equity.

## **Responsibility of Management and the Board of Directors**

Management is responsible for the information disclosed in this MD&A and has in place the appropriate information systems, procedures and controls to ensure that the information used internally by management and disclosed externally is materially complete and reliable. In addition, our Board of Directors and Audit Committee provide an oversight role with respect to our public and financial disclosures. Both have reviewed and approved this MD&A and the accompanying condensed consolidated interim financial statements for the quarter ended September 30, 2020.

## **Outstanding Share Data**

The company's authorized share capital as at November 23, 2020, consists of 1,000 Voting Shares, of which 100 were outstanding at period-end; an unlimited number of Class A Non-Voting Shares, of which 2,013,093 are outstanding; and an unlimited number of Class B Non-Voting Shares, of which 924,576 are outstanding.

## **Risk and Uncertainties**

There are two primary areas of risk for us as a lender. The first is the risk that borrowers will fail to meet their obligations and repay mortgages as they come due. Secondly, there is a risk that sufficient quality investment opportunities will not be available to keep our capital fully deployed. As our primary goal is the preservation of our investors' capital, even at the expense of potential returns, we consider the risk of borrower default to be our primary concern.

A robust new home construction market greatly reduces both of these risks, as it provides a strong marketplace into which builders can sell their completed projects, it maintains or increases the value of the security for our loans, and it provides an ongoing source of new projects and borrowers. A downturn in the market that substantially decreases security values could have a significant negative effect on our business. We cannot predict the performance of the housing market in the future with certainty.

In order to mitigate these risks, we restrict our loan amounts to a target of up to 75% of what we consider the fair market value of the security to be. The 25% equity component is a requirement for our borrowers and we believe it provides us with a sufficient margin for error in the event of a drop in property values. The short-term nature of our loans also gives us the flexibility to convert our entire portfolio of mortgages to cash within a reasonable time period, if economic conditions warrant. We also maintain sufficient construction expertise to allow us to economically complete any project on which we have loaned funds.

Our share terms provide that the Class A Non-Voting shareholders have a priority over other shareholders with respect to both the payment of dividends at an 8% rate, and any potential return of capital. This creates a significant reduction in the risk profile of the Class A Non-Voting Shares, as an impairment in the value of the mortgage portfolio, or a lack of funds available for distributions, will always be absorbed, to the full extent of their investment, by the Class B Non-Voting Shares before the Class A shareholders' rights are affected. We believe that this structure substantially reduces risk for the Class A shareholder.

Other risks and uncertainties exist for our business that are typical for business in general and for lenders in particular. These include changes in interest rates, potential environmental issues associated with the mortgage security, borrower solvency, any significant changes in competition, changes in tax legislation and other factors as described under Forward-Looking Information.

### **Additional Information**

Additional information about Builders Capital is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our website at [www.builderscapital.com](http://www.builderscapital.com).