March 15, 2017

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, 2016.

The financial statements underlying this MD&A, including 2015 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 15, 2017.

Other Information

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

Non-standard Measures

We refer to terms that are not specifically defined in the CPA Canada 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, please refer to the section "Non-standard Measures".

Caution Regarding 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, 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 2017 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 the Business Environment & Risks section.

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 the company or on its behalf.

Our Business

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

For 94 years, our focus has been the business of real estate. We've built over 100 communities across western Canada since the 1950s and have helped to shape much of Alberta's landscape. We manage over 3.95 million square feet (sf) in commercial real estate assets and 612 residential rental units.

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

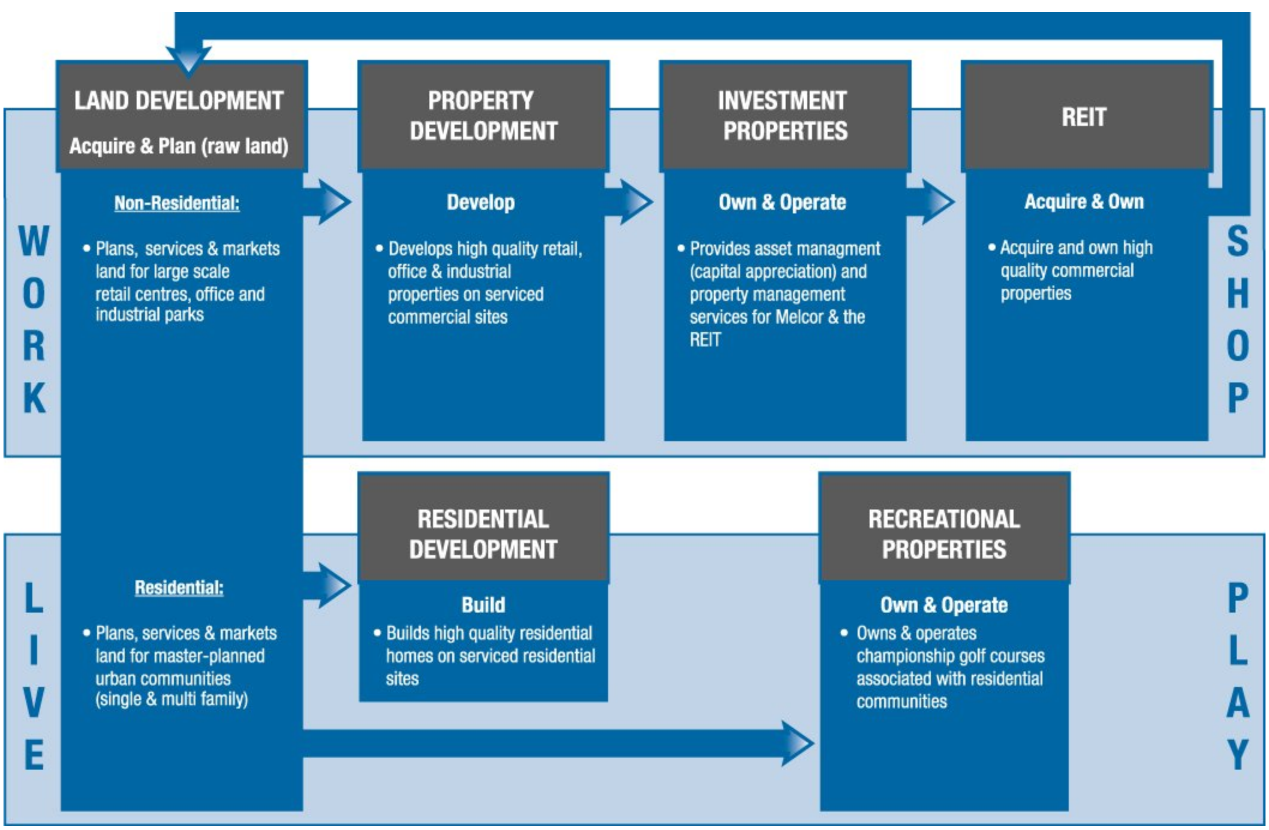
We have been a public company since 1968 (TSX:MRD). On May 1, 2013, we formed Melcor Real Estate Investment Trust (the REIT) through an initial public offering (the IPO). We retain a controlling 56.7% effective interest in the REIT and continue to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement.

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

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

In addition, we own and operate championship golf courses associated with our residential communities in our fifth division, Recreation Properties. Melcor has over $1.89 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 the southwestern US.

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

Strategy

Our fundamental goals are to:

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

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

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

Throughout 2016, the economic environment in Alberta remained challenged by the sustained decline in the price of oil. We continued to approach development with caution and focused on selling lots early in the year and reducing overall inventory on the residential community side and delaying commercial development until pre-leasing thresholds were met.

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

Sustain & Improve

We execute our proven business model for sustainable results by:

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

Grow & Diversify

We build for future growth by:

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

Assets

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

Property Development completed and transferred 6 buildings (90,694 sf) to Investment Properties during 2016. A further 31,108 sf remain under development. We expect to begin construction on 2 new regional shopping centres and build new phases in existing developments in 2017.

Division	Assets	Strategy
Community Development	9,901 acres of raw land inventory in strategic growth corridors	Maintain right mix of inventory, available at the right time Increase market share
Property Development	Prospects for over 7 million sf of new development based on existing plans Completed and transferred 90,694 sf in 2016	Develop strong relationships with regional/national/ multinational tenants Ongoing development of high quality retail, business and industrial centres
Investment Properties & REIT	Over 3.95 million sf of commercial property and 612 residential units under management, diversified across 4 asset classes in 3 provinces and 2 states New buildings coming online as Property Development completes projects	Improve existing assets with value-added investments and enhanced quality to achieve higher occupancy rates and increase rent / square foot Be the landlord of choice by providing consistent, high-quality service
Recreational Properties	4 championship golf courses	Maintain strong reputation through consistent course quality and player experience Grow total revenue from food and beverage operations

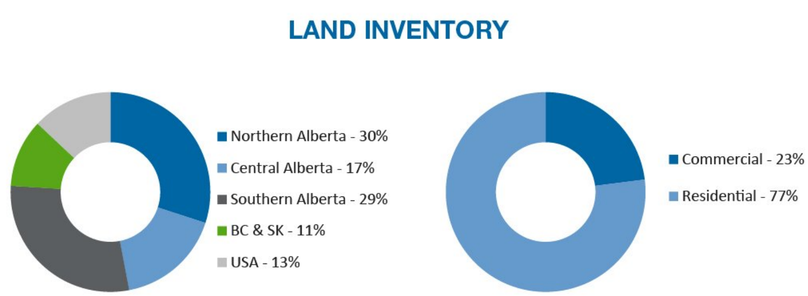
Diversification

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

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

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

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

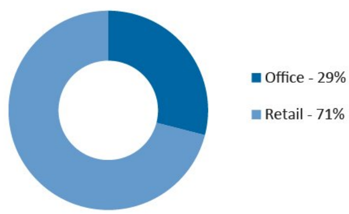


Property Development adds value to raw land by developing retail, office and industrial properties in Alberta.

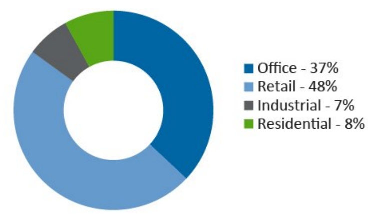
The Property Development division supports Melcor's strategic objectives of asset diversification, income growth and value creation by constructing income-producing developments, primarily on land acquired from the Community Development division. On completion, the properties are transferred to Investment Properties, thus completing a value chain from raw land to annuity income. The properties may also be sold to the REIT, pursuant to a right of first offer, which enables Melcor to monetize the value created while retaining a long-term controlling interest in the asset.

Melcor has been developing commercial properties since the 1970s and has built over 2 million sf. Our future development pipeline is over 7 million sf based on approved development plans.

GLA Under Development

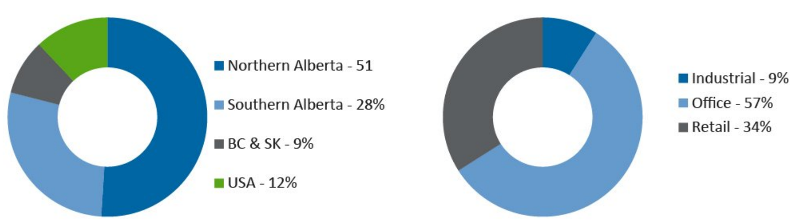


GLA For Future Development



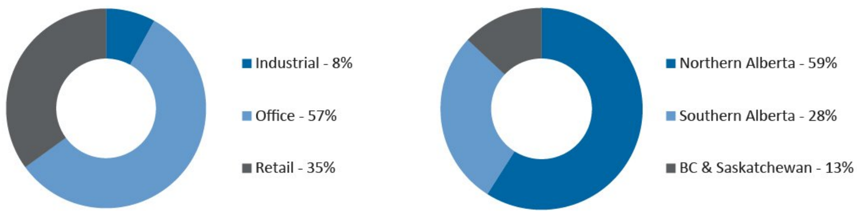
Investment Properties manages our geographically diversified income-producing properties - including those owned by the REIT - to provide consistent annuity income and cash flow. Our total portfolio under management is well diversified across asset class, property mix and region. The regional asset mix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

Total Gross Leasable Area Managed



The REIT owns 2.78 million sf of income-producing assets that are managed by Investment Properties. The REIT is a vehicle for realizing the value created throughout the Melcor value chain as raw land is developed for commercial use (Community Development) and commercial properties are built (Property Development) or redeveloped (Investment Properties) and sold to the REIT. The REIT will continue to seek and execute acquisitions to grow the portfolio, both through the Property Development pipeline and third party acquisitions.

Total Gross Leasable Area Owned by the REIT

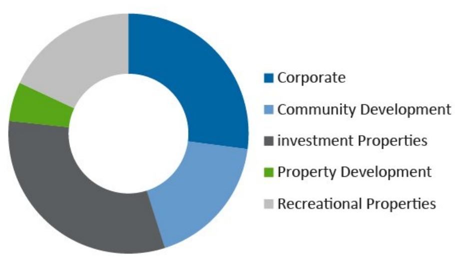


Key Performance Drivers

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 developments, continually moving future projects through the municipal approval process, managing our assets and ensuring tenant satisfaction, and developing strong relationships with our suppliers, contractors, builders, tenants and other stakeholders. The average tenure of our team is 8.5 years and we have 21 team members (13 active) on Melcor's Quarter Century Club.

Employees by Division



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

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

Real Estate Inventory

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

- 9,901 acres of developable land
- 3,953,196 sf of leasable commercial property and 612 residential units under management in 3 provinces and 2 states
- Potential to develop over 7 million sf of new leasable property (based on existing planned development)

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

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

Developed lot inventory

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

	December 31, 2016			December 31, 2015		
(including joint arrangements at 100%)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)
Open	1,433	63.1	144.4	1,144	67.6	139.6
Purchases	—	—	—	—	—	—
New developments	507	22.8	32.1	1,665	29.7	28.0
Internal sales	—	—	(18.8)	—	—	(3.8)
Sales	(958)	(21.3)	(15.4)	(1,376)	(34.2)	(19.4)
	982	64.6	142.3	1,433	63.1	144.4

Single-family lot inventory was 31% lower at the end of 2016 as we scaled back production to maintain no more than one year inventory. Maintaining a maximum of one year of serviced lot inventory is one of our key disciplines for conservative management of our business.

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

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

Land purchases (in acres, net of joint arrangement interests)	2016	2015	Total Land Holdings
Edmonton & Region	39.91	—	2,947
Central Alberta	8.08	146.97	1,653
Calgary & Region	—	—	2,325
Lethbridge	54.35	—	550
British Columbia	—	—	525
Saskatchewan	—	—	616
United States	42.24	—	1,285
	144.58	146.97	9,901

We acquired 144.58 acres of land in strategic growth corridors in 2016 and continue to seek investment opportunities.

Financial Resources

Given the capital-intensive nature of our business, we require access to sufficient capital in order to continue to grow, develop land and take advantage of opportunities to acquire land or property that fit our growth strategy.

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

We also use fixed rate, long-term mortgage financing on our revenue 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. In addition, at the end of 2016, Melcor had project specific financings on three residential community projects totaling $5.21 million.

The REIT is expected to be an important financial resource going forward as it exercises its option to purchase assets developed by our Property Development division, thus monetizing the value of our Investment Property assets. In 2016, the REIT did not acquire any assets from Melcor. As at December 31, 2016, we retained an effective 56.7% ownership of the REIT.

Our operations are supported by a syndicated operating line of credit with total availability of $205.65 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 2016, Melcor is well positioned to take advantage of acquisition and growth opportunities.

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

2016 Highlights

($000s except as noted)	2016	2015	Change
Revenue	**242,461**	263,309	(7.9)%
Gross margin (%) *	**44.7%**	45.8%	(2.4)%
Fair value adjustment on investment properties	**15,795**	9,574	65.0 %
Net income	**34,433**	75,958	(54.7)%
Net margin (%) *	**14.2%**	28.8%	(50.7)%
Funds from operations *	**42,564**	54,271	(21.6)%
Shareholders' equity	**994,721**	977,970	1.7 %
Total assets	**1,891,988**	1,891,969	— %
Per Share Data			
Basic earnings	**1.04**	2.29	(54.6)%
Diluted earnings	**1.04**	2.29	(54.6)%
Funds from operations *	**1.28**	1.64	(22.0)%
Book value *	**29.83**	29.43	1.4 %

* See non-standard measures for definitions and calculations.

While the economic environment remained challenging in many of our Alberta markets in 2016, we achieved solid results and advanced several strategies that position Melcor for future growth and success.

Community Development focused on diversifying residential product types to respond to demand in the more price-sensitive Alberta markets. In addition, we worked closely with our builders to implement promotions to move inventory and create activity.

Property Development completed and transferred 6 buildings (90,694 sf) in 2016 with a further 31,108 sf near completion. Revenue from the Property Development division is eliminated on consolidation. Pre-elimination, total revenue increased 2% over 2015. This activity 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 2 new developments and a new 53,000 sf office building at an existing development breaking ground in spring 2017.

Investment Properties maintained stable occupancy rates and healthy renewals in a challenging market and now manages 3.95 million sf (growth of 12% over 2015).

Our long-term strategy of creating a pipeline of stable, income-producing assets to reduce volatility in our operating results continues to generate results and helped to offset the revenue contraction seen in our Community Development division. Revenue from our income-producing portfolio (including REIT properties) grew by 4% to partially offset the 8% decline in revenue from Community Development due to regional softness in residential real estate. Diversity in the Community Development division's product types (from multi-family to estate) contributed to steady activity in under-served asset classes.

Throughout the year, we maintained our conservative and disciplined approach to investment and development activities and the management of our assets and liabilities. We reduced our inventory of single-family lots in some markets. Lower sales and a focused effort on collections across divisions contributed to a 9.7% reduction in receivables over 2015. Over the past few years, we have focused on operating more efficiently and have reduced our general and administrative spending by $4.01 million or 16.2% since 2014.

We continued to invest in income-producing commercial properties and grew our portfolio of managed properties by 12%:

- We acquired 3 income-producing office buildings in the Greater Denver, Colorado area:
    - a 128,383 sf office for $20.07 million (US$17.03 million).
    - a 95,127 sf office for $13.07 million (US$9.75 million).
    - a 82,659 sf office for $13.22 million (US$10.19 million).
- We disposed of a 240 unit multi-family apartment in the Greater Dallas, Texas area for $38.42 million (US$29.19 million). This disposition completes our exit from the Texas market to better hedge our exposure to resource economies.

We also acquired Northridge Place, a 72 unit, 65,474 sf apartment on 1.63 acres in St. Albert, Alberta for $14.83 million.

We continued to invest in land inventory and increased our land holdings by 144.58 acres in strategic growth corridors. The acquired land is primarily allocated to residential development and includes 42.24 acres acquired in the US. We continue to move land use designations through the municipal approval process to increase our supply of shovel ready assets so that we are ready to capitalize when market demand improves.

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

Return to Shareholders

We continue to distribute profits to our investors. During 2016, we paid annual dividends of $0.48 per share. The dividend paid out in 2016 was reduced over the prior year to ensure the appropriate balance between returning profit to shareholders and conserving cash for investment opportunities and our capital allocation strategy.

We declared a $0.13 per share dividend on March 15, 2017 payable on April 5, 2017 to shareholders of record on March 27, 2017. The dividend is an eligible dividend for Canadian tax purposes.

We have been paying dividends since 1969.

Revenue & Margins

We earned revenue of $242.46 million in 2016 compared to $263.31 million in 2015 for a decrease of 8%. Our long-term strategy of creating a pipeline of stable, income-producing assets to reduce volatility in our operating results continues to generate results and helped to partially offset the revenue contraction seen in our Community Development division. Revenue from our income-producing portfolio (including REIT properties) grew by 4% to partially offset the 8% decline in revenue from Community Development due to regional softness in residential real estate. Transfers from Property Development to Investment Properties, in conjunction with third party acquisitions, contributed to 12% growth in GLA under management. Property Development revenue (up 52%) is eliminated on consolidation.

Gross margin decreased 1% to 45% in 2016. Community Development gross margin was 34% in 2016 compared to 40% in 2015. This decrease was driven by sales promotions designed to proactively drive sales activity and gain market share, primarily in the Edmonton region. Community Development gross margin is affected by a number of factors, including the lot type sold, development costs, the timing of the original land purchase and the relative real-estate market strength at the time of sale. Land that has been in inventory for many years typically generates higher margin on sale. The overall growth in revenue from income properties, with 61% gross margin (Income Properties and REIT combined), serves to neutralize the drag on Community Development margin.

Net margin declined over 2015 at 14%, primarily as a result of fair value adjustments on REIT units. Net income was $34.43 million.

Fair value gains of $15.80 million were recorded in 2016 (2015: $9.57 million) as a result of:

- the transfer of land inventory (measured at cost) to Property Development where it is classified as investment properties on the balance sheet (measured at fair value), resulting in fair value gains of $1.79 million (2015: $1.82 million);
- leasing activity and completion of construction on Property Development projects resulting in fair value gains of $6.13 million (2015: $7.72 million); and

- Increased fair value adjustments in our Investment Properties and REIT divisions, compared to 2015, due to gains in our US residential assets, including the sale of Lakeside 121 where the sale price exceeded the carrying value.

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 earnings items included in income such as fair value adjustments on investment properties and stock based compensation expense.

Below is a reconciliation of net income to FFO:

($000s)	Year Ended	
	2016	2015
Net income for the year	**34,433**	75,958
Amortization of operating lease incentives	**6,344**	6,045
Fair value adjustment on investment properties	**(15,795)**	(9,574)
Depreciation on property and equipment	**1,571**	1,705
Stock based compensation expense	**302**	339
Non-cash financing costs	**1,179**	1,627
Gain on sale of asset	**(37)**	(58)
Deferred income taxes	**628**	3,490
Fair value adjustment on REIT units	**13,939**	(25,261)
FFO *	**42,564**	54,271
Per Share Data		
FFO per share *	**1.28**	1.64

* See non-standard measures for definitions and calculations.

FFO during the year declined to $42.56 million compared to $54.27 million in 2015. FFO was impacted by lower sales in certain regions. Income, excluding fair value adjustments, from income-producing assets (Investment Properties and REIT divisions) grew by 7% compared to 2015 which has helped stabilize overall income. Cost management strategies led to a $2.93 million reduction in G&A, while reductions in our overall leverage resulted in finance cost savings over 2015.

Divisional Results

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

- Community Development, which acquires raw land for future commercial and residential community development;
- Property Development, which develops high-quality retail, office and industrial revenue-producing properties on serviced commercial sites developed by Community Development;
- Investment Properties, which manages and leases the commercial developments produced by the Property Development division and an externally purchased portfolio of assets, as well as assets held in the REIT;
- The REIT, which owns and holds 38 income-producing properties; and
- Recreational Properties, which owns and operates championship golf courses associated with Melcor residential communities.

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

The following tables summarize results of our operating divisions:

	Community Development		Property Development		Investment Properties		REIT		Recreational Properties	
	Year ended December 31		Year ended December 31		Year ended December 31		Year ended December 31		Year ended December 31	
($000s except as noted)	**2016**	**2015**	**2016**	2015	**2016**	2015	**2016**	2015	**2016**	2015
Revenue	**154,201**	167,281	**45,729**	30,068	**35,774**	32,103	**66,042**	65,482	**9,176**	9,665
Portion of total revenue	**50%**	55%	**15%**	10%	**12%**	11%	**21%**	21%	**3%**	3%
Cost of sales	**(102,508)**	(100,193)	**(45,650)**	(29,743)	**(13,994)**	(12,678)	**(25,770)**	(25,613)	**(6,180)**	(6,400)
Gross profit	**51,693**	67,088	**79**	325	**21,780**	19,425	**40,272**	39,869	**2,996**	3,265
Gross margin (%)	**34%**	40%	**—%**	1%	**61%**	61%	**61%**	61%	**33%**	34%
Portion of total gross profit	**44%**	52%	**—%**	—%	**19%**	15%	**34%**	31%	**3%**	3%
General and administrative expense	**(8,537)**	(9,649)	**(1,858)**	(1,621)	**(2,620)**	(3,636)	**(2,653)**	(2,529)	**(2,275)**	(2,294)
Fair value adjustment on investment properties	**—**	—	**6,130**	7,717	**11,449**	2,122	**(6,546)**	(5,418)	**—**	—
Gain on sale of assets	**—**	—	**—**	—	**—**	—	**—**	—	**37**	58
Interest income	**1,119**	2,356	**4**	—	**6**	14	**35**	56	**—**	—
Segment Earnings	**44,275**	59,795	**4,355**	6,421	**30,615**	17,925	**31,108**	31,978	**758**	1,029

Community Development

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

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

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

As at December 31, 2016 we held 9,901 acres of raw land for future development which positions the division well for future growth. Our developed land inventory at December 31, 2016 includes 982 single-family lots, 65 acres for multi-family unit development, and 142 non-residential acres.

Sales Activity

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

The majority of our operations are in Alberta where overall market conditions remained soft in 2016.

The following table summarizes our activity in 2016 and 2015:

Consolidated	2016	2015
Sales data:		
Single-family sales (number of lots)	958	1,376
Gross average revenue per single family lot ($)	142,800	139,000
Multi-family sales (acres)	21.32	34.21
Gross average revenue per multi-family acre ($)	1,274,600	1,019,400
Commercial sales (acres)	18.81	2.9
Gross average revenue per commercial land acre ($)	781,600	793,100
Other land sales - Industrial, Other (acres)	107.22	142.71
Gross average revenue per other land acre ($)	174,700	109,145
Financial results:		
Revenue ($000s)	154,201	167,281
Earnings ($000s)	44,275	59,795

Regional Highlights

Edmonton & Region	2016	2015
Sales data:		
Single-family sales (number of lots)	499	867
Multi-family sales (acres)	15.86	16.81
Commercial sales (acres)	16.70	—
Other land sales - Industrial & Other (acres)	2.75	141.24
Financial results:		
Revenue ($000s)	72,503	100,732
Earnings ($000s)	17,713	34,612

The Edmonton region developed at a slower pace in 2016 with a focus on certain segments that remain under-supplied. The significant trend throughout the year was lower price products including duplexes, townhomes and detached garage homes, which made up the bulk of sales. The communities of Rosenthal and Webber Greens in west Edmonton and all communities in Spruce Grove remained fairly active.

We sold 16.70 acres to Property Development for $13.11 million for the development of Jensen Lakes Crossing, a neighbourhood shopping centre in St. Albert. We also sold two multi-family sites in Jensen Lakes.

The Edmonton region established promotions early in 2016 to move builder inventory and generate activity. These promotions were successful at moving certain product type and have carried over to early 2017. We expect interest in entry level product types to remain strong in 2017 with increasing interest in traditional single-family lots.

Red Deer & Region	2016	2015
Sales data:		
Single-family sales (number of lots)	67	113
Multi-family sales (acres)	—	3.2
Other land sales - Industrial & Other (acres)	90.06	—
Financial results:		
Revenue ($000s)	14,322	15,550
Earnings ($000s)	4,846	8,110

The Red Deer market remained soft in 2016 with a 28% reduction in building permits issued for single-family and semi-detached homes over 2015. In 2015, the number of building permits issued was down 40% over 2014. We increased our share of this market to 65% of the permits issued in 2016. In 2017, we will introduce the new community of Evergreen in northwest Red Deer, opening up a new development quadrant for the city.

Calgary & Region	2016	2015
Sales data:		
Single-family sales (number of lots)	138	280
Multi-family sales (acres)	5.46	8.53
Commercial sales (acres)	2.11	2.90
Other land sales - Industrial & Other (acres)	14.41	1.47
Financial results:		
Revenue($000s)	36,521	34,786
Earnings ($000s)	13,381	13,681

The Calgary housing market remained soft in 2016, resulting in a 51% decline in single-family lots sold as builders carried inventory from prior years. This decline was offset by an increase in acres sold for development, including 2.11 acres sold to Property Development, 5.46 acres sold for 2 multi-family sites in the new Greenwich development, 8.73 acres sold in The District for the construction of single-tenant office building and 5.68 acres sold to an industrial developer.

Efforts to diversify product mix and concentrate on lower priced housing segments paid off in our Cochrane and Airdrie communities. Duplex lots led single-family sales in the current price-sensitive market. We are focused on maintaining an adequate supply of diverse housing options to meet market demand.

We expect similar market conditions in 2017 and continue to focus on lower priced housing options as well as managing inventory levels. We remain focused on planning and approvals for new developments.

In 2016, we received plan approval for Cobblestone, a new community in Airdrie which is scheduled for development in 2018. We also continue to secure approval on phase 2 of Lanark Lake and expect to begin marketing phase 1 in 2018.

Lethbridge	2016	2015
Sales data:		
Single-family sales (number of lots)	90	81
Financial results:		
Revenue ($000s)	9,340	8,146
Earnings ($000s)	2,315	1,935

The Lethbridge market remains insulated from the impact that the price of oil has on some of our Alberta regions. Revenue grew by 15% to $9.34 million compared to $8.15 million in 2015. We sold lots in all three active developments in 2016. We also registered a new phase in The Canyons and held the grand opening of a new phase in Garry Station.

Kelowna	2016	2015
Sales data:		
Single-family sales (number of lots)	39	10
Multi-family sales (acres)	—	5.67
Financial results:		
Revenue ($000s)	13,175	4,570
Earnings/(loss) ($000s)	2,248	(614)

The Kelowna market remained strong in 2016. Revenue in Kelowna grew by 188% over 2015 as the BlueSky subdivision and a multi-family project (Dunbar Villas) continued to build momentum. A new phase of BlueSky will commence in the spring of 2017, and we have purchased adjacent land to expand the development potential of BlueSky by 135 lots. Construction on the first phase of a new development, North Clifton Estates, will also commence this spring. We also continue to move a third development, Thomson Flats, through the planning process.

United States	2016	2015
Sales data:		
Single-family sales (number of lots)	125	25
Financial results:		
Revenue ($000s)	8,340	3,497
Earnings ($000s)	3,772	2,071

The US region sold the remainder of our serviced lot inventory in Arizona and acquired 42 acres of commercial land adjacent to our existing land holding in Aurora, CO. We also advanced approvals on our 1,100 acre development in Aurora, CO. The region continues to actively seek land acquisition opportunities and to advance planning and approvals on existing land assets.

Property Development

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

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

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

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

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

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

Division Highlights

($000s and at JV%, except as noted)	2016	2015
Total revenue	**45,729**	30,068
Revenue from property transfers	**45,650**	26,550
3rd Party property sales	**—**	3,311
Management fees	**79**	207
Margin (%) on property transfers	**27%**	25%
Square footage transferred (sf, at 100%)	**90,694**	51,298
Number of buildings transferred	**6**	5
Fair value gains on investment properties	**6,130**	7,717

Property Development completed and transferred 6 buildings (90,694 sf) to Investment Properties during 2016. A further 31,108 sf remain under development. We plan to begin construction on a further 154,500 sf in the 2017 construction season.

Over the past few years, the Property Development division has been focused on the planning, design and pre-leasing of future Edmonton area projects. As a result of this focus, we are breaking ground on 2 new neighbourhood shopping centres (Jensen Lakes Crossing and The Shoppes at Jagare Ridge) and constructing a second office building (53,000 sf) at The Village at Blackmud Creek in 2017. The division continues to make progress in pre-leasing and planning on future Calgary area projects.

Regional Highlights

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

($000s)	2016	2015
Northern Alberta	**2,822**	2,931
Southern Alberta	**3,308**	4,786
	6,130	7,717

Northern Alberta transferred 70,548 sf (3 buildings) to Investment Properties. Notable activity during 2016 includes:

- Campsite Industrial: We completed and transferred the 15-acre site for the Northern Alberta Institute of Technology (NAIT) in Spruce Grove, Alberta. We recognized $16.25 million in revenue and $4.02 million in margin on transfer (25%) to Investment Properties.
- Telford Industrial: We completed and transferred a multi-tenant building and recognized transfer revenue of $16.60 million and a margin on transfer of $4.33 million (26%). We have now completed three buildings in this industrial park.
- Jensen Lakes Crossing: We announced that Landmark Cinemas Canada will be an anchor tenant at our new neighbourhood shopping centre in St. Albert, Alberta. The deal exemplifies our commitment to unique and quality developments and complements the adjoining residential community that is under development by our land division. Construction is expected to commence in 2017 with tenancy in 2018.

Southern Alberta: This region transferred 20,146 sf to Investment Properties (3 buildings) in 2016, including:

- Kingsview Market: We completed and transferred two CRUs (18,506 sf) at Kingsview Market Square, bringing the total sf developed to date on the property to 181,927 sf.
- The District at North Deerfoot: We completed and transferred a free standing automotive building (1,640 sf) at The District at North Deerfoot. This development is expected to yield 2,250,000 sf on completion.
- Chestermere Station: We commenced construction on 2 buildings (a free standing restaurant and a CRU) in the development. Construction is expected to be completed in 2017.

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

Future development opportunities

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

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

Current Projects					
Project	Location	Type	Total SF *	Developed to Date*	SF Under Development
The Village at Blackmud Creek	South Edmonton	*Regional business park*	725,000	57,381	53,000
Telford Industrial	Leduc	*Industrial Park*	500,000	142,790	—
West Henday Promenade	West Edmonton	*Regional mixed use centre*	726,000	109,711	6,500
Kingsview Market	Airdrie	*Regional shopping centre*	331,000	181,927	—
Chestermere Station	Chestermere	*Neighbourhood shopping centre*	297,416	220,576	20,585
Clearview Market	Red Deer	*Neighbourhood shopping centre*	150,090	139,567	10,523
The District at North Deerfoot	North Calgary	*Regional business / industrial park*	2,250,000	494,359	—
Campsite Industrial	Spruce Grove	*Industrial Park*	170,000	13,654	—
The Shoppes at Jagare Ridge	South Edmonton	*Neighbourhood shopping centre*	105,000	—	28,000
Jensen Lakes Crossing	St. Albert	*Neighbourhood shopping centre*	173,000	—	67,000

Expected Future Projects					
Project	Location	Type	Total SF *	Ownership Interest	Expected Start (year)
The Shoppes at Canyons	Lethbridge	*Neighbourhood shopping centre*	105,000	100%	2019
Greenwich	West Calgary	*Regional mixed use centre*	395,000	100%	2019
Rollyview	Leduc	*Neighbourhood shopping centre*	150,000	100%	2019
Keystone Common	North Calgary	*Regional power centre*	775,000	100%	2022
West Pointe Marketplace	Lethbridge	*Regional power centre*	750,000	100%	2021+
West Calgary Marketplace	West Calgary	*Regional power centre*	800,000	100%	2022+

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

Investment Properties

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

Our Investment Properties division oversees 3.95 million sf of income-producing commercial GLA and 612 residential units.

Our commercial property portfolio is primarily comprised of properties developed and transferred from our Property Development division. Our goal is to improve the operating efficiency of each property for stable and growing cash flows making them attractive assets for the REIT to purchase under its Right of First Offer (ROFO) option. In our management capacity, we are committed to efficient property management for optimized operating costs, occupancy and rental rates, providing the REIT and our joint venture partners with best in class management services. We focus on client retention through continuous customer contact and ongoing service evaluations. We also enhance our portfolio by upgrading the appearance, functionality and desirability of our properties, thereby increasing their rental potential.

Our US properties provide the division with a stable income stream that diversifies our exposure to the western Canadian resource sector. We also own 7 parking lots and other assets which are held for the long-term, providing current stable income and future re-development opportunities.

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

Operating Results

($000s except as noted)	2016	2015
Commercial properties GLA under management (sf, total)	**3,953,196**	3,521,063
Properties owned and managed (sf)	**823,466**	418,279
Properties managed (sf)	**3,129,730**	3,102,784
Revenue (total)	**35,774**	32,103
Commercial properties	**12,439**	9,514
US properties	**17,022**	16,649
Management fees	**4,892**	4,515
Parking lots and other assets	**1,421**	1,425
Net operating income (NOI) *	**20,934**	19,232
Funds from operations *	**19,759**	16,247
Funds from operations per share *	**0.59**	0.49

** 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 commercial properties

We continued to grow via property development and third-party acquisition in 2016. The pace of growth has slowed over the past two years due to softer economic conditions in most of our operating regions. Over the past twelve months, Property Development transferred six buildings, adding 90,694 sf to owned and managed GLA which generated a significant increase in commercial property revenue and NOI over 2015. In 2015, five buildings were transferred from Property Development, adding 51,298 sf of GLA. Approximately 31,629 sf of 2015 building transfers were subsequently sold to the REIT as part of a property sale completed in November 2015. With 154,500 sf of GLA under active development in the Property Development division, we expect continued growth. In October 2016, we acquired Northridge Place Apartments (72 units with a total of 65,474 sf on 1.63 acres) in St. Albert, Alberta for a purchase price of $14.83 million.

Revenue generated on assets acquired from Property Development and held through the period was $4.44 million in 2016 (2015 - $0.58 million). Our newly acquired residential property contributed $0.22 million in revenue in 2016. During 2015 we recognized revenue of $0.63 million related to assets sold to the REIT. Same asset revenue increased by 2% over 2015.

Occupancy on properties owned by Investment Properties was 94% at December 31, 2016 (2015 - 90%) at year end. Stability in occupancy reflects the slower pace of development over the past two years and a larger proportion of the portfolio being comprised of mature properties. Weighted average base rental rates were $26.26 (2015 - $20.14). Higher rates reflect the commencement of our lease with NAIT at our Campsite Business Park which includes a 15 acre site which is not included in GLA.

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

($000s except as noted)	2016	2015
Same asset NOI *	**6,014**	6,003
Third party acquisition	**144**	—
Properties transferred from PD	**3,296**	439
Properties transferred to REIT	**(24)**	464
NOI before adjustments	**9,430**	6,906
Amortization of operating lease incentives	**370**	419
Straight-line rent adjustment	**(873)**	(596)
NOI	**8,927**	6,729

** See non-standard measures for definition.*

Divisional NOI is defined as rental revenue less property operating costs plus amortization of operating lease incentives plus/minus straight-line rent adjustment. Same asset gross margin decreased over 2015 due to re-classification of certain costs related to management of the REIT assets from G&A to operating costs in the current year. Same asset operating expenses were further impacted by an uptick in bad debt expense, primarily in our secondary retail markets. Higher straight-line rent adjustments and lower amortization of operating lease incentives offset higher operating expenses, resulting in stable same asset NOI over 2015.

US properties

We completed three commercial property acquisitions and disposed of a residential property in 2016. We completed two commercial property acquisitions and two residential property dispositions in 2015. Through asset acquisitions and divestitures, we have eliminated our investments in Texas and increased investments in Phoenix and Denver, reflecting our commitment to increasing our US commercial portfolio in regions which hedge our exposure to resource economies. Details of acquisitions and disposals completed through 2016 and 2015 are as follows:

	Date	Type	Area	Price (millions $)
Acquisitions				
Offices at Promenade, Greater Denver Area, Colorado	Feb 2016	Office	128,383 sf / 8.74 ac	$20.07 (US$17.03)
Offices at Inverness, Greater Denver Area, Colorado	Mar 2016	Office	95,127 sf / 6.85 ac	$13.07 (US$9.75)
Syracuse Hill One, Greater Denver Area, Colorado	Mar 2016	Office	82,659 sf / 4.56 ac	$13.22 (US$10.19)
Evans Business Center, Greater Phoenix Area, Arizona	Sept 2015	Office	47,385 sf / 4.55 ac	$8.47 (US$6.43)
Centennial Airport Plaza, Denver, Colorado	Apr 2015	Office	63,112 sf / 4.59 ac	$6.14 (US$4.88)
Dispositions				
Lakeside 121, Greater Dallas Area, Texas	Dec 2016	multi-residential	240 units / 11.01 ac	$38.42 (US$29.19)
Augusta Meadows, Greater Houston Area, Texas	Dec 2015	multi-residential	264 units / 13.19 ac	$37.52 (US$26.86)
Artesia, Greater Phoenix Area, Arizona	Oct 2015	single residential	1 unit	$0.90 (US$0.70)
Pebble Creek, Greater Houston Area, Texas	July 2015	multi-residential	240 units / 11.47 ac	$42.73 (US$32.38)

Revenue increased 2% over 2015, primarily due to the stronger US dollar contributing to foreign currency translation gains. 2016 revenue growth was tempered by the timing lag between the sale of residential assets in 2015 and the reinvestment of funds in 2016. Revenues from residential assets sold over the past two years was $3.51 million (US$2.65 million) (2015 - $10.23 million (US $8.03 million)). Comparatively, revenue from newly acquired commercial assets in 2016 was $8.00 million (US$6.05 million) (2015 - $1.08 million (US$0.85 million)). Same asset revenue was steady over 2015.

Occupancy on commercial US properties was 89% (2015 - 93%). This decrease is due to a tenant rollover at one of our Phoenix area properties which was acquired in 2014. Rental rates on commercial US properties were $17.83 (2015 - $18.46). The decrease in rental rates is due to acquisitions of properties which operate in a lower rental rate markets.

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

($000s except as noted)	2016	2015
Same asset NOI *	**1,769**	1,809
Third party acquisitions	**3,041**	388
Third party disposals	**1,265**	3,952
NOI before adjustments	**6,075**	6,149
Foreign currency translation	**1,835**	1,684
Amortization of operating lease incentives	**223**	24
Straight-line rent adjustment	**(566)**	(40)
NOI	**7,567**	7,817

** See non-standard measures for definition.*

Divisional NOI is defined as rental revenue less property operating costs plus amortization of operating lease incentives plus/minus straight-line rent adjustment. Same asset NOI declined 2% over 2015 due to lower occupancy on our commercial assets in conjunction with the timing of maintenance projects undertaken on our residential assets.

Management fees

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 increased by $0.38 million or 8% compared to 2015. Growth in management fees is due to additional fees negotiated with our partners on two of our JV agreements in order to align the fee structure with other management agreements and fairly compensate Melcor for administration of the assets. The agreements were amended retroactively, resulting in higher than normal income. The increase in GLA under management and higher fees on account of increased property revenues offset a decline in leasing fees, which fluctuate based on the timing of leasing activity by the REIT.

During 2016 we recognized $1.42 million in revenues on our 516 parking stalls and other assets, which is consistent with 2015. These revenues fluctuate from period to period.

Funds from Operations

Funds from operations (FFO) increased by $3.51 million or 22% over 2015 as a result of higher NOI and lower G&A. G&A costs were lower than 2015 due to the re-classification of certain costs related to management of the REIT assets from G&A to operating costs in the current year. G&A was further reduced by lower expense related to payments made to the REIT under Head and Bridge Lease Agreements entered into for property acquisitions from Investment Properties completed during December 2014. These amounts are eliminated on consolidation.

Fair Value of Investment Portfolio

	2016	2015
Fair value of portfolio ($000s)	**317,790**	233,844
Weighted average capitalization rate	**6.37%**	6.38%
Weighted average terminal cap rate	**6.71%**	6.72%
Weighted average discount rate	**7.44%**	7.25%

The fair value of our portfolio increased by $83.95 million over 2015 as a result of four asset acquisitions valued at $64.19 million in third party property acquisitions and $44.97 million in buildings transferred from Property Development. Portfolio growth was offset by US residential asset disposals valued at $38.96 million.

For the year ended December 31, 2016, Melcor's internal valuation team performed the valuation assessment. Of 35 legal phases assessed, 23 investment properties with a fair value of $143.31 million were valued by qualified independent external valuation professionals during the year. In 2015, 10 investment properties of 29 legal phases with a fair value of $142.55 million were valued by qualified independent external valuation professionals during the year.

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

($000s)	2016	2015
Alberta - all assets	**(5,030)**	(9,945)
US - residential	**20,269**	12,892
US - commercial	**(3,790)**	(825)
	11,449	2,122

We recognized fair value losses on our commercial portfolio as a result of the decrease in stabilized NOI on certain assets in conjunction with capital and tenant spending which did not result in a significant increase in fair value. Losses were offset by gains in our US residential assets, which were the result of a decline in capitalization rates on our Phoenix area assets as well as the sale of Lakeside 121 where the sale price exceeded the carrying value. Fair value gains in 2015 were driven from asset dispositions completed during the year where the sale price exceeded carrying value. These gains were offset by fair value losses on our commercial assets as a result of the decrease in stabilized NOI, increase in capitalization rates and capital and tenant spending which did not result in a significant increase in fair value. Refer to note 29 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

REIT

The REIT owned 38 income-producing office, retail and industrial properties, comprising 2,775,782 sf GLA and a land lease community at December 31, 2016. 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 hold a controlling 56.7% effective interest in the REIT through ownership of all Class B LP Units (December 31, 2015 - 56.7%). As we have concluded that Melcor retains control of the REIT we consolidate 100% of the REIT's revenues, expenses, assets and liabilities.

Operating results

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

($000s except as noted)	2016	2015
Rental revenue	**66,042**	65,482
Net operating income (NOI) *	**42,329**	41,313
Same asset NOI *(see calculation following)*	**38,980**	39,696
Fair value adjustments	**(6,546)**	(5,418)
Occupancy	**92%**	94%
Funds from operations *	**26,668**	26,345
Funds from operations per share *	**0.80**	0.79

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

Rental revenue for the year ended December 31, 2016 increased $0.56 million or 1% over 2015 as a result of portfolio growth of 39,464 sf. We acquired additional phases at two existing properties in late 2015 and densified existing retail properties with two newly constructed CRUs. Rental revenue from the newly acquired/constructed GLA was $1.58 million in 2016 (2015 - $0.23 million). On a same-asset basis, base rent was stable with an increase in average base rent as rent-steps on escalating leases kicked in and there were fewer tenants on rent-free periods, which offset the slight decline in occupancy.

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 2016 we retained and renewed 66 of 88 of expiring tenancies representing 168,407 sf of GLA. Our 71% retention rate is healthy in light of challenging market conditions in many of our markets; however fell short of our target of 75%. We took back an additional 53,795 sf of GLA due to early terminations (both tenant and landlord initiated) during the year which further impacted occupancy. Additional vacancy from lease rollovers was partially mitigated with 88,538 sf in new leasing completed during the year.

Direct operating expenses increased by $0.16 million or 1% over 2015. Excluding the impact of the newly acquired/constructed GLA, direct operating expenses were steady over 2015. On a same-asset basis, property taxes increased 4% over 2015 as a result of recently constructed suburban retail properties converting from land based valuation to income based taxation. These increases were offset by a 9% reduction in utility costs as a result of lower energy consumption combined with cost savings on utility contracts and several 'green' initiatives'. Mill rates and appraised values across the rest of the portfolio remained relatively stable over 2015. On a same-asset basis, operating expenses were stable over 2015 and reflect inflationary growth in the cost of goods and services, offset by various initiatives to reduce costs so as to improve our competitiveness within the market.

($000s except as noted)	2016	2015
Same asset NOI *	**38,980**	39,696
Acquisitions	**1,292**	173
NOI before adjustments	**40,272**	39,869
Amortization of operating lease incentives	**3,216**	3,057
Straight-line rent adjustment	**(1,159)**	(1,613)
Divisional NOI	**42,329**	41,313

** See non-standard measures for definition.*

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 net income.

GLA added in the property acquisition completed in November 2015 and new construction in 2015 and 2016 led to a 2% increase in NOI over 2015. The slight decline in occupancy was offset by rent steps-ups and fewer tenants on rent-free periods over the comparative period. On a same-asset basis, NOI declined by 2% as a result of negative movement in non-cash adjustments with lower straight-line rent adjustments and higher tenant incentive amortization.

Funds from Operations

FFO increased by $0.32 million or 1% over 2015. The increase reflects higher NOI, which was partially offset by higher general and administrative expenses during the period.

Fair Value of REIT Portfolio

	2016	2015
Number of properties	**38**	38
Total GLA (sf)	**2,895,306**	2,888,246
GLA (REIT owned %) (sf)	**2,775,782**	2,768,750
Fair value of portfolio ($000s)	**659,611**	660,935
Weighted average capitalization rate	**6.63%**	6.57%
Weighted average terminal cap rate	**6.83%**	6.81%
Weighted average discount rate	**7.70%**	7.71%

For the year ended December 31, 2016, Melcor's internal valuation team performed the valuation assessment. Of 47 legal phases assessed, 22 investment properties with a fair value of $287.00 million were valued by qualified independent external valuation professionals during the year, resulting in a fair value loss of $6.55 million recorded on investment properties in the statements of income and comprehensive income. In 2015, 27 properties of 47 legal phases with a fair value of $443.75 million were valued by external valuation professionals, resulting in a fair value loss of $5.42 million. Refer to note 29 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

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

($000s)	2016	2015
Northern Alberta	**(3,773)**	(8,253)
Southern Alberta	**(3,322)**	1,833
Saskatchewan & British Columbia	**549**	1,002
	(6,546)	(5,418)

Fair value losses in Northern Alberta were primarily driven by capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. This was partially offset by fair value gains realized upon completion of construction of a 7,732 sf CRU at a regional shopping centre. Capitalization rates and stabilized NOI remained stable over 2015 within our Northern Alberta portfolio. Fair value losses in our Southern Alberta portfolio was the result of a decrease in stabilized NOI on one of our suburban office properties in the greater Calgary area. Fair value adjustments represent a change of approximately 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)	2016	2015
Revenue	9,176	9,665
Gross profit	2,996	3,265
Gross margin (%)	32.7%	33.8%
Earnings	758	1,029

The financial performance of our golf courses is greatly influenced by the weather conditions during the golf season. Unfavourable weather conditions in Alberta throughout much of the season contributed to a 5% decrease in revenue and 26% decrease in earnings in 2016. The number of rounds played at Melcor managed courses decreased by 1% over 2015, with Black Mountain in Kelowna offsetting a 7% reduction in rounds played at the Alberta courses. Total rounds at all four courses decreased 3% to 116,681 rounds.

We continue to focus on food and beverage initiatives as part of our strategy for attracting tournaments and growing revenue. Food and beverage revenue was $2.98 million, unchanged from 2015.

		2016		
	Ownership interest	Season opened	Season closed	Rounds of golf *
Managed by Melcor:				
Lewis Estates (Edmonton)	60%	March 31	November 14	33,442
The Links (Spruce Grove)	100%	April 1	November 14	26,727
Black Mountain (Kelowna)	100%	March 11	November 15	33,002
Managed by a Third Party:				
Jagare Ridge (Edmonton)	50%	April 8	October 6	23,510
		2015		
	Ownership interest	Season opened	Season closed	Rounds of golf *
Managed by Melcor:				
Lewis Estates (Edmonton)	60%	April 20	October 31	35,131
The Links (Spruce Grove)	100%	April 19	October 31	29,032
Black Mountain (Kelowna)	100%	March 28	November 8	30,042
Managed by a Third Party:				
Jagare Ridge (Edmonton)	50%	April 30	October 18	25,715

** Rounds of golf indicated at 100%.*

General and Administrative Expense

Cost management strategies implemented across Melcor contributed to a $2.93 million decrease in general and administrative expenses over 2015.

Income Tax Expense

The statutory tax rate for the year ended December 31, 2016 is 27% compared to 26% for the year ended December 31, 2015. Significant adjustments that impacted the 2016 effective tax rate includes permanent difference related to revaluation adjustments on investment properties and REIT units and a higher tax rate for income earned in our US subsidiary. The adjustments are offset by the non-taxable portion of REIT income. In 2015, significant adjustments included a 3% increase in the statutory tax rate that affected our deferred tax liability, permanent differences related to revaluation adjustments on investment properties and REIT units, a higher tax rate for income earned in our US subsidiary and the non-taxable portion of REIT income.

Financing

As at December 31, 2016, our total general debt outstanding was $608.61 million compared to $631.01 million in 2015. The financing function is managed by our corporate division and decisions on how to deploy operating and acquisitions funds is a centrally managed corporate decision. We use various forms of financing to fund our development and acquisition activities. We are often able to leverage the assets in one division to fund development opportunities in others.

A summary of our debt is as follows:

As at ($000s)		**2016**	**2015**
Melcor - revolving credit facilities	a	**32,728**	84,813
REIT - revolving credit facility	b	**17,324**	19,258
Project specific financing	c	**5,213**	25,280
Secured vendor take back debt on land inventory	d	**65,408**	76,092
Debt on investment properties and golf course assets	e	**455,189**	393,319
REIT - convertible debenture	f	**32,749**	32,246
		608,611	631,008

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 the community development assets of the company.

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

Under the terms of the facilities, Melcor pledges specific agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral. The facilities mature on July 31, 2018, are renewable one year in advance of expiry and may be modified.

A summary of the credit facilities is as follows:

As at ($000s)		**2016**	**2015**
Credit limit approved	i)	**205,649**	213,949
Supportable credit limit	ii)	**163,892**	188,825
Credit used		**(32,728)**	(84,813)
Credit available		**131,164**	104,012

i) The portion of these loan limits that relate solely to Melcor Developments Ltd. is $120.00 million (2015 - $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)	2016	2015
Total letter of credit facility	72,358	75,185
Letters of credit issued	(39,425)	(47,347)
Available for issue	32,933	27,838

b) REIT - revolving credit facility

The REIT has an available credit limit based upon the carrying values of specific investment properties up to a maximum of $35,000 for general purposes, including a $5,000 swingline sub-facility. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. The facility matures on May 1, 2018, with an extension option of up to three years at the discretion of the lenders.

As at December 31, 2016 we had $17,324 drawn from the facility, and posted letters of credit of $nil, which is presented net of unamortized transaction costs and discounts on outstanding bankers acceptance.

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)	2016	2015
Project specific debt on investment properties under development, with interest rates at nil (2015 - 3.20%)	—	11,850
Project specific debt on land, with interest rates between 3.20% and 4.08% (2015 - 3.20% to 4.20%)	5,213	13,430
	5,213	25,280
Weighted average effective interest rate	3.63%	3.24%

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 2017 to 2021.

As at ($000s)	2016	2015
Agreements payable with interest at the following contractual rates:		
Fixed rates of 3.00% - 6.00% (2015 - 3.85% to 6.00%)	65,408	76,092
Weighted average effective interest rate	4.56%	4.68%

As at December 31, 2016 $13.50 million of debt was payable in US dollars (2015 - $15.64 million) of debt was payable in US dollars.

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 $455.19 million reflects financing placed on investment properties that have a carrying value of $870.86 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 2.48% to 3.60% in 2016.

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

As at ($000s)	**2016**	**2015**
Canadian mortgages at fixed rates	**348,021**	305,836
Canadian mortgages at variable rates	**52,033**	41,964
US mortgages at fixed rates	**48,763**	17,552
US mortgages at variable rates	**8,660**	29,550
	457,477	394,902
Interest rate ranges	**(2.48% - 6.16%)**	(2.48% - 6.16%)
Weighted average effective interest rate	**3.54%**	3.76%

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
2017	15,037	3.42%	6
2018	65,520	4.04%	11
2019	77,179	3.44%	10
2020	51,617	3.38%	8
2021	56,333	2.94%	8
2022	—	—%	—
2023	15,936	4.00%	2
2024	34,359	3.73%	4
2025	27,155	3.64%	6
2026	34,096	3.61%	5

As at December 31, 2016, $57.42 million of debt was payable in US dollars (2015: $47.10 million).

f) REIT - convertible debenture

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

The REIT debenture was 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, 2016, compared to December 31, 2015.

As at ($000s except as noted)	**2016**	**2015**
Cash & cash equivalents	**39,892**	48,674
Restricted cash	**—**	2,288
Accounts receivable	**16,918**	18,744
Agreements receivable	**116,244**	152,183
Revolving credit facilities	**50,052**	104,071
Accounts payable and accrued liabilities	**35,274**	40,534
Total assets	**1,891,988**	1,891,969
Total liabilities	**897,267**	913,999
Debt to equity ratio *	**0.90**	0.93

**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, 2015, we sold the REIT a multi-tenant CRU (held within a 50% joint venture) and a single-tenant industrial property for a purchase price of $15.25 million. The purchase price was satisfied through the REIT's line of credit and available cash.

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:

		Payments due by period			
	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Debt on investment properties and golf course assets	457,477	29,729	169,843	127,641	130,264
Revolving credit facilities	50,052	50,052	—	—	—
Secured vendor take back debt on land inventory	65,408	15,627	31,927	17,854	—
Project specific financing	5,213	5,213	—	—	—
REIT debenture	32,749	—	32,749	—	—
Interest expense	82,219	23,107	33,526	13,066	12,520
Operating leases	271	271	—	—	—
Total contractual obligations	693,389	123,999	268,045	158,561	142,784

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:

	2016	2015
Cash flows from operating activities	**68,997**	30,536
Cash flows used in investing activities	**(15,299)**	33,299
Cash flows from financing activities	**(61,363)**	(34,619)

Cash from operations was $38.46 million higher in 2016 due primarily to the collection of agreements receivable in the Community Development division. The impact of lower sales is offset by cash inflows of $15.01 million arising from net development activities and a reduction of cash outflows from operating assets and liabilities to $4.93 million . We also invested $9.75 million in land purchases and $6.36 million in tenant incentives and direct leasing costs to support our tenant base.

In 2015, land purchases was $2.50 million and our investment in tenant incentives and direct leasing costs was $6.80 million. Net outflows from development activities was $4.79 million and operating assets and liabilities was $23.35 million.

Cash used in investing activities was $15.30 million. We acquired three suburban properties in the US and one multi-family residential property in Alberta for cash payments of $38.72 million and sold a residential property and residential units in the US for net proceeds of $38.96 million. Investment properties purchased was $18.62 million and proceeds from properties sold was $84.24 million in 2015.

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 2016 we invested $14.77 million in properties under development, property improvements and capitalized borrowing costs, compared with $31.25 million in 2015.

Cash from financing activities decreased by $26.74 million over 2015 due primarily to repayments made on borrowings. In 2016, the revolving credit facilities made net repayments of $54.02 million compared to a net draw of $17.56 million in 2015. General debt contributed to a net cash inflow of $5,608 million through financings received and repayments made, compared to a net cash outflow of $33,429 million in 2015. We also recognized $1.25 million in cash inflows related to the expiration of our restricted cash covenant in the REIT with the underwriters, thus allowing us to use the remaining balance for general purposes.

In 2016, we paid dividends of $0.48 per share, for a total cash outflow of $15.97 million. This compares to dividends of $0.60 per share in 2015, for a cash outflow of $19.91 million.

Share Data

Melcor has been a public company since 1968 and trades under the symbol “MRD” on the Toronto Stock Exchange. As at December 31, 2016 there were 33,350,898 common shares issued and outstanding and 795,700 options, each convertible to one common share upon exercise or exchange. There is only one class of shares issued.

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

Off Balance Sheet Arrangements

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

A discussion of our letter of credit facility arrangement can be found in the Financing section. Refer to note 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.

	2016				2015			
($000s)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	106,391	63,432	42,084	30,554	91,721	87,921	46,113	37,554
Net income	24,109	16,260	1,778	(7,714)	32,658	24,823	3,917	14,560
Per Share								
Basic earnings	0.73	0.49	0.05	(0.23)	0.98	0.75	0.12	0.44
Diluted earnings	0.73	0.49	0.05	(0.23)	0.99	0.74	0.12	0.44
Book value *	29.83	29.19	28.80	28.86	29.43	28.47	27.67	27.76

**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)	2016	2015
Revenue	**106,391**	91,721
Cost of sales	**(63,333)**	(45,936)
Gross profit	**43,058**	45,785
General and administrative expense	**(6,083)**	(7,136)
Fair value adjustment on investment properties	**208**	2,767
Adjustments related to REIT units	**461**	6,369
Gain on sale of assets	**(1)**	—
Operating earnings	**37,643**	47,785
Interest income	**340**	344
Foreign exchange gains (loss)	**(412)**	1,008
Finance costs	**(3,375)**	(9,084)
Net finance costs	**(3,447)**	(7,732)
Income before income taxes	**34,196**	40,053
Income tax expense	**(10,087)**	(7,395)
Net income for the period	**24,109**	32,658
Earnings per share attributable to Melcor's shareholders:		
Basic earnings per share	**0.73**	0.98
Diluted earnings per share	**0.73**	0.99

Highlights of the fourth quarter include:

- Our Property Development division completed and transferred 1 building (44,000 sf) to Investment Properties.
- Our Community Development division registered 9 plans in 6 communities, which added 381 lots to inventory with 616 lots sold in Q4-2016. This compares to 18 plan registrations in 10 communities adding 582 lots to inventory with 517 lots sold in Q4-2015.
- Our Investment Properties division sold Lakeside 121, a 240 unit residential rental property in the Greater Dallas area (Texas) for $38.42 million (US $29.19 million). This sale completes our strategic exit from the Texas market as we focus on markets that hedge our exposure to resource economies.
- Our Investment Properties division also acquired Northridge Place Apartments (72 units with a total of 65,474 sf on 1.63 acres) in St. Albert, Alberta for a purchase price of $14.83 million. This acquisition is consistent with our strategy of diversifying our assets.

Segmented information for the fourth quarter is as follows:

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

Three months ended December 31, 2015	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	72,887	5,367	7,869	16,963	835	—	103,921	(12,200)	91,721
Cost of sales	(37,794)	(5,385)	(3,879)	(6,824)	(1,168)	(148)	(55,198)	9,262	(45,936)
Gross profit	35,093	(18)	3,990	10,139	(333)	(148)	48,723	(2,938)	45,785
General and administrative expense	(2,750)	(518)	(971)	(697)	(429)	(2,488)	(7,853)	717	(7,136)
Fair value adjustment on investment properties	—	(1,485)	127	1,904	—	—	546	2,221	2,767
Gain on sale of assets	—	—	—	—	—	—	—	—	—
Interest income	331	—	3	10	—	—	344	—	344
Segment Earnings	32,674	(2,021)	3,149	11,356	(762)	(2,636)	41,760	—	41,760
Foreign exchange gains									1,008
Finance costs									(9,084)
Adjustments related to REIT units									6,369
Income before income taxes									40,053
Income tax expense									(7,395)
Net income for the period									32,658

Outlook

We own a high quality portfolio of assets, including raw land, developed land inventory (including 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 in economic outlook over the past few years as a result of lower oil prices. Despite these clear economic headwinds, we continue to execute on our strategic plan and achieved solid results in 2016. Diversification of both asset class and geography continues to ease the challenges of the Alberta economy.

We expect variations in market demand based on region and asset class to continue in 2017. On the residential side, we expect starter homes and lower priced options including duplexes and townhomes to continue to lead the market. We also expect Kelowna and Lethbridge to remain unaffected by the pressures of our other markets. On the commercial side, retail activity remains steady and we expect that trend to continue. Our US assets continue to deliver positive returns and we again expanded our commercial asset base via opportunistic buys in economies that are growing and that are counter cyclical to our resource dependence in Alberta.

Our business model has adapted to changing times for over 90 years. We will continue to take advantage of opportunities to diversify our asset base both geographically and by product type. We will maintain our disciplined, conservative approach to operations to ensure that we remain profitable while achieving our fundamental goals of protecting shareholder investment and sharing corporate profit with our shareholders.

With appropriate levels of serviced land inventory, high occupancy rates and large capacity on our operating facility, Melcor remains in an excellent position to take advantage of opportunities that may arise in a challenging real estate market.

Interest in the REIT

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

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

As of March 15, 2017, Melcor holds an approximate 56.7% (December 31, 2015 - 56.7%) effective interest in the REIT through ownership of all Class B LP units of the partnership through an affiliate and a corresponding number of special voting units of the REIT. The Class B LP units are economically equivalent to, and are exchangeable for, trust units. Melcor is the ultimate controlling party.

As we retain control over the REIT, we consolidate the REIT and record 100% of its revenues, expenses, assets and liabilities. We reflect the public's 43.3% (December 31, 2015 - 43.3%) interest 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 3.00% of gross property revenue;

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

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

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

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

Business Environment & Risks

A discussion of credit risk, liquidity risk and market risk can be found in note 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 rebalance 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 may enter into financing commitments in the normal course of business and, as a result, may be required to fund these, particularly through joint arrangements. If we are unable to fulfill any of these commitments, damages could be pursued against Melcor.

Community Development

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

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

Property Development

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

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

Investment Properties and REIT

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

Recreational Properties

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

While weather is outside our control, we manage our golf courses to provide consistent playing conditions to support the popularity of our courses.

Other Financial Information

Normal Course Issuer Bid

We announced a Normal Course Issuer Bid on March 27, 2015 which expired March 30, 2016. Under this bid, we were allowed to purchase up to 1,653,451 common shares (5% of issued and outstanding) with a daily repurchase restriction of 3,057 common shares.

On March 29, 2016 we announced a new Normal Course Issuer bid commencing March 31, 2016 and ending March 30, 2017. Under the bid, we may acquire up to 1,661,810 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,433 common shares.

During 2016, we repurchased 12,231 shares which were canceled and returned to treasury (2015 - 16,428 common shares were purchased, canceled and returned to treasury).

Critical Accounting Estimates

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

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

Changes in Accounting Policies and Adoption of IFRS

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

Subsequent Events

Please refer to note 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.

Joint arrangement activity at 100% ($000s)	2016	2015
Revenue	**139,282**	226,230
Earnings	**39,771**	16,923
Assets	**859,830**	997,312
Liabilities	**310,568**	404,090

*Joint arrangement activity at Melcor's ownership % ($000s) **	2016	2015
Revenue	**62,224**	103,466
Earnings	**18,881**	17,478
Assets	**401,410**	437,059
Liabilities	**140,399**	169,731

** 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, 2016. 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, 2016.

There has been no change to Melcor's disclosure controls and procedures or internal control over financial reporting during the year ended December 31, 2016, that materially affected, or is reasonably likely to materially affect, Melcor's internal control over financial reporting.

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

Non-standard Measures

Throughout this MD&A, we refer to terms that are not specifically defined in the CICA Handbook and do not have any standardized meaning prescribed by IFRS. These non-standard measures may not be comparable to similar measures presented by other companies.

We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results.

The non-standard terms that we refer to in this MD&A are defined below.

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

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

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

Adjusted earnings attributable to Melcor's shareholders ("adjusted earnings"): this measure is calculated as earnings adjusted for the following: adjustments related to REIT units; management fees earned from the REIT; and unitholders' portion of earnings of the REIT.

Adjusted EPS and Adjusted diluted EPS: this measure is calculated as adjusted earnings attributable to Melcor's shareholders per basic and diluted weighted average shares outstanding.

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	
	2016	2015
Segment earnings	**30,615**	17,925
Fair value adjustment on investment properties	**(11,449)**	(2,122)
General and administrative expenses	**2,620**	3,636
Interest income	**(6)**	(14)
Amortization of operating lease incentives	**593**	444
Straight-line rent adjustments	**(1,439)**	(637)
Divisional NOI	**20,934**	19,232

REIT

($000s)	Year Ended	
	2016	2015
Segment earnings	**31,108**	31,978
Fair value adjustment on investment properties	**6,546**	5,418
General and administrative expenses	**2,653**	2,529
Interest income	**(35)**	(56)
Amortization of operating lease incentives	**3,216**	3,057
Straight-line rent adjustments	**(1,159)**	(1,613)
Divisional NOI	**42,329**	41,313

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	
	2016	2015
Net income for the year	**34,433**	75,958
Amortization of operating lease incentives	**6,344**	6,045
Fair value adjustment on investment properties	**(15,795)**	(9,574)
Depreciation on property and equipment	**1,571**	1,705
Stock based compensation expense	**302**	339
Non-cash financing costs	**1,179**	1,627
Gain on sale of asset	**(37)**	(58)
Deferred income taxes	**628**	3,490
Fair value adjustment on REIT units	**13,939**	(25,261)
FFO *	**42,564**	54,271

Investment Properties

($000s)	Year Ended	
	2016	2015
Divisional income for the year	**30,615**	17,925
Fair value adjustment on investment properties	**(11,449)**	(2,122)
Amortization of operating lease incentives	**593**	444
Divisional FFO	**19,759**	16,247

REIT

($000s)	Year Ended	
	2016	2015
Divisional income for the year	**31,108**	31,978
Fair value adjustment on investment properties	**6,546**	5,418
Amortization of operating lease incentives	**3,216**	3,057
Divisional FFO	**40,870**	40,453

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

Adjusted earnings attributable to Melcor's shareholders (adjusted earnings): (net income attributable to Melcor's shareholders) +/- (adjustments related to REIT units) + (management fees earned from the REIT) +/- (unitholders' portion of earnings of the REIT)

Adjusted basic EPS and Adjusted diluted EPS: (adjusted earnings attributable to Melcor's shareholders) / (basic/diluted weighted average number of common shares outstanding)