MANAGEMENT'S DISCUSSION & ANALYSIS

March 13, 2019

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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, 2018.

The financial statements underlying this MD&A, including 2017 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 13, 2019.

OTHER INFORMATION

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

NON-STANDARD MEASURES

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

FORWARD-LOOKING STATEMENTS

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

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

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent Melcor's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Forward-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2019 and beyond, future development plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

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

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

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 95 years, our focus has been the business of real estate. We've built over 140 communities across western Canada since the 1950s and have helped to shape much of Alberta's landscape. We manage 4.13 million square feet (sf) in commercial real estate assets and 609 residential rental units. We are celebrating our 50th year as a public company (TSX:MRD).

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

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

- acquiring raw land and planning residential communities and commercial developments (Community Development)
- project managing development, leasing and construction of commercial properties (Property Development)
- operating a portfolio of commercial and residential properties, focused on property improvements and capital appreciation of owned properties and property management of REIT owned properties (Investment Properties)
- acquiring and owning high quality office, retail, industrial and residential assets (Melcor Real Estate Investment Trust or the REIT, formed May 1, 2013 through an IPO. We retain a controlling 53.0% effective interest in the REIT and continue to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement.)

In addition, we own and operate championship golf courses associated with our residential communities in our fifth division, Recreation Properties. Melcor has $2.02 billion in assets.

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

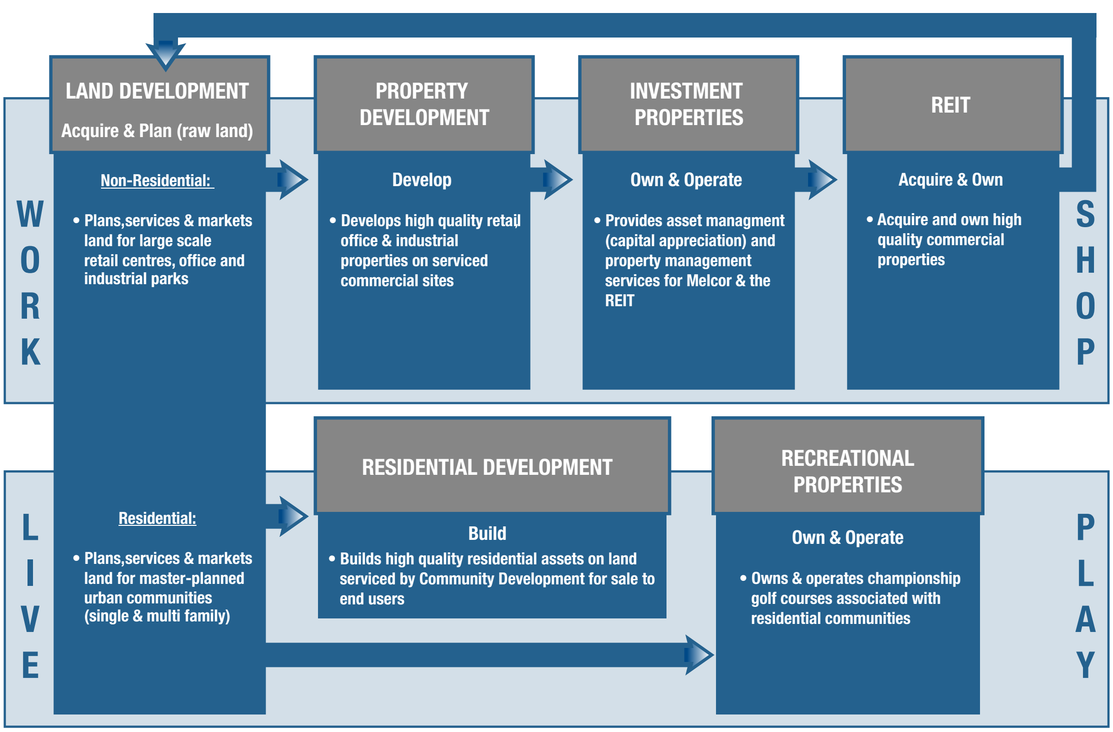
In addition to extending the value of our asset base, these diversified operating divisions enable us to manage our business through real estate cycles (both general market conditions and the seasonality associated with construction and development) and diversify our revenue base.

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

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

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

The sections titled OUR BUSINESS & STRATEGY contain forward-looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to Forward- looking Statements on page 9.



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

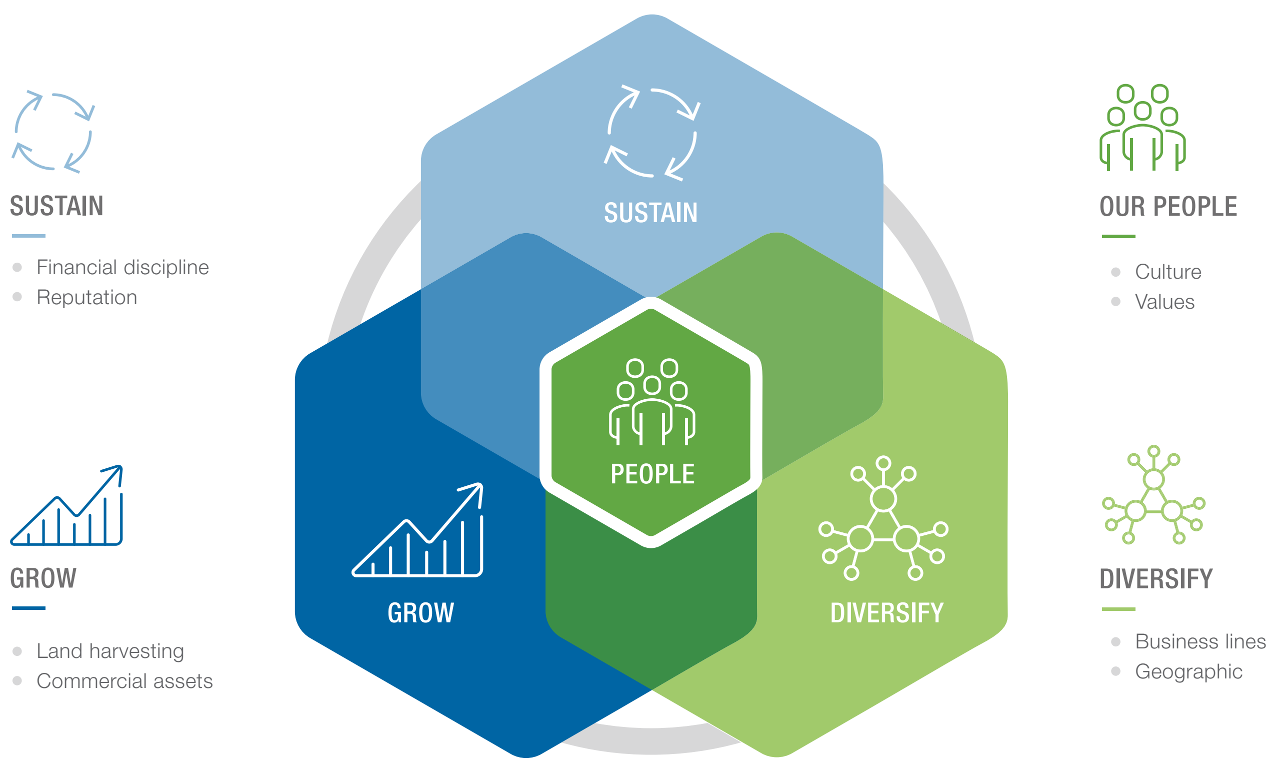
Our operating focus is to deliver high quality products and industry-leading value in each of our divisions: developing master-planned communities, constructing and leasing business parks, managing our income-producing portfolio and operating championship golf courses.

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

In 2018, we remained cautious about developing residential lots in Canada and focused on selling lots early in the year and reducing overall lot inventory. Commercial property development progressed as pre-leasing thresholds were met. Throughout the past few years, we have shifted the product type in our residential developments to meet changes in market demand. Our diversification strategies, which include both revenue type diversification and geographic diversification, served to offset the softness in Canadian residential development. Our commercial property divisions now manage 4.13 million sf of income-generating assets, which tend to be more stable throughout the year. With the development of our first new community in the US in many years as well as strategic finished lot purchases and sales, the US sold 30% of our single-family lots in 2018.

We have 95 years of experience in Alberta's cyclical economy. Throughout this time, we have managed through many downturns and have learned to not only weather the cycle, but to make our business stronger by recognizing and taking advantage of opportunities while balancing our risk and exposure.

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



ASSETS

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

DIVISION	ASSETS	STRATEGY
COMMUNITY DEVELOPMENT	10,334 acres of raw land inventory in strategic growth corridors	Maintain right mix of inventory, available at the right time to meet market needs
		Increase market share by maintaining best in class design and community amenities
PROPERTY DEVELOPMENT	Prospects for over 6.5 million sf of new development based on existing plans	Plan, build and lease retail, office, industrial and multi-family residential real estate projects
	Completed and transferred 65,990 sf (5 buildings) in 2018	Maintain 3-5 year inventory of developable assets
	A further 121,800 sf is under development	Maximize value of existing assets through vertical development or re-development
INVESTMENT PROPERTIES & REIT	4.13 million sf of commercial property and 609 residential units under management, diversified across 4 asset classes in 3 provinces and 2 states	Improve existing assets with value-added investments to achieve higher occupancy rates and increase rent per square foot
	New buildings coming online as Property Development projects are completed	Be the landlord of choice by providing consistent, high-quality service
RECREATIONAL PROPERTIES	4 championship golf courses	Maintain strong reputation through consistent course quality and player experience
		Grow revenue from food and beverage operations

DIVERSIFICATION

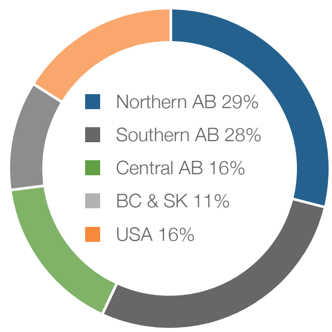
Our operating divisions diversify our revenue streams in a number of ways:

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

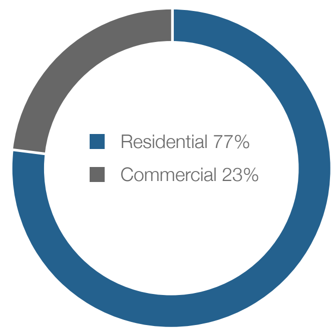
Community Development is one of our most geographically diversified divisions and invests in Canada and the US to build inventory for future development. This division holds a variety of land types for future residential or commercial development in strategic growth corridors. It is also diversified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

Melcor has been planning and developing innovative communities since the 1950s. We have developed over 40,000 lots in over 140 communities across Alberta, BC and the United States.

INVENTORY BY REGION



INVENTORY BY LAND USE

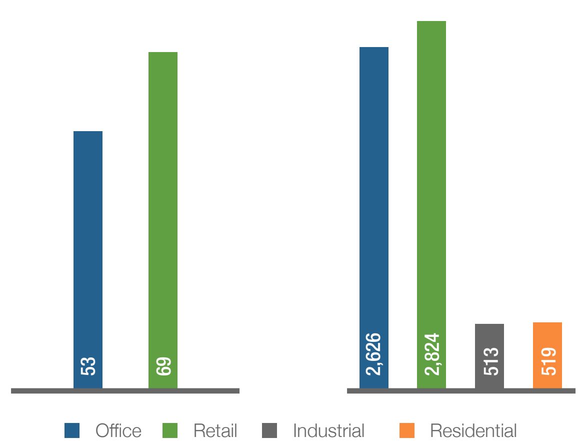


Property Development adds value to raw land by developing retail, office, industrial and multi-family residential properties in Alberta.

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

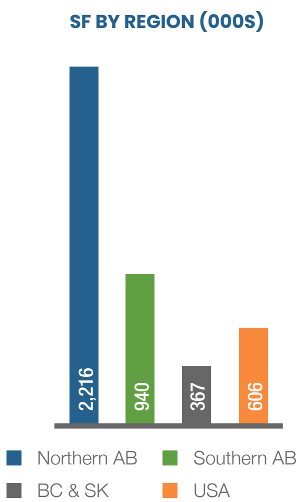
Melcor has been developing commercial properties since the 1970s and has built over 2 million sf. Our future development pipeline is 6.5 million sf based on development plans.

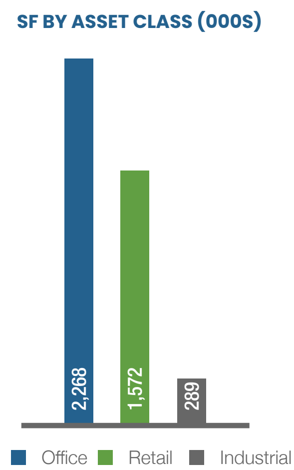
CURRENT DEVELOPMENT SF (000S) **FUTURE DEVELOPMENT SF (000S)**



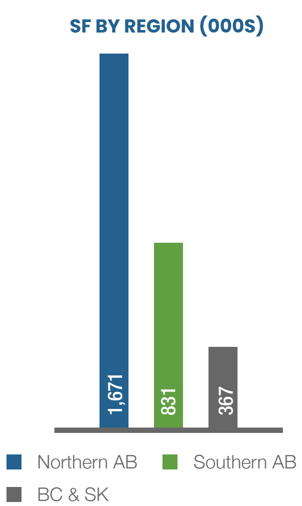
KEY PERFORMANCE DRIVERS

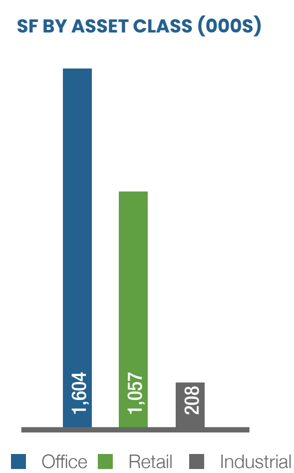
Investment Properties manages 4.13 million sf of geographically diversified income-producing assets - including those owned by the REIT - to provide consistent annuity income and cash flow. Our total portfolio under management is well diversified across asset class, property mix and region. The regional asset mix is primarily commercial in western Canada, with the majority of these assets owned by the REIT. With a number of commercial acquisitions and residential dispositions completed since 2014, our US portfolio is a blend of residential and commercial properties. The goals of the Investment Properties division are to be the landlord of choice by providing exceptional customer care and to continually enhance and improve existing properties through capital investment to maximize occupancy, rental rates and tenant retention and prepare properties for vend-in to the REIT.





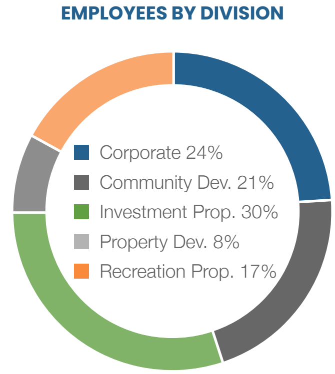
The REIT owns 2.87 million sf of income-producing assets that are managed by Investment Properties. The REIT is a vehicle for realizing the value created throughout the Melcor value chain as raw land is developed for commercial use (Community Development) and commercial properties are built (Property Development) or redeveloped (Investment Properties) and sold to the REIT. The REIT will continue to seek and execute acquisitions to grow its portfolio, both through the Property Development pipeline and third party acquisitions. To date, the REIT has acquired over 1 million sf from Melcor.





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 8.25 years and we have 22 team members (11 active) in Melcor's Quarter Century Club.



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

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

REAL ESTATE INVENTORY

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

- 10,334 acres of developable land
- 4,128,914 sf of leasable commercial property and 609 residential units under management in 3 provinces and 2 states
- Potential to develop over 6.5 million sf of new commercial property (based on existing planned development)

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

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

DEVELOPED LOT INVENTORY

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

	December 31, 2018			
	Canada			US
(including joint arrangements at 100%)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)
Open	1,187	68.56	136.13	294
Transfers	—	—	2.50	—
Finished lot purchase	—	—	—	—
New developments	1,198	13.99	9.17	309
Internal sales	—	—	(5.25)	—
Sales	(1,073)	(23.55)	(12.11)	(467)
Year end	1,312	59.00	130.44	136

	December 31, 2017			
	Canada			US
(including joint arrangements at 100%)	Single-family (Lots)	Multi-family (Acres)	Non-residential (Acres)	Single-family (Lots)
Open	1,004	64.61	142.37	—
Transfers	—	(3.65)	3.65	—
Finished lot purchase	—	—	—	294
New developments	1,588	10.42	3.04	94
Internal sales	—	—	(4.15)	—
Sales	(1,405)	(2.82)	(8.78)	(94)
Year end	1,187	68.56	136.13	294

We remained cautious with development in our Canadian markets in 2018, with new lot development down by 25%. Single-family lot sales in Canada were down by 24% compared to 2017, contributing to a 11% increase in ending inventory. We developed 309 single-family lots in Harmony, our new community outside of Denver, CO in 2018 and sold 173 of these in the year. In addition, we sold the 294 single-family lots that we bought in finished form in 2017. We continue to develop in Harmony to meet market demand.

RAW LAND INVENTORY

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

Following is a summary of land acquisitions during the year:

Land purchases (in acres, net of joint arrangement interests)	2018	2017	Total Land Holdings
Edmonton & Region	134.63	107.84	2,997
Red Deer & Region	0.45	14.04	1,633
Calgary & Region	2.50	31.32	2,285
Lethbridge	—	59.40	587
British Columbia	0.63	43.06	570
Saskatchewan	—	—	616
United States	62.00	515.78	1,646
	200.21	771.44	10,334

We acquired 200.21 acres of land in strategic growth corridors in 2018 and continue to seek investment opportunities. Major land acquisitions in the US and in the Edmonton region are adjacent to land that is currently in inventory to build strategic position.

The majority of land acquired in 2017 was in the United States to advance our geographic diversification strategy.

FINANCIAL RESOURCES

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

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

We primarily use fixed rate, long-term mortgage financing on our income-producing assets to raise capital for acquisitions, development activities, and other business expenditures. As such, most of our borrowings are in the form of long-term, property specific financings such as mortgages or project financings secured by specific assets. At the end of 2018, Melcor also had project specific financings on two residential and three commercial projects totaling $62.64 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. On January 12, 2018, the REIT acquired five commercial properties (172,629 sf) for $80.88 million from Melcor (the Melcor Acquisition). Subsequent to the closing of the Melcor Acquisition our effective ownership in the REIT is 53.0% (December 31, 2017 - 56.7%).

Our operations are supported by a syndicated operating line of credit with total availability of $200.10 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 2018, 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.

2018 HIGHLIGHTS

($000s except as noted)	2018	2017	Change
Revenue	**267,434**	257,950	3.7%
Gross margin (%) *	**46.8%**	45.3%	3.3%
Fair value adjustment on investment properties	**863**	(8,828)	109.8%
Net income	**64,273**	38,525	66.8%
Net margin (%) *	**24.0%**	14.9%	61.1%
Funds from operations *	**56,127**	59,021	(4.9)%
Shareholders' equity	**1,067,565**	1,008,590	5.8%
Total assets	**2,023,076**	1,990,983	1.6%
Per Share Data			
Basic earnings	**1.92**	1.15	67.0%
Diluted earnings	**1.92**	1.15	67.0%
Funds from operations *	**1.68**	1.77	(5.1)%
Book value *	**32.01**	30.21	6.0%

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

2018 results were positively impacted by our diversification strategy as we sold our first lots in our new community of Harmony outside of Denver, CO and expanded our portfolio of office properties in Scottsdale, AZ via a third party acquisition. Our Property Development team also had a productive construction season, adding new retail properties to our portfolio of income-producing assets. These positive influences on our 2018 results were offset by softness in the Canadian residential market, with single-family lot sales down 24% compared to 2017. Development of new single-family lots in Canada also declined by 25% over last year as we focused on inventory management throughout the year. Promotions were in place throughout 2018 in two communities to move inventory. We continue to monitor demand and inventory in all communities to ensure inventory levels remain appropriate.

Occupancy in our income-producing assets (including REIT properties) were slightly lower at 89% compared to 92% in 2017. New properties with higher occupancy partially offset lower occupancy in Edmonton office properties and lower occupancy on the US office building acquired in the third quarter. Investment Properties manages 4.13 million sf of commercial properties, up 5% as a result of third party acquisitions and new properties developed by the Property Development division. They also manage 609 residential units. The increase in GLA was partially offset by sales in the year (two properties, 50,652 sf). Revenue from our income-producing portfolio increased modestly by 1% over 2017 while the Community Development division saw an increase of 6%.

Diversity in the Community Development division's product types and geographical focus contributed to steady activity in a challenging market and contributed $8.81 million to earnings in the year towards Funds from operations (FFO). FFO decreased by 5% due to the $3.67 million reclassification between current and deferred taxes triggered by sale of assets to the REIT. Excluding this reclassification, FFO increased 1% in the year. Our income-producing properties also remain a steady source of FFO and help to stabilize overall income.

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

INVESTING FOR GROWTH

We continued to invest in land inventory and increased our land holdings by 200.21 acres in strategic growth corridors. The acquired land is primarily allocated to residential development and includes 62.00 acres acquired in the US. We continue to move land use approvals through the municipal approval process to increase our supply of shovel ready assets.

Our Property Development division completed and transferred 5 buildings (65,990 sf) in 2018 with a further 121,800 sf under development at year end. Revenue was up 179% over 2017 as 73% more GLA was completed and transferred compared to last year. Revenue from the Property Development division is eliminated on consolidation. Transfers to Investment Properties will positively impact results in future years as we continue to grow our income-producing assets for long-term holding or for sale to the REIT. We continued to progress commercial land through the development, approvals and lease-up process and have an additional 11 buildings in 7 developments expected to be completed and transferred to Investment Properties in 2019.

We completed the following Investment Property acquisitions during the year:

- a 130,400 sf office property consisting of two buildings on 8.5 acres for $24.53 million (US$18.91 million) in Glendale, AZ on September 26, 2018.
- two investment properties in Lethbridge, AB. An office building at a purchase price of $6.32 million (purchased by the REIT) and a commercial building at a purchase price of $2.69 million (purchased by Melcor) on December 3, 2018.

We completed the following dispositions during the year:

- a retail property in Leduc, AB which was originally developed by Melcor and owned since 1974, was sold for $6.73 million by the REIT on January 31, 2018.
- a retail property in Edmonton, AB which was originally developed by Melcor and owned since 2009, was sold for $13.80 million by the REIT on April 16, 2018.
- two residential condo units in the US for $0.52 million (US$0.41 million).

We completed the following transaction during the year:

- we sold five commercial properties (172,629 sf of owned GLA) to the REIT for $80.88 million on January 12, 2018. This represents our fourth asset sale to the REIT and demonstrates how our value chain enables the monetization of value created through the development of commercial properties. Concurrent with the transaction, the REIT generated cash of $17.30 million from the issuance of trust units.

RETURN TO SHAREHOLDERS

We continue to distribute profits to our shareholders. During 2018, we paid dividends of $0.52 per share, consistent with 2017.

We declared a $0.13 per share dividend on March 13, 2019 payable on March 29, 2019 to shareholders of record on March 22, 2019. The dividend is an eligible dividend for Canadian tax purposes.

We have been paying dividends since 1969.

REVENUE & MARGINS

Revenue grew by 4% to $267.43 million in 2018 as a result of the 6% increase in Community Development division revenue. In 2018 our Community Development division sold 467 single-family lots in the US (Arizona and Colorado) generating revenue of $31.52 million (US$24.06 million). Revenue from our income-producing portfolio (including REIT properties) remained stable over 2017. Property Development transfer revenue (up 179%) is eliminated on consolidation but will contribute to future growth in our income-producing portfolio.

Gross margin was up 2% to 47% in 2018. This increase was also led by Community Development, which had gross margin of 41% compared to 37% in 2017 as fewer promotions were in place. Margins in Community Development are affected by a number of factors, including the lot type sold, development costs, the timing of the original land purchase and the relative real-estate market strength at the time of sale. Land that has been in inventory for many years typically generates higher margin on sale. The 60% gross margin on income properties (Investment Properties and the REIT combined) is more stable in nature and serves to neutralize volatility in Community Development margin.

Net margin improved to 24% from 15% in 2017. Net margin is impacted by swings in fair values adjustments recorded on our investment properties and REIT units. Net income was $64.27 million, up from $38.53 million in 2017.

Fair value gains of $0.86 million were recorded in 2018 compared to fair value losses of $8.83 million in 2017. The following contributed to this swing:

- the transfer of land inventory (measured at cost) to Property Development where it is classified as investment properties on the balance sheet (measured at fair value), resulting in fair value gains of $1.02 million (2017: $0.34 million);
- leasing activity and completion of construction on Property Development projects resulting in fair value gains of $7.36 million (2017: $3.31 million); and
- net fair value losses recorded in our Investment Properties and REIT divisions, driven primarily by increased vacancy on certain Edmonton office properties and our Red Deer retail property (Northern Alberta) in conjunction with spending on tenant incentives and capital projects.

FUNDS FROM OPERATIONS

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

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

Below is a reconciliation of net income to FFO:

	Year Ended	
($000s)	2018	2017
Net income for the year	**64,273**	38,525
Amortization of operating lease incentives	**6,710**	6,304
Fair value adjustment on investment properties	**(863)**	8,828
Depreciation on property and equipment	**1,417**	1,436
Stock based compensation expense	**450**	408
Non-cash financing costs	**1,466**	414
Gain on sale of asset	**(6)**	(17)
Deferred income taxes	**(3,493)**	2,565
Fair value adjustment on REIT units	**(13,827)**	558
FFO *	**56,127**	59,021
Per Share Data		
FFO per share *	**1.68**	1.77

* See non-standard measures for definitions and calculations.

FFO decreased by 5% to $56.13 million from $59.02 million in 2017. FFO was negatively impacted in 2018 by a $3.67 million reclassification between current and deferred taxes recognized in the first quarter as a result of the asset sale to the REIT. Excluding this reclassification, FFO would have increased 1% in the year. With strong 2018 results, Community Development contributed an additional $8.81 million to earnings in the year and was the biggest contributor to this increase in FFO. Our income properties (Investment Properties and REIT divisions, excluding fair value adjustments) remain a steady source of FFO and help to stabilize overall income.

DIVISIONAL RESULTS

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

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

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

The following table summarizes operating division results:

	Year Ended December 31									
	COMMUNITY DEVELOPMENT		PROPERTY DEVELOPMENT		INVESTMENT PROPERTIES		REIT		RECREATIONAL PROPERTIES	
($000s except as noted)	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Revenue	**168,336**	158,285	**30,751**	11,015	**32,545**	34,792	**70,173**	66,613	**8,391**	8,650
Portion of total revenue	**54%**	57%	**10%**	4%	**10%**	12%	**23%**	24%	**3%**	3%
Cost of sales	**(99,765)**	(99,114)	**(30,350)**	(10,700)	**(13,236)**	(13,876)	**(28,097)**	(26,500)	**(6,013)**	(5,889)
Gross profit	**68,571**	59,171	**401**	315	**19,309**	20,916	**42,076**	40,113	**2,378**	2,761
Gross margin (%)	**41%**	37%	**1%**	3%	**59%**	60%	**60%**	60%	**28%**	32%
Portion of total gross profit	**52%**	48%	**—%**	—%	**15%**	17%	**32%**	33%	**2%**	2%
General and administrative expense	**(9,501)**	(8,908)	**(2,406)**	(2,065)	**(2,439)**	(3,197)	**(2,884)**	(2,718)	**(2,298)**	(2,183)
Fair value adjustment on investment properties	**—**	—	**7,356**	3,308	**447**	(2,668)	**(11,385)**	(12,800)	**—**	—
Gain on sale of assets	**—**	—	**—**	—	**—**	—	**—**	—	**14**	35
Interest income	**905**	906	**27**	16	**8**	33	**137**	62	**—**	—
Segment Earnings	**59,975**	51,169	**5,378**	1,574	**17,325**	15,084	**27,944**	24,657	**94**	613

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

COMMUNITY DEVELOPMENT

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

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

Our focus is to grow market share and income 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.

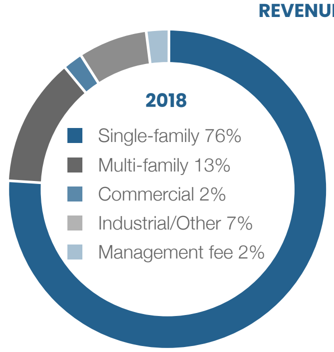
As at December 31, 2018 we held 10,334 acres of raw land for future development which positions the division well for future growth. Our developed land inventory at December 31, 2018 included 1,312 single-family lots, 59 acres for multi-family development, and 130 commercial and industrial acres.

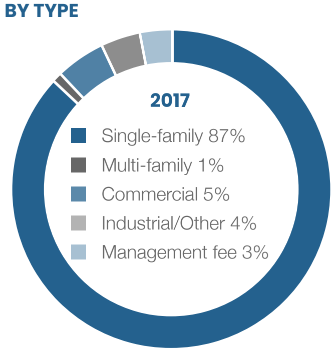
SALES ACTIVITY

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

With the development of a new community in the Denver, CO area and the sales of finished lots in Arizona, our Community Development operations in the US contributed to growth in the year, while our Alberta and BC markets experienced continued softness.

REVENUE BY TYPE





The following table summarizes our Community Development activity:

CONSOLIDATED	2018	2017
Canada sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	**1,073**	1,311
Gross average revenue per single family lot ($)	**131,700**	138,600
Multi-family sales (acres)	**23.55**	2.82
Gross average revenue per multi-family acre ($)	**922,700**	800,000
Commercial sales (acres)	**5.25**	12.93
Gross average revenue per commercial land acre ($)	**978,100**	1,087,800
Other land sales - Industrial, Other (acres)	**18.10**	33.26
Gross average revenue per other land acre ($)	**674,000**	176,800
US sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	**467**	94
Gross average revenue per single family lot ($)	**74,600**	106,700
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	**168,336**	158,285
Earnings ($000s)	**59,975**	51,169

REGIONAL HIGHLIGHTS

EDMONTON & REGION	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	**599**	828
Multi-family sales (acres)	**11.62**	2.82
Commercial sales (acres)	**4.10**	11.84
Other land sales - Industrial, Other (acres)	**7.47**	4.18
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	**70,929**	85,239
Earnings ($000s)	**27,321**	28,318

The market for residential homes in the Edmonton region was soft in 2018, however we did see a 12% increase in the average selling price of single-family lots in this region. This increase is due to traction in one of our newer communities, Jensen Lakes, which offers a wide range of product offerings including lake backing estate and semi-estate lots which are highly coveted and a focus on reducing estate inventory in Jagare Ridge. We continue to adapt to market conditions and offer lower priced options in all neighbourhoods, such as duplexes, townhomes, detached garage homes and zero lot-line housing. Throughout 2018, we actively marketed and sold lots to the public, including a focus on Jagare Ridge. This helped to drive momentum in an otherwise lagging market.

We expect to focus on clearing out existing inventory held by Melcor and by our builders in 2019 and have active marketing programs to support this objective.

Single-family lot sales were down 28% in 2018. Multi-family sales were up at 11.62 acres, contributing revenue of $8.51 million at JV%. We also sold 4.10 acres of commercial land to Property Development for $4.10 million ($2.05 million at JV%) for continued development of The Shoppes at Jagare Ridge in southwest Edmonton. The Edmonton region sold an additional 7.47 acres of raw and industrial land during the year to third parties, contributing an additional $1.16 million.

RED DEER & REGION	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	**164**	83
Other land sales - Industrial, Other (acres)	**—**	10.53
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	**11,485**	12,406
Earnings ($000s)	**3,751**	5,647

The central Alberta residential market continued to be constrained in 2018 by the economic conditions impacting the province. 2018 results met our expectations and were bolstered by two new projects that were well received by our builder partners and home buyers. The first phase of Evergreen in Red Deer achieved 86 lot sales. The neighbourhood has strong momentum and experienced over 20 home starts by year end and the first showhome opened recently. Phase three of the Vista in Ryders Ridge in Sylvan Lake also achieved 52 single-family lot sales.

We utilized a variety of incentive and rebate programs to help support sales of existing spec inventory for our builders and are comfortable that we have appropriate inventory levels heading into 2019. While the market, in terms of permits issued, contracted in Red Deer in 2018 - Melcor's market share increased close to 70%.

We expect that 2019 will remain slow, however we are well placed to respond to stronger market conditions when they return. We have excellent raw land holdings in the region and our existing neighbourhoods continue to see strong builder and consumer support.

CALGARY & REGION	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	**274**	296
Multi-family sales (acres)	**3.59**	—
Commercial sales (acres)	**1.15**	1.09
Other land sales - Industrial, Other (acres)	**10.63**	18.55
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	**43,284**	31,903
Earnings ($000s)	**15,078**	11,404

Overall home sales in the Calgary Metropolitan Area were softer than 2017, reflected in the 7% decrease in our single-family lot sales. Despite this, we maintained single-family lot inventory within our target range due to a moderated lot development program in 2018. We sold 3.59 acres of multi-family land in our Greenwich community, and through internal transfers to Property Development and sales to third parties, we sold an additional 11.78 acres of non-residential land in Kingsview Market and The District.

We completed development on single-family lots in Sunset Ridge, Westmere and Kings Heights. We partially serviced two non-residential phases, one in The District and one in Greenwich, with the balance of construction on those phases to occur in 2019. These non-residential phases will provide inventory for both sales to third parties and transfer to our Property Development division.

We also continue to advance land through the municipal approval process and received two land use approvals in 2018; one for a future commercial development called The Annex in Northeast

Calgary and the second for a revised commercial mixed-use in Greenwich. We also received approval on amendments to the South Shepard and Keystone Area Structure Plans that will allow us to proceed with land use and outline plan approvals.

We anticipate consistent sales activity in 2019 and have sufficient land with various levels of approval to meet market demands in the short and medium term.

LETHBRIDGE	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	31	79
Multi-family sales (acres)	8.34	—
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	8,847	7,753
Earnings ($000s)	3,635	1,725

Lethbridge benefited from two multi-family sites that closed in the latter half of 2018, generating revenue of $5.20 million and driving the increase in revenue and earnings. The market continues to be softer in 2018 as a result of oversupply. We completed construction of a central park amenity in Garry Station to drive momentum in that neighbourhood.

KELOWNA	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	5	25
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	1,775	10,953
Earnings ($000s)	(268)	388

The Kelowna market softened considerably in 2018 as a result of a combination of provincial and federal policy announcements and market activity for single-family lots was down in all communities. We continued to focus on inventory management and preparation for market improvements by advancing construction at both BlueSky and North Clifton Estates. Inventory will be ready to bring on in a short time frame at BlueSky once market activity resumes. We anticipate the first phase of North Clifton Estates to be ready by late summer 2019. This new lake-front neighbourhood (owned with a joint venture partner) has received a lot of interest and we anticipate it to be absorbed at a quicker rate. We also continue to move a third development, Thomson Flats, through the planning process and expect area plan approval in 2019.

UNITED STATES	2018	2017
Sales data (including joint ventures at 100%)		
Single-family sales (number of lots)	467	94
Financial results: (including joint ventures at Melcor's interest)		
Revenue ($000s)	31,516	10,031
Earnings ($000s)	10,030	3,687

Community development activity grew in the US activity in 2018, resulting in a 214% increase in revenue. We sold 467 lots, including 294 serviced lots in Casa Grande, AZ to two separate builders and 173 serviced lots in Aurora, CO to 3 separate builders and have another 86 lots under builder contract. We completed development of 309 serviced lots in Harmony, our master-planned community in Aurora, CO. We received final approvals on the next phase of Harmony which contains 181 lots.

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

We continue to seek land acquisition opportunities in AZ and CO and to advance planning and approvals on all land holdings. During the year we acquired 60 acres in Buckeye, AZ, located 10 miles west of our La Privada and Paseo Place land holdings.

PROPERTY DEVELOPMENT

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

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

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

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

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

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

DIVISION HIGHLIGHTS

($000s and at JV%, except as noted)	2018	2017
Total revenue	30,751	11,015
Revenue from property transfers	30,350	10,700
Management fees	401	315
Margin (%) on property transfers	20%	31%
Square footage transferred (sf, at 100%)	65,990	38,199
Number of buildings transferred	5	4
Fair value gains on investment properties	7,356	3,308

Property Development completed and transferred 5 buildings (65,990 sf) to Investment Properties during 2018. A further 121,800 sf remains under development and we continue to move new projects through the planning and development approval process. 2019 is projected to be another active construction year for the division, with an additional 186,500 sf in development expected to commence construction during the year.

REGIONAL HIGHLIGHTS

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

($000s)	2018	2017
Northern Alberta	7,289	2,094
Southern Alberta	67	1,214
	7,356	3,308

Northern Alberta transferred 65,990 sf (5 buildings) to Investment Properties. Notable activity during 2018 includes:

- **Jensen Lakes Crossing**: We completed construction of Landmark Cinemas Canada (35,365 sf), our anchor tenant at our new neighbourhood shopping centre in St. Albert, AB. We also completed construction on an additional CRU (8,857 sf) in the fourth quarter. During 2019, we expect to complete construction and leasing on three additional CRUs and one land lease property.
- **The Shoppes at Jagare Ridge**: We completed construction on two CRUs and a gas station in 2018 (21,768 sf) in this south Edmonton neighbourhood shopping centre. The development realized fair value gains of $6.20 million ($3.10 million at JV%) in 2018. We also commenced construction on an additional two CRUs.

Southern Alberta continues to actively construct a 6,400 sf CRU in Southern Alberta and have an additional two CRUs (18,500 sf) awaiting permitting.

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	56,800	52,800
Telford Industrial	Leduc	Industrial Park	500,000	143,100	—
West Henday Promenade	West Edmonton	Regional mixed use centre	726,000	116,300	—
Kingsview Market	Airdrie	Regional shopping centre	331,000	181,900	18,500
Chestermere Station	Chestermere	Neighbourhood shopping centre	278,100	241,600	—
Clearview Market	Red Deer	Neighbourhood shopping centre	230,100	150,100	—
The District at North Deerfoot	North Calgary	Regional business / industrial park	2,250,000	522,250	6,400
Campsite Industrial	Spruce Grove	Industrial Park	170,000	13,700	—
The Shoppes at Jagare Ridge	South Edmonton	Neighbourhood shopping centre	105,000	20,500	35,200
Jensen Lakes Crossing	St. Albert	Neighbourhood shopping centre	150,000	45,700	8,900

** 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.*

Expected Future Projects					
Project	Location	Type	Total SF *	Ownership Interest	Expected Start (year)
The Shoppes at Canyons	Lethbridge	Neighbourhood shopping centre	105,000	100%	2020
Greenwich	West Calgary	Regional mixed use centre	325,000	100%	2019
Rollyview	Leduc	Neighbourhood shopping centre	150,000	100%	2021
Woodbend Market	Leduc	Neighbourhood shopping centre	140,000	100%	2019
Laredo	Red Deer	Neighbourhood shopping centre	30,000	100%	2020
Mattson	Edmonton	Neighbourhood shopping centre	78,000	50%	2021
Vista Ridge	Sylvan Lake	Neighbourhood shopping centre	25,000	50%	2020
Secord/Rosenthal	Edmonton	Neighbourhood shopping centre	120,000	55%	2021
Keystone Common	North Calgary	Regional power centre	775,000	100%	2022+
West Pointe Marketplace	Lethbridge	Regional power centre	750,000	100%	2022+
Westview Commercial	West Calgary	Neighbourhood shopping centre	150,000	100%	2022+

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

INVESTMENT PROPERTIES

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

Our Investment Properties division oversees 4.13 million sf of income-producing commercial GLA and 609 residential units.

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

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

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

OPERATING RESULTS

($000s except as noted)	2018	2017
Commercial properties GLA under management (sf, total)	**4,128,914**	3,920,092
Properties owned and managed (sf)	**880,779**	842,385
Properties managed (sf)	**3,248,135**	3,077,707
Revenue (total)	**32,545**	34,792
Canadian properties	**11,327**	14,359
US properties	**14,807**	14,266
Management fees	**5,083**	4,767
Parking lots and other assets	**1,328**	1,400
Net operating income (NOI) *	**19,295**	21,051
Funds from operations *	**18,016**	18,550
Funds from operations per share *	**0.54**	0.56

** See non-standard measures for calculation.*

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

CANADIAN PROPERTIES

Our Canadian property portfolio grew in 2018 via our Property Development activities and a third party acquisition completed in December 2018. Over the past twelve months, the Property Development division completed and transferred five buildings, adding 65,990 sf to owned and managed GLA and generating an increase in commercial property revenue and NOI over 2017. In 2017, four buildings were transferred from Property Development, adding 38,199 sf of GLA. With 121,800 sf of GLA under active development in the Property Development division, we expect continued growth.

On January 12, 2018, we sold five newly-constructed commercial properties to the REIT representing 172,629 sf of owned GLA. Revenue generated on assets sold to the REIT was $0.40 million in 2018 compared to $6.27 million in 2017.

Revenue generated on assets acquired from Property Development and held through the period was $2.68 million in 2018 (2017 - $4.72 million).

Occupancy on properties owned by Investment Properties was 96% at December 31, 2018 (2017 - 91%). The increase in occupancy is due to new properties transferred from the Property Development division as well as lease ups on one of our industrial properties. Weighted average base rental rates were $23.36 (2017 - $25.86), down 10% due to the acquisition of Stafford Common and higher industrial occupancy both of which have lower weighted average base rents.

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

($000s except as noted)	2018	2017
Same asset NOI *	6,221	5,955
Third party acquisition	12	—
Properties transferred from PD	1,274	45
Properties transferred to REIT	213	4,553
NOI	7,720	10,553
Amortization of operating lease incentives	(330)	(338)
Straight-line rent adjustment	1,056	247
Gross profit	8,446	10,462

** See non-standard measures for definition.*

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

Gross profit was $8.45 million down 19% from 2017 as a result of the sale to Melcor REIT in Q1-2018. NOI on properties sold to the REIT was $4.55 million in 2017 (2018 - $0.21 million).

Same asset NOI was up 4% over 2017 at $6.22 million due to higher occupancy.

US PROPERTIES

In the third quarter we acquired a 130,400 sf office property consisting of two buildings in Glendale, Arizona for $24.53 million (US$18.91 million). This property was 85% occupied on closing. Our portfolio is concentrated in the Phoenix and Denver areas; regions we view as a hedge to our Canadian resource derived economic exposure.

Revenue increased 4% over 2017, primarily due to the purchase of the Glendale property which generated revenue of $0.87 million in 2018 (2017 - no acquisitions). Same asset revenue was down 3% over 2017 due to higher vacancy in our Phoenix area commercial properties.

Occupancy on commercial US properties was 84% (2017 - 87%). This decrease is due to the acquisition of Glendale, which had an occupancy rate of 85% as well as tenant rollover and increased vacancy particularly within our Denver portfolio. Rental rates on commercial US properties were $19.64 (2017 - $18.43). The increase in rental rates is due to the acquisition of Glendale, which had a weighted average lease rate of $21.99.

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

($000s except as noted)	2018	2017
Same asset NOI *	4,957	4,718
Third party acquisitions	364	—
NOI	5,321	4,718
Foreign currency translation	1,575	1,398
Amortization of operating lease incentives	(808)	(597)
Straight-line rent adjustment	97	416
Gross profit	6,185	5,935

** See non-standard measures for definition.*

Same asset NOI was up 5% over 2017 due to timing of maintenance projects undertaken on our residential assets.

MANAGEMENT FEES & OTHER

We earn management fees under the asset management and property management agreements with the REIT and under other joint venture agreements where Melcor acts as the asset manager. Management fees were up $0.32 million or 7% compared to 2017, primarily as a result of the movement of property from Investment Properties to the REIT early in the year.

During 2018 we recognized $1.33 million in revenues on our parking stalls and other assets, down 5% from 2017 revenue of $1.40 million due to the sale of the Phillips Lofts Parking Lot in September 2017 (28 stalls on 0.17 acres) in Edmonton, Alberta for $2.99 million (net of transaction costs). These revenues fluctuate from period to period.

FUNDS FROM OPERATIONS

Funds from operations (FFO) decreased by $0.53 million or 3% over 2017 as a result of the sale of properties to the REIT in the first quarter of 2018. This decrease was partially offset by properties acquired from Property Development during the year as well the third party acquisition made at the end of the third quarter.

FAIR VALUE OF INVESTMENT PORTFOLIO

	2018	2017
Fair value of portfolio ($000s)	309,688	318,413
Weighted average capitalization rate	6.47%	6.30%
Weighted average terminal cap rate	6.79%	6.61%
Weighted average discount rate	7.43%	7.40%

The fair value of our portfolio decreased by $8.73 million over 2017. The decrease in fair value was the result of $87.35 million in buildings sold from Investment Properties to REIT in the first quarter, partially offset by $29.96 million in transfers of completed properties from Property Development, $1.31 million in property improvements and third party acquisitions of $27.28 million. Other changes included fair value gains of $0.45 million, disposals of $0.52 million, foreign currency translation loss of $10.40 million, and changes to tenant improvements and straight line rent.

For the year ended December 31, 2018, Melcor's internal valuation team performed the valuation assessment. Of 32 legal phases assessed, 8 investment properties with a fair value of $52.59 million were valued by qualified independent external valuation professionals during the year. In 2017, 21 investment properties of 35 legal phases with a fair value of $295.57 million were valued by qualified independent external valuation professionals during the year.

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

($000s)	2018	2017
Alberta - all assets	(554)	2,572
US - residential	225	(2,883)
US - commercial	776	(2,357)
	447	(2,668)

We recognized fair value gains on our US portfolio as a result of the increase in stabilized NOI and a decrease in capitalization rates on certain commercial assets; partially offset by capital and tenant spending which did not result in a significant increase in fair value. Losses on our Alberta assets were primarily due to price adjustments realized on assets sold to the REIT in January 2018. Fair value gains in 2017 were the result of US residential asset dispositions, where the sale price exceeded carrying value. Refer to note 29 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

REIT

The REIT owned 37 income-producing office, retail and industrial properties, representing 2,868,901 sf in GLA and a land lease community at December 31, 2018. The REIT's portfolio has a diversified tenant profile, with a mix of national, regional and local tenants operating in a variety of industries.

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

OPERATING RESULTS

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

($000s except as noted)	2018	2017
Rental revenue	70,173	66,613
Net operating income (NOI) *	43,983	42,101
Same asset NOI (see calculation following)	38,962	40,803
Fair value adjustments	(11,385)	(12,800)
Occupancy	90%	92%
Funds from operations *	42,426	40,519
Funds from operations per share *	1.27	1.21

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

Rental revenue increased $3.56 million or 5% over 2017. The increase in revenue within this division was a result of the Melcor Acquisition (Jan-2018) and LFS Building (Dec-2018) purchases, partially offset by property sales and lower same-asset revenue. Rental revenue from the acquired properties was $7.00 million in 2018. During 2018 we also recognized $0.38 million of rental revenue from properties sold within the last two years (2017 - $1.74 million). Same-asset revenues were down over 2017 due to lower same-asset occupancy, impacting base rents as well as our recovery ratio.

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 2018 we completed 305,344 sf of lease renewals (including holdovers) and had 72,967 sf in new leases commence for occupancy of 89.9%. We exceeded our retention rate target, with the renewal of 77.4% of expiring leases (representing 57 leases) in spite of challenging market conditions in many of our operating regions.

Weighted average base rent was $16.51, up $0.63 compared to December 31, 2017 due to the Melcor Acquisition, which had a weighted average base rate of $28.08. The increase was partially offset by lower rates on new and renewed leasing completed during the year and third party sales completed in 2018.

Direct operating expenses were up 6% over 2017. Excluding the impact of properties acquired and disposed of over the past twelve months, direct operating expenses were flat. On a same-asset basis, property taxes and utilities increased by 3% due to higher mill rates and increased utility consumption on account of colder weather and increases to levies and taxes in Alberta. The timing of maintenance projects led to a 2% decrease in same-asset operating expenses to date in 2018. As a cornerstone of our property management strategy, we are committed to efficient and cost effective maintenance of our buildings to ensure maximum value to our tenants and unitholders.

($000s except as noted)	2018	2017
Same asset NOI *	38,962	40,803
Acquisitions	4,740	—
Disposals	281	1,298
NOI before adjustments	43,983	42,101
Amortization of operating lease incentives	(3,097)	(3,062)
Straight-line rent adjustment	1,190	1,074
Net rental income	42,076	40,113

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

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

Portfolio growth over the past year contributed to a 4% increase in NOI (before adjustments). On a same-asset basis, NOI was down 5% over 2017 as a result of lower occupancy and weighted average base rates.

FUNDS FROM OPERATIONS

FFO within this division increased by 5% over 2017 as a result of the Melcor Acquisition and the third party acquisition completed in the fourth quarter. Stability in FFO demonstrates the REIT's consistency in stabilizing Melcor's overall operating results.

FAIR VALUE OF REIT PORTFOLIO

	2018	2017
Number of properties	37	37
Total GLA (sf)	2,998,938	2,830,368
GLA (REIT owned %) (sf)	2,868,901	2,710,862
Fair value of portfolio ($000s)	704,339	642,763
Weighted average capitalization rate	6.69%	6.68%
Weighted average terminal cap rate	6.75%	6.79%
Weighted average discount rate	7.70%	7.75%

For the year ended December 31, 2018, Melcor's internal valuation team performed the valuation assessment. In 2018, 24 phases of 50 legal phases with a fair value of $367.55 million were valued by qualified independent external valuation professionals. Valuations performed during the year resulted in fair value losses of $11.39 million. In 2017, 27 phases of 46 legal phases with a fair value of $392.70 million were valued by qualified independent external valuation professionals, resulting in a fair value loss of $12.80 million. Refer to note 29 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

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

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

($000s)	2018	2017
Northern Alberta	(12,816)	(16,959)
Southern Alberta	33	4,710
Saskatchewan & British Columbia	1,398	(551)
	(11,385)	(12,800)

Fair value losses in Northern Alberta were due to increased vacancy on certain Edmonton office properties and our Red Deer retail property in conjunction with spending on tenant incentives and capital projects. Fair value gains in Southern Alberta were realized on Calgary area retail properties and our office property in Lethbridge where market fundamentals remain strong. Our retail portfolio in Saskatchewan & office assets in British Columbia drove fair value gains in the region with higher NOI and a 25 to 50 basis point decrease in capitalization rates. The remainder of fair value losses across the portfolio were due to capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. Fair value adjustments represent a change of approximately 2% in the fair value of our portfolio.

RECREATIONAL PROPERTIES

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

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

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

Black Mountain was named the Golf Facility of the Year by the PGA of BC in October 2018.

OPERATING RESULTS

($000s except as noted)	2018	2017
Revenue	8,391	8,650
Gross profit	2,378	2,761
Gross margin (%)	28.3%	31.9%
Earnings	94	613

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 3% decrease in revenue and 85% decrease in earnings in 2018. The number of rounds played at all four courses was down 6% to 96,930 rounds.

We continue to focus on food and beverage initiatives as part of our strategy for attracting tournaments and stabilizing revenue. In 2018, food and beverage revenue contributed revenue of $2.74 million compared with $2.76 million in 2017.

		2018		
	Ownership interest	Season opened	Season closed	Rounds of golf*
Managed by Melcor:				
Lewis Estates (Edmonton)	60%	April 27	October 30	24,158
The Links (Spruce Grove)	100%	April 27	October 30	21,179
Black Mountain (Kelowna)	100%	April 6	November 8	29,663
Managed by a Third Party:				
Jagare Ridge (Edmonton)	50%	May 1	October 21	21,930

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

** Rounds of golf indicated at 100%*

GENERAL AND ADMINISTRATIVE EXPENSE

General and administrative expenses decreased by 8% over 2017, primarily due to a one-time retirement allowance accrued in the prior year. Management continues to prudently monitor our administrative expenses.

INCOME TAX EXPENSE

The statutory tax rate for the year ended December 31, 2018 is 27%, consistent with 2017. Significant adjustments that impacted the 2018 effective tax rate include the non-taxable portion of REIT income, the recovery of deferred taxes on the REIT transfer, as well as permanent differences related to revaluation adjustments on investment properties and REIT units.

FINANCING

As at December 31, 2018, our total general debt outstanding was $659.56 million compared to $658.26 million in 2017. 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)		2018	2017
Melcor - revolving credit facilities	a	**46,529**	76,529
REIT - revolving credit facility	b	**—**	—
Project specific financing	c	**62,639**	20,926
Secured vendor take back debt on land inventory	d	**40,842**	64,891
Debt on investment properties and golf course assets	e	**454,342**	444,807
REIT - convertible debentures	f	**55,204**	54,775
Less: Liability held for sale		**—**	(3,670)
		659,556	658,258

a) Melcor - revolving credit facilities

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

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

Under the terms of the facilities, Melcor pledges specific agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral. The facilities that mature on July 31, 2020, are renewable one year in advance of expiry and may be modified.

A summary of the credit facilities is as follows:

As at ($000s)		2018	2017
Credit limit approved	i)	**200,103**	205,649
Supportable credit limit	ii)	**164,980**	162,597
Credit used		**(46,529)**	(76,529)
Credit available		**118,451**	86,068

i. The portion of these loan limits that relate solely to Melcor Developments Ltd. is $120.00 million (2017 - $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)	2018	2017
Total letter of credit facility	**72,170**	71,810
Letters of credit issued	**(31,784)**	(40,256)
Available for issue	**40,386**	31,554

b) REIT - revolving credit facility

The REIT has an available credit limit based on the carrying values of specific investment properties up to a maximum of $35.00 million for general purposes, including a $5.00 million swingline sub-facility. An additional $10.00 million is available by way of an accordion feature, subject to lender approval. Depending on the form under which the new facility is accessed, rates of interest will vary between prime plus 1.25% or bankers' acceptance plus 2.25% stamping fee. The agreement also provides the REIT with $5.00 million in available letters of credit which bear interest at 2.25%. The facility matures June 1, 2021.

As at December 31, 2018 we had $nil (December 31, 2017 - $nil) drawn from the facility; and posted letters of credit of $0.15 million (December 31, 2017 - $nil).

c) Project specific financing

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

The composition of our project specific financing is as follows:

As at ($000s)	2018	2017
Project specific debt on investment properties under development, with interest rates between 4.25% and 4.45% (2017 - 3.50% to 3.70%)	30,811	12,217
Project specific debt on land, with interest rates between 4.95% and 9.48% (2017 - 4.58% to 5.70%)	31,828	8,709
	62,639	20,926
Weighted average effective interest rate	6.67%	4.94%

As at December 31, 2018 $19,791 (2017 - $nil) of debt was payable in US dollars (2018 - US $14,507 and 2017 - US $nil).

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 2019 to 2022.

As at ($000s)	2018	2017
Agreements payable with interest at the following contractual rates:		
Fixed rates of 3.00% - 5.95% (2017 - 3.00% to 6.00%)	36,460	58,318
Variable rate of 5.95% (2017 - 5.20%)	4,382	6,573
	40,842	64,891
Weighted average effective interest rate	4.69%	5.04%

As at December 31, 2018 $nil of debt was payable in US dollars (2017 - $10.62 million).

e) Debt on investment properties and golf course assets

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

Debt on investment properties and golf course assets in the amount of $454.34 million, excluding fair value adjustments and deferred finance fees, reflects financing placed on investment properties that have a carrying value of $860.46 million.

Rates are negotiated at a pre-agreed benchmark bond rate plus a spread and are negotiated with different lenders to ensure competitive terms and multiple sources. New mortgage rates from Canadian lending institutions ranged from 3.58% to 4.15% in 2018.

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

As at ($000s)	2018	2017
Canadian mortgages at fixed rates	338,549	345,709
Canadian mortgages at variable rates	47,658	49,816
US mortgages at fixed rates	63,316	44,576
US mortgages at variable rates	7,931	7,786
	457,454	447,887
Interest rate ranges	(2.54% - 5.57%)	(2.48% - 6.16%)
Weighted average effective interest rate	3.47%	3.42%

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
2019	51,695	3.79%	9
2020	53,956	3.34%	8
2021	61,982	3.00%	10
2022	26,096	3.43%	4
2023	67,501	4.10%	6
2024	34,359	3.73%	4
2025	39,686	4.04%	7
2026	34,285	3.61%	5
2027	—	—%	—
2028	17,102	4.07%	3

As at December 31, 2018, $71.25 million of debt was payable in US dollars (2017: $52.36 million).

f) REIT - convertible debentures

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

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

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

LIQUIDITY & CAPITAL RESOURCES

The following table represents selected information as at December 31, 2018, compared to December 31, 2017.

As at ($000s except as noted)	2018	2017
Cash & cash equivalents	**26,727**	42,505
Restricted cash	**—**	16,956
Accounts receivable	**10,849**	17,384
Agreements receivable	**126,490**	129,949
Revolving credit facilities	**46,529**	76,529
Accounts payable and accrued liabilities	**44,825**	51,979
Total assets	**2,023,076**	1,990,983
Total liabilities	**955,511**	982,393
Debt to equity ratio *	**0.90**	0.97

**See non-standard measures for definition*

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

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

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

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

On January 12, 2018, we sold the REIT five commercial properties for a total purchase price of $80.88 million. The purchase price was settled through assumption of $31.04 million in mortgages payable; issuance of 1,331,202 Class C LP Units, representing $13.31 million in Retained Debt by Melcor; issuance of 283,447 Class B LP Units at a price of $8.82, representing $2.50 million; and cash of $34.03 million. Concurrent with closing of this sale, the REIT issued 2,035,000 trust units in exchange for subscription receipts previously issued and outstanding and the maturity date of the 2017 Debentures was extended to December 31, 2022. Melcor's interest in the REIT on closing the Melcor Acquisition is approximately 53.0%.

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

CASH REQUIREMENTS

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

Contractual obligations include:

	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	457,454	67,145	140,794	110,059	139,456
Revolving credit facilities	46,529	46,529	—	—	—
Secured vendor take back debt on land inventory	40,842	20,377	20,106	359	—
Project specific financing	62,639	62,639	—	—	—
REIT debenture	57,500	34,500	—	23,000	—
Interest expense	65,012	9,408	23,983	16,586	15,035
Operating leases	759	170	361	228	—
Total contractual obligations	730,735	240,768	185,244	150,232	154,491

We also have a contractual obligation of $98.37 million on the non-controlling interest portion of REIT units as they are redeemable at the option of the holder.

SOURCES AND USES OF CASH

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

($000s)	2018	2017
Cash flows from operating activities	**30,827**	7,406
Cash flows used in investing activities	**(38,826)**	(29,341)
Cash flows from (used in) financing activities	**(8,909)**	26,694

Cash from operations was $23.42 million higher in 2018. Net income, adjusted for non-cash items, contributed $54.07 million to cash from operations compared to $57.58 million in 2017. In 2018 we purchased 200 acres of land inventory for $7.82 million compared with 771 acres and 294 lots for $42.58 million in 2017 (net of vendor financing). Included in the 200 acres of land purchased in the year was 62 acres of land purchased in Buckeye, Arizona (US) for $2.80 million (US$2.05 million) as we continue to focus on diversifying our land holdings. Development ramped up on our Colorado (US) land holdings, which contributing $9.74 million to the $22.64 million in development activities in 2018. This compares with US land development costs of $3.71 million in 2017.

At the end of 2017, we had $5.03 million due from one of our registered builders that was in receivership. These funds were all collected in 2018, with accrued interest, contributing to the decrease in our agreements receivable balance in 2018 compared with the prior year. We also incurred $8.28 million in tenant incentives and direct leasing costs in 2018 to renew and secure new leases.

Cash used in investing activities was $38.83 million, an increase of $9.49 million over 2017. On September 26, 2018, we purchased an office property consisting of two buildings in Glendale, Arizona (US) for $24.53 million (US$18.91 million). We also purchased two buildings in Lethbridge, AB on December 3, 2018 for $9.01 million.

Cash used in investing activities was partially offset by strategic dispositions made during the year. On January 31, 2018 we disposed of an industrial property classified as held for sale at the end of 2017 for proceeds of $6.73 million. This sale price was settled through mortgage assumption of $3.66 million and cash of $3.07 million. On April 16, 2018 we sold an investment property for $13.32 million. Concurrent with the sale we paid off the associated mortgage liability which had a balance of $6.95 million. We also sold two units during the year at one of our US residential properties for proceeds of $0.52 million.

We continue to invest in improving our asset base through value enhancing projects. Additions to investment properties include development activities in Property Development and enhancements to properties held in the Investment Properties and REIT operating divisions. In 2018 we invested $21.42 million in properties under development, property improvements and capitalized borrowing costs, compared with $36.15 million in 2017.

Cash from financing activities was down $35.60 million over 2017 largely a result of repayments on our revolving credit facilities of $30.00 million In 2018, the revolving credit facilities made net repayments of $30.00 million compared to net draws of $26.48 million in 2017. General debt contributed to a net cash inflow of $21.72 million through financings received and repayments made, compared to a net cash outflow of $4.50 million in 2017.

During the year, we repurchased 57,156 shares which were canceled and returned to treasury for $0.76 million. No purchases were made under the NCIB in 2017.

In 2018, we paid dividends of $0.52 per share (2017 - $0.52 per share), for a total cash outflow of $17.36 million, comparable to amounts paid in 2017.

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, 2018 there were 33,346,495 common shares issued and outstanding, 1,040,647 stock options, and 67,400 restricted share units. Each stock option and restricted share unit is convertible to one common share upon exercise or exchange. There is only one class of shares issued. As at March 13, 2019 there were 33,301,611 common shares issued and outstanding, 1,028,947 stock options, and 67,400 restricted share units.

Please refer to note 17 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 20 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.

	2018			
($000s)	Q4	Q3	Q2	Q1
Revenue	119,982	60,245	42,793	44,414
Net income	36,526	11,469	1,631	14,647
FFO	30,671	12,841	7,695	4,920
Per Share				
Basic earnings	1.09	0.34	0.05	0.44
Diluted earnings	1.09	0.34	0.05	0.44
FFO basic	0.92	0.38	0.23	0.15
FFO diluted	0.92	0.38	0.23	0.15
Book value *	32.01	29.39	29.30	29.41

	2017			
($000s)	Q4	Q3	Q2	Q1
Revenue	109,633	62,795	46,955	38,567
Net income	32,084	11,517	3,927	(9,003)
FFO	30,850	12,787	9,306	6,078
Per Share				
Basic earnings	0.96	0.34	0.12	(0.27)
Diluted earnings	0.96	0.34	0.12	(0.27)
FFO basic	0.93	0.38	0.28	0.18
FFO diluted	0.93	0.38	0.28	0.18
Book value *	30.21	29.39	29.30	29.41

**See non-standard measures for definition*

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

FOURTH QUARTER

Three months ended ($000s except as noted)	2018	2017
Revenue	119,982	109,633
Cost of sales	(66,510)	(61,634)
Gross profit	53,472	47,999
General and administrative expense	(5,674)	(7,348)
Fair value adjustment on investment properties	605	3,923
Adjustments related to REIT units	6,216	1,909
Loss on sale of assets	—	(18)
Operating earnings	54,619	46,465
Interest income	241	194
Foreign exchange gain (loss)	166	(26)
Finance costs	(6,129)	(5,938)
Net finance costs	(5,722)	(5,770)
Income before income taxes	48,897	40,695
Income tax expense	(12,371)	(8,611)
Net income for the period	36,526	32,084
Earnings per share attributable to Melcor's shareholders:		
Basic earnings per share	1.09	0.96
Diluted earnings per share	1.09	0.96

Highlights of the fourth quarter include:

- Our Property Development division completed and transferred 2 buildings (20,093 sf) to Investment Properties.
- We purchased a total of 69.08 acres of raw land in the quarter, including:
  - 5.59 acres in St. Albert, AB
  - 1.49 acres in Calgary, AB
  - 62.00 acres in Buckeye, AZ
- Our Community Development division registered 16 plans in 12 communities, which added 637 lots to inventory with 710 lots sold in Q4-2018. This compares to 11 plan registrations in 7 communities adding 796 lots to inventory with 864 lots sold in Q4-2017.
- On December 3, 2018 we purchased two investment properties in Lethbridge, AB - an office building at a purchase price of $6.32 million (including transaction costs) purchased by the REIT and a commercial building at a purchase price of $2.69 million (including transaction costs) purchased by Melcor.
- On October 9, 2018 we began purchasing shares under our NCIB and during the fourth quarter we purchased 57,156 shares at a cost of $0.76 million. These shares have been canceled and returned to treasury.

Segmented information for the fourth quarter is as follows:

Three months ended December 31, 2018 ($000s)	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	95,426	10,577	8,913	17,336	677	—	132,929	(12,947)	119,982
Cost of sales	(55,486)	(10,500)	(3,706)	(6,980)	(1,018)	—	(77,690)	11,180	(66,510)
Gross profit	39,940	77	5,207	10,356	(341)	—	55,239	(1,767)	53,472
General and administrative expense	(2,492)	(622)	(620)	(727)	(351)	(1,577)	(6,389)	715	(5,674)
Fair value adjustment on investment properties	—	986	4,791	(6,224)	—	—	(447)	1,052	605
Interest income	147	8	2	33	—	51	241	—	241
Segment Earnings (loss)	37,595	449	9,380	3,438	(692)	(1,526)	48,644	—	48,644
Foreign exchange gain									166
Finance costs									(6,129)
Adjustments related to REIT units									6,216
Income before income taxes									48,897
Income tax expense									(12,371)
Net income for the period									36,526

Three months ended December 31, 2017 ($000s)	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue	85,776	5,765	8,910	16,263	693	—	117,407	(7,774)	109,633
Cost of sales	(51,118)	(5,600)	(3,456)	(6,733)	(980)	—	(67,887)	6,253	(61,634)
Gross profit	34,658	165	5,454	9,530	(287)	—	49,520	(1,521)	47,999
General and administrative expense	(2,381)	(577)	(1,244)	(780)	(317)	(2,768)	(8,067)	719	(7,348)
Fair value adjustment on investment properties	—	795	(1,503)	3,829	—	—	3,121	802	3,923
Loss on sale of assets	—	—	—	—	—	(18)	(18)	—	(18)
Interest income	87	2	27	22	—	56	194	—	194
Segment Earnings (loss)	32,364	385	2,734	12,601	(604)	(2,730)	44,750	—	44,750
Foreign exchange gain									(26)
Finance costs									(5,938)
Adjustments related to REIT units									1,909
Income before income taxes									40,695
Income tax expense									(8,611)
Net income for the period									32,084

OUTLOOK

Melcor owns a high quality portfolio of assets, including raw land, developed land inventory (residential lots and acres for multi-family and commercial development), income-producing properties and championship golf courses. Alberta, our largest market, has undergone dramatic changes throughout the past few years, primarily related to lower oil prices. We continue to execute on our strategic plan and achieved stable results in 2018. We continue to intentionally diversify our business across asset class and geography, including continued investment in the US with raw land and commercial property acquisitions and the launch of our 1,100-acre community in Aurora. We anticipate that these diversification strategies will continue to ease our reliance on the Alberta economy going forward.

We expect continued softness in the residential market in Alberta in 2019 and are focused on reducing existing lot inventory held by both Melcor and our builders. On the commercial side, retail activity remains steady and we expect that to continue in 2019. Our US assets delivered positive results in economies that are growing and that are counter cyclical to our resource dependence in Alberta.

Our business model has adapted to changing times for 95 years. We will continue to take advantage of opportunities to diversify our asset base both geographically and by product type. We will maintain our disciplined, conservative approach to operations to ensure that we remain profitable while achieving our fundamental goals of protecting shareholder investment and sharing corporate profit with our shareholders.

With appropriate levels of serviced land inventory, movement of residential and commercial land through the municipal approvals process, steady occupancy rates and capacity on our operating facility, we remain well-positioned for the future.

INTEREST IN THE REIT

The REIT is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust dated January 25, 2013, and 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 13, 2019, Melcor holds a 53.0% (December 31, 2017 and 2018 - 56.7%) effective interest in the REIT through ownership of all Class B LP units of the partnership through an affiliate and a corresponding number of special voting units of the REIT. The Class B LP units are economically equivalent to, and are exchangeable for, trust units. Melcor is the ultimate controlling party.

As we retain control over the REIT, we consolidate the REIT and record 100% of its revenues, expenses, assets and liabilities. We reflect the public's 47.0% interest (December 31, 2018 - 43.3%) in the REIT as a financial liability.

Arrangements between Melcor and the REIT

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

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

a. a base annual management fee calculated and payable on a quarterly basis, equal to 0.25% of the REIT's gross book value;

b. a capital expenditures fee equal to 5.0% of all hard construction costs incurred on capital projects in excess of $0.10 million;

c. an acquisition fee equal to 0.5% - 1.0% of the purchase price;

d. a financing fee equal to 0.25% of the debt and equity of all financing transactions completed for the REIT to a maximum of actual expenses incurred by Melcor.

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

a. a base fee of 3.0% of gross property revenue;

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

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

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

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

BUSINESS ENVIRONMENT & RISKS

A discussion of credit risk, liquidity risk and market risk can be found in note 28 to the consolidated financial statements.

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

GENERAL RISKS

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

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

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

INDUSTRY RISK

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

CONCENTRATION OF ASSETS RISK

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

FINANCING RISK

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

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

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

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

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

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

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

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

ENVIRONMENTAL RISK

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

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

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

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

Environmental laws and other requirements can change and we may become subject to more stringent environmental laws or other requirements in the future. Compliance with more stringent environmental laws or requirements, the identification of currently unknown environmental issues or an increase in the costs required to address a currently known condition may have a material adverse effect on our business, cash flows, financial condition and results of operations and ability to pay dividends to shareholders.

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

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

CYBER SECURITY RISK

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

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

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

COMMUNITY DEVELOPMENT

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

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

PROPERTY DEVELOPMENT

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

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

INVESTMENT PROPERTIES AND REIT

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

RECREATIONAL PROPERTIES

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

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

OTHER FINANCIAL INFORMATION

NORMAL COURSE ISSUER BID

On March 29, 2018 we announced a Normal Course Issuer bid commencing March 31, 2018 and ending March 30, 2019. Under the bid, we can acquire up to 1,669,782 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,262 common shares. We are also able to arrange a block purchase of a larger number of shares than our daily repurchase restriction one time per calendar week.

In connection with the commencement of the NCIB, we entered into an automatic share purchase plan (ASPP) agreement with a broker to allow for the purchase of common shares under the NCIB at times when we ordinarily would not be active in the market due to regulatory restrictions or self-imposed trading blackout periods. During the year, we repurchased 57,156 shares which were canceled and returned to treasury (2017 - nil).

Subsequent to year end, we have repurchased 54,318 common shares from the public market under the ASPP agreement.

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 30 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 24 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)**	2018	2017
Revenue	193,250	169,505
Earnings	57,627	42,679
Assets	1,033,828	1,008,635
Liabilities	402,526	403,964

*Joint arrangement activity at Melcor's ownership % ($000s)**	2018	2017
Revenue	82,811	82,046
Earnings	27,126	22,280
Assets	455,808	444,378
Liabilities	169,308	169,740

** 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, 2018. 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, 2018.

There has been no change to Melcor's disclosure controls and procedures or internal control over financial reporting during the year ended December 31, 2018, that materially affected, or is reasonably likely to materially affect, Melcor's internal control over financial reporting.

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

NON-STANDARD MEASURES

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

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

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

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

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

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

CALCULATIONS

We use the following calculations in measuring our performance.

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

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

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

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

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

INVESTMENT PROPERTIES

($000s)	2018	2017
Segment earnings *	17,325	15,084
Fair value adjustment on investment properties	(447)	2,668
General and administrative expenses	2,439	3,197
Interest income	(8)	(33)
Amortization of operating lease incentives	1,138	798
Straight-line rent adjustments	(1,152)	(663)
Divisional NOI	19,295	21,051

Refer to note 25 to the consolidated financial statements

REIT

($000s)	2018	2017
Segment earnings *	27,944	24,657
Fair value adjustment on investment properties	11,385	12,800
General and administrative expenses	2,884	2,718
Interest income	(137)	(62)
Amortization of operating lease incentives	3,097	3,062
Straight-line rent adjustments	(1,190)	(1,074)
Divisional NOI	43,983	42,101

Refer to note 25 to the consolidated financial statements

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

CONSOLIDATED

($000s)	2018	2017
Net income for the year	64,273	38,525
Amortization of operating lease incentives	6,710	6,304
Fair value adjustment on investment properties	(863)	8,828
Depreciation on property and equipment	1,417	1,436
Stock based compensation expense	450	408
Non-cash financing costs	1,466	414
Gain on sale of asset	(6)	(17)
Deferred income taxes	(3,493)	2,565
Fair value adjustment on REIT units	(13,827)	558
FFO	56,127	59,021

INVESTMENT PROPERTIES

($000s)	2018	2017
Divisional income for the year *	17,325	15,084
Fair value adjustment on investment properties	(447)	2,668
Amortization of operating lease incentives	1,138	798
Divisional FFO	18,016	18,550

Refer to note 25 to the consolidated financial statements

REIT

($000s)	2018	2017
Divisional income for the year *	27,944	24,657
Fair value adjustment on investment properties	11,385	12,800
Amortization of operating lease incentives	3,097	3,062
Divisional FFO	42,426	40,519

Refer to note 25 to the consolidated financial statements

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

CONSOLIDATED STATEMENT OF INCOME

For the years ended December 31

($000s)	2018	2017
Revenue (note 22)	267,434	257,950
Cost of sales (note 22)	(142,223)	(141,142)
Gross profit	125,211	116,808
General and administrative expense (note 22)	(23,429)	(25,353)
Fair value adjustment on investment properties (note 11, 22 and 29)	863	(8,828)
Adjustments related to REIT units (note 26)	3,438	(8,085)
Gain on sale of assets	6	17
Operating earnings	106,089	74,559
Interest income	1,291	1,129
Foreign exchange gain (loss)	429	(591)
Finance costs (note 21)	(24,568)	(21,412)
Net finance costs	(22,848)	(20,874)
Income before income taxes	83,241	53,685
Income tax expense (note 23)	(18,968)	(15,160)
Net income for the year	64,273	38,525
Earnings per share attributable to Melcor's shareholders (note 18):		
Basic earnings per share	1.92	1.15
Diluted earnings per share	1.92	1.15

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the years ended December 31

($000s)	2018	2017
Net income for the year	64,273	38,525
Other comprehensive income		
Items that may be reclassified subsequently to net income:		
Currency translation differences (note 19)	12,181	(8,242)
Comprehensive income	76,454	30,283

See accompanying notes to the consolidated financial statements.

On behalf of Melcor's Board of Directors:

Gordon Clanachan
Audit Committee Chair

Timothy Melton
Chairman

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

($000s)	2018	2017
ASSETS		
Cash and cash equivalents	26,727	42,505
Restricted cash (note 3D)	—	16,956
Accounts receivable	10,849	17,384
Income taxes recoverable	—	8,933
Agreements receivable (note 9)	126,490	129,949
Land inventory (note 10)	758,940	729,300
Investment properties (note 11 and 29)	1,032,687	975,856
Property and equipment (note 12)	14,020	14,658
Other assets (note 13)	53,363	48,710
Asset held for sale (note 8 and 29)	—	6,732
	2,023,076	1,990,983
LIABILITIES		
Accounts payable and accrued liabilities (note 14)	44,825	51,979
Income taxes payable	8,605	—
Provision for land development costs (note 15)	77,658	87,139
General debt (note 16)	659,556	658,258
Deferred income tax liabilities (note 23)	66,493	69,826
REIT units (note 26 and 29)	98,374	94,898
Subscription receipts (note 26)	—	16,623
Liability held for sale (note 8 and 29)	—	3,670
	955,511	982,393
SHAREHOLDERS' EQUITY		
Equity attributable to Melcor's shareholders		
Share capital (note 17A)	72,821	72,729
Contributed surplus	3,366	2,939
Accumulated other comprehensive income (AOCI) (note 19)	29,129	16,948
Retained earnings	962,249	915,974
	1,067,565	1,008,590
	2,023,076	1,990,983

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

($000s)	Share Capital	Contributed Surplus	AOCI	Retained Earnings	Total Equity
	Equity attributable to Melcor's shareholders				
Balance at January 1, 2018	72,729	2,939	16,948	915,974	1,008,590
Net income for the year	—	—	—	64,273	64,273
Cumulative translation adjustment (note 19)	—	—	12,181	—	12,181
Transactions with equity holders					
Dividends	—	—	—	(17,362)	(17,362)
Share repurchase (note 17A)	(125)	—	—	(636)	(761)
Employee share based compensation					
Value of services recognized	—	450	—	—	450
Share issuance	217	(23)	—	—	194
Balance at December 31, 2018	72,821	3,366	29,129	962,249	1,067,565

($000s)	Share Capital	Contributed Surplus	AOCI	Retained Earnings	Total Equity
	Equity attributable to Melcor's shareholders				
Balance at January 1, 2017	72,137	2,594	25,190	894,800	994,721
Net income for the year	—	—	—	38,525	38,525
Cumulative translation adjustment (note 19)	—	—	(8,242)	—	(8,242)
Transactions with equity holders					
Dividends	—	—	—	(17,351)	(17,351)
Employee share based compensation					
Value of services recognized	—	408	—	—	408
Share issuance	592	(63)	—	—	529
Balance at December 31, 2017	72,729	2,939	16,948	915,974	1,008,590

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the years ended December 31 ($000s)	2018	2017
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income for the year	64,273	38,525
Non cash items:		
Amortization of tenant incentives (note 13)	6,710	6,304
Depreciation of property and equipment (note 12 and 22)	1,417	1,436
Stock based compensation expense (note 17g and 22)	450	408
Non cash financing costs	1,466	414
Straight-line rent adjustment	(2,054)	(1,446)
Fair value adjustment on investment properties (note 11, 22 and 29)	(863)	8,828
Fair value adjustment on REIT units (note 26 and 29)	(13,827)	558
Gain on sale of assets	(6)	(17)
Deferred income taxes (note 23)	(3,493)	2,565
Cash provided by operating activities before changes in non-cash working capital	54,073	57,575
Agreements receivable	3,459	(13,705)
Development activities (note 3u)	(22,636)	1,149
Payment of tenant incentives and direct leasing costs	(8,279)	(5,944)
Purchase of land inventory (note 10)	(7,821)	(42,579)
Operating assets and liabilities (note 3U)	12,031	10,910
	30,827	7,406
INVESTING ACTIVITIES		
Purchase of investment properties (note 11)	(33,541)	—
Additions to investment properties (note 11)	(21,417)	(36,150)
Net proceeds from disposal of investment properties (note 11)	516	7,379
Net proceeds from disposal of asset held for sale (note 8 and 11)	16,389	—
Purchase of property and equipment (note 12)	(798)	(625)
Proceeds from disposal of assets	25	55
	(38,826)	(29,341)
FINANCING ACTIVITIES		
Proceeds from issuance of trust units (note 26)	17,302	—
Net proceeds from issuing convertible debenture (note 16F)	—	21,543
Revolving credit facilities	(30,000)	26,477
Proceeds from general debt	128,236	56,774
Repayment of general debt	(106,518)	(61,278)
Dividends paid	(17,362)	(17,351)
Common shares repurchased (note 17A)	(761)	—
Share capital issued	194	529
	(8,909)	26,694
FOREIGN EXCHANGE GAIN (LOSS) ON CASH HELD IN A FOREIGN CURRENCY	1,130	(2,146)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE YEAR	(15,778)	2,613
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	42,505	39,892
CASH AND CASH EQUIVALENTS, END OF THE YEAR	26,727	42,505

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in $000s except per share and acre amounts)

1. DESCRIPTION OF THE BUSINESS

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

Melcor Developments Ltd. ("Melcor" or "we") is incorporated in Canada. The registered office is located at Suite 900, 10310 Jasper Avenue Edmonton, AB T5J 1Y8. We operate in Canada and the United States ("US"). Our shares are traded on the Toronto Stock Exchange under the symbol "MRD". As at December 31, 2018 Melton Holdings Ltd. holds approximately 47.0% of the outstanding shares and pursuant to IAS 24, Related party disclosures, is the ultimate controlling shareholder of Melcor.

As at March 13, 2019, Melcor, through an affiliate, holds an approximate 53.0% effective interest in Melcor REIT ("REIT" or "the REIT") through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. Melcor continues to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. Trust units of the REIT are traded on the Toronto Stock Exchange under the symbol "MR.UN".

2. BASIS OF PRESENTATION

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") as set out in Part I of the Chartered Professional Accountants ("CPA") Handbook.

Our consolidated financial statements have been prepared in accordance with IFRS. These consolidated financial statements were authorized for issue by the Board of Directors on March 13, 2019.

3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

A. BASIS OF MEASUREMENT

Our consolidated financial statements have been prepared under the historical cost convention, except for investment properties, derivatives and REIT units which are measured at fair value.

We prepare our financial statements in conformity with IFRS which requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Changes in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions change. We believe that the underlying assumptions are appropriate. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in notes 6 and 5, respectively.

B. BASIS OF CONSOLIDATION

These consolidated financial statements include:

i. The accounts of Melcor Developments Ltd. and its wholly-owned subsidiaries:

- Melcor Developments Arizona Inc.
- Melcor Lakeside Inc.
- Stanley Investments Inc.
- Melcor REIT Holdings GP Inc.
- Melcor REIT Holdings Limited Partnership
- Melcor Homes Ltd.

ii. The accounts of Melcor REIT Limited Partnership (the "Partnership") (53.0% owned by Melcor Developments Ltd as at December 31, 2018). The remaining 47.0% publicly held interest in the REIT is presented as a liability in our consolidated financial statements. Refer to notes 7 and 26 for details related to our interest in the REIT.

iii. Investments in 29 joint arrangements (2017 – 30) with interests ranging from 7% to 60%. These arrangements are undivided interests in the assets, liabilities, revenue and expenses and we record our proportionate share in accordance with the agreements. Refer to note 24 for details on joint arrangements.

All intercompany transactions and balances are eliminated on consolidation.

C. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired.

D. RESTRICTED CASH

Restricted cash can only be used for specified purposes. As at December 31, 2017 our restricted cash represented amounts held in escrow pending the closing of the Melcor Acquisition (note 26).

E. LAND INVENTORY

Land inventory is recorded at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less costs to complete the development and selling costs. Cost includes all costs incurred to purchase development land, capitalized carrying costs related to holding the land under development, and development costs to build infrastructure. The estimated unexpended portion of costs to complete building the infrastructure, which are classified as "provision for land development costs" (refer to note 3J), are recorded as a liability upon the approval of the development plan with the municipality.

The cost of land and carrying costs are allocated to each phase of development based on a prorated acreage of the total land parcel at the time a plan is registered with a municipality. The cost of sale of a lot is allocated on the basis of the estimated total cost of the project prorated by the anticipated selling price of the lot over the anticipated selling price of the entire project at the date of plan registration.

Where we acquire land subject to deferred payments greater than one year, it is initially recognized at the fair value of the future estimated contractual obligations.

F. INVESTMENT PROPERTIES

Investment properties include commercial, industrial, and residential properties, and a manufactured home community held for the long term to earn rental income or for capital appreciation, or both. It also includes properties under development for future use as investment properties.

Acquired investment properties are measured initially at cost, including related transaction costs associated with the acquisition when the acquisition is accounted for as an asset purchase. Costs capitalized to properties under development include direct development and construction costs, borrowing costs, and property taxes.

After initial recognition, investment properties are recorded at fair value, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows.

Melcor Developments Ltd. has an internal valuation team consisting of individuals who are knowledgeable and have experience in the fair value techniques applied in valuing investment property. At least once every two years, the valuations are performed by qualified external valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued. Changes in fair value are recognized in the consolidated statements of income and comprehensive income in the period in which they arise.

Fair value measurement of an investment property under development is only applied if the fair value is considered to be reliably measurable. In rare circumstances, investment property under development is carried at cost until its fair value becomes reliably measurable. It may sometimes be difficult to determine reliably the fair value of an investment property under development. In order to evaluate whether the fair value of an investment property under development can be determined reliably, management considers the following factors, among others:

- the provisions of the construction contract;
- the stage of completion;
- whether the project or property is standard (typical for the market) or non-standard;
- the level of reliability of cash inflows after completion;
- the development risk specific to the property;
- past experience with similar construction; and
- status of construction permits.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to Melcor and the cost of the item can be measured reliably. All repairs and maintenance costs are expensed when incurred.

Initial direct leasing costs incurred in negotiating and arranging tenant leases are added to the carrying amount of investment properties. All direct leasing costs are external expenditures and no amounts for internal allocations are capitalized with respect to the negotiation or arranging of tenant leases.

G. PROPERTY AND EQUIPMENT

Property and equipment is initially measured at cost, which includes expenditures that are directly attributable to the acquisition of the asset. Subsequent to its initial recognition, property and equipment is carried at cost less accumulated depreciation and any accumulated impairment losses.

The major categories of property and equipment are depreciated using the declining balance method of depreciation as follows:

Buildings	4%
Golf course greens and tees	6%
Golf course equipment	20-30%
Corporate assets	20-50%

Property and equipment is tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows. The recoverable amount is the higher of an asset's fair value less costs to sell and the discounted expected future cash flows of the relevant asset or group of assets calculated on a value-in-use basis. An impairment loss is recognized for the amount by which the asset or group of assets' carrying amount exceeds its recoverable amount.

We evaluate impairment losses for potential reversals when events or circumstances warrant such consideration.

H. OTHER ASSETS

Other assets include prepaid expenses, inventory, deposits, straight-line rent adjustments and tenant incentives incurred in respect of new or renewed leases. Tenant incentives are amortized on a straight-line basis over the lease term and are recorded as a reduction of revenue.

I. BORROWING COSTS

General and specific borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets. Borrowing costs are capitalized while acquisition or construction is actively underway and ceases once the asset is substantially complete, or suspended if the development of the asset is suspended. The amount of borrowing cost capitalized is determined by applying a weighted average cost of borrowings to qualifying assets. Qualifying assets include our land under development and investment properties under development assets. All other borrowing costs are recognized as finance costs in the consolidated statement of income in the period in which they are incurred.

J. PROVISION FOR LAND DEVELOPMENT COSTS

We recognize a provision for land development related to the construction, installation and servicing of municipal improvements related to subdivisions under development once we have an approved development agreement with the municipality, as this is the point in time when an obligation arises. The provision is recognized as a liability with an equal amount capitalized to land inventory. Provisions for land development are measured at management's best estimate of the expenditure required to complete the approved development plan at the end of the reporting period. Adjustments are made to the liability with a corresponding adjustment to cost of sales as actual costs are incurred. Provisions are discounted, where material, by discounting the expected future cash flows at a rate that reflects risk specific to the provision and the time value of money.

K. PROVISION FOR DECOMMISSIONING OBLIGATIONS

Decommissioning obligations are measured at the present value of the expected cost to settle the obligation. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows as well as any changes in the discount rate. Increases or decreases in the provision are recognized as an expense or income. Actual costs incurred upon settlement of the decommissioning obligation are recorded against the provision.

L. RECOGNITION OF REVENUE

Revenue is generated from contracts with customers and other revenues. Contracts with customers include the sale of developed land, golf course operations and service revenue from investment properties. Other revenues include rental revenue from investment property leases and management fees from joint venture operations.

Revenue from contracts related to the sale of developed land is recognized at a point in time, which is when a minimum of 15% of the sale price has been received, the sale is unconditional and possession has been granted. All contracts related to the sale of developed land have one performance obligation, the delivery of a fully developed lot to the customer. Common areas within a development community that are subsequently transferred to municipal or government organizations or home-owner associations are not considered an extension of a customer and therefore; this does not represent a separate performance obligation.

Revenue from golf course operations (green fees, food and beverage) is recognized at a point in time and the performance obligation is satisfied in the accounting period in which the services are provided. Membership revenue from golf courses is recognized over time on a monthly basis in the period in which the performance obligations are completed.

Service revenues are amounts outlined separately in the lease agreement for distinct services provided including utilities, maintenance and security recoveries from tenants which are recognized on a monthly basis in the period in which the corresponding costs are incurred and performance obligations are completed.

Rental revenues include both lease and service revenue components. Lease revenues from investment properties include base rents, recoveries of operating expenses including property taxes, parking revenue, incidental income and sign and storage lease revenue. Revenue recognition under a lease commences when the tenant has a right to use the leased asset. The total amount of contractual rent to be received from the operating leases is recognized on a straight line basis over the term of the lease; a straight line rent receivable which is included in other assets, is recorded for the difference between the rental revenue recognized and the contractual amount received. When incentives are provided to our tenants, the cost of these incentives is recognized over the lease term, on a straight line basis as a reduction to rental revenue.

Investment property leases are accounted for as operating leases given that we have retained substantially all of the risks and benefits of the ownership of our investment properties.

Management fee revenue is comprised of fees paid by our joint arrangement partners based on development and/or sales activities, which fluctuates period to period depending on the stage of various projects.

M. INCOME TAXES

Current income tax is the expected amount of tax payable to the taxation authorities, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the liability method based on the temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax assets are the result of recognizing the benefit associated with deductible temporary differences, unused tax credits, and tax loss carryforwards. The carrying amount of the deferred tax liabilities and assets is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the reporting period date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

We presume that investment property measured at fair value will be recovered entirely through sale. Measurement of the related deferred taxes reflects the tax consequences of recovering the carrying amount through sale.

The REIT qualifies as a mutual fund trust within the meaning of the Income Tax Act (Canada) ("Tax Act") and as a real estate investment trust eligible for the 'REIT Exception', as defined in the rules applicable to Specified Investment Flow-Through ("SIFT") trusts and partnerships in the Tax Act. We expect to allocate all of the REIT's taxable income and to continue to qualify for the REIT Exception. As the REIT is a flow-through entity, we record current and deferred taxes on our 53.0% interest in the REIT.

N. STOCK BASED COMPENSATION

We use the Black-Scholes option pricing model to fair value options granted to our employees, and the intrinsic method to fair value restricted share units ("RSUs"). The estimated fair value of awards on the date of grant is recognized as compensation expense on a graded vesting basis over the period in which the employee services are rendered. We estimate the number of expected forfeitures at the grant date and make adjustments for actual forfeitures as they occur. Stock based awards that give the holder the right to purchase shares are accounted for as equity-settled plans.

O. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing our net income for the period by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants, and similar instruments is computed using the treasury stock method. Our potentially dilutive common shares comprise stock options and RSUs granted to employees.

P. FOREIGN CURRENCY

The consolidated financial statements are presented in Canadian dollars, which is the functional currency for our Canadian operations and our presentation currency.

Assets and liabilities of our US operations, for which the functional currency is the US dollar, are translated into our presentation currency at the exchange rates in effect at the reporting period end date and revenues and expenses are translated at average exchange rates for the period. Gains or losses on translation of foreign operations are recognized as other comprehensive income or loss.

Gains or losses on the settlement of debt or on foreign exchange cash balances are recognized in income in the period realized.

Q. FINANCIAL INSTRUMENTS

At initial recognition, we classify our financial instruments in the following categories depending on the purpose for which the instruments were acquired:

FINANCIAL ASSETS

Finance assets that are held for collection of contractual cash flows represent solely payments of principle and interest are measured at amortized cost. This includes cash and cash equivalents, restricted cash, accounts receivable and agreements receivable. Financial assets are initially recognized at fair value plus transaction costs, adjusted for an expected credit loss. Subsequently, receivables are measured at amortized cost using the effective interest rate method adjusted for expected credit losses.

For financial assets, Melcor applies the simplified expected credit loss approach, which requires expected lifetime losses to be recognized from initial recognition of the accounts receivables and agreements receivables.

FINANCIAL LIABILITIES

Other liabilities are initially recognized at fair value, net of any transaction costs incurred. Other liabilities include accounts payable and accrued liabilities, and general debt. REIT Units are classified as fair value through profit or loss ("FVTPL") and are designated as FVTPL to offset the accounting mismatch of REIT investment properties carried at fair value.

We record our financial liabilities at fair value on initial recognition. Subsequently, financial liabilities are measured at amortized cost using the effective interest rate method and financial liabilities designated as FVTPL are remeasured at fair value with changes in their fair value recorded through income.

Modifications of financial liabilities carried at amortized cost that do not result in derecognition give rise to a modification gain or loss equal to the change in discounted contractual cash flows using the original effective interest rate. This modification gain or loss is recognized in the consolidated statements of net income and comprehensive income.

FINANCIAL GUARANTEE CONTRACTS

Financial guarantee contracts are recognized as a financial liability at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of:

i. the amount determined in accordance with the expected credit loss model under IFRS 9, Financial Instruments, and

ii. the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15, Revenue from Contracts with Customers.

The fair value of financial guarantees is determined based on the present value of the difference in cash flows between the contractual payments required under the debt instrument and the payments that would be required without the guarantee, of the estimated amount that would be payable to a third party for assuming the obligations.

Where guarantees in relation to loans or other payables of associates are provided for no compensation, the fair values are accounted as contributions and recognized as part of the cost of the investment.

R. NON-CONTROLLING INTEREST IN MELCOR REIT

We hold an effective 53.0% interest in the REIT through ownership of all Class B LP Units. A non-controlling interest, REIT units, has been recognized on the statement of financial position to reflect the 47.0% interest held by the public through ownership of all trust units. The trust units are redeemable at the option of the holder and, therefore, are considered a puttable instrument in accordance with International Accounting Standard ("IAS") 32, Financial Instruments – Presentation ("IAS 32"). Certain conditions under IAS 32 allow the REIT to present the trust units as equity; however, on consolidation we do not meet these conditions and therefore must present the non-controlling interest as a financial liability.

As a financial liability designated as fair value through profit or loss ("FVTPL") we recorded the REIT units at fair value on initial recognition. Subsequent to initial recognition we remeasure the liability each period at fair value based upon the trust unit's closing trading price. Fair value gains and losses are recorded through income in the period they are incurred.

Distributions on trust units are recognized in the period in which they are approved and are recorded as an expense in income. For presentation purposes we aggregate the distribution expense with the fair value adjustment on the trust units under the caption 'adjustments related to REIT units'.

S. FINANCIAL DERIVATIVES

Our financial derivatives include interest rate swaps and the conversion feature on the REIT convertible debenture. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and subsequently remeasured at their fair value. The host instrument financial liability is recognized initially at the fair value of a similar liability that does not have conversion feature. The conversion feature is separated from the host instrument and recognized at fair value. The fair value of the host instrument is recorded net of any related transaction costs. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Derivative instruments are recorded in the consolidated statement of financial position at their fair value. Changes in fair value of derivative instruments that are not designated as hedges for accounting purposes are recognized in the income statement.

Melcor has not designated any derivatives as hedges for accounting purposes.

T. OPERATING SEGMENTS

Our operating segments are strategic business units that offer different products and services, and are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

U. STATEMENT OF CASH FLOWS

Development activities is defined as the net change of land inventory and the provision for land development costs and excludes the purchase of raw land. Purchase of raw land is the cost of land net of vendor financing received (see note 10 – land inventory).

Operating assets and liabilities is defined as the net change of accounts receivable, deposits, prepaids and inventory, income taxes payable, accounts payable and accrued liabilities and deferred finance costs capitalized during the year. Excluded from operating assets and liabilities are investment property additions that are unpaid and included in accounts payable and accrued liabilities at year end.

4. ACCOUNTING STANDARD CHANGES

A. NEW AND AMENDED STANDARDS ADOPTED

We have adopted the following new standard interpretation effective January 1, 2018.

i. **IFRS 15 Revenue from Contracts with Customers** supersedes IAS 18, 'Revenue', IAS 11, 'Construction Contracts' and other interpretive guidance associated with revenue recognition. IFRS 15 is to applied to each prior reporting period presented retrospectively or through the recognition of the cumulative effect to opening retained earnings.

Impact of adoption

The adoption of IFRS 15 was done through the modified retrospective approach and did not result in any adjustments upon transition, change in recognition or timing of recognition of revenue from contracts in Melcor. Adoption does require additional detail included within our recognition of revenue policy (note 3L), and disclosures to the year end financial statements to distinguish between revenue related to lease contracts, joint ventures and revenues earned from contracts with customers, as well as the timing of revenue recognition for revenues earned from contracts with customers (note 22).

Lease revenues will continue to be accounted for under IAS 17, Leases, with the exception of any service component revenue earned on a lease contract which will now be accounted for under IFRS 15. Management fee revenue earned on Melcor's joint arrangements will continue to be accounted for under IFRS 11 and revenues from land sales and golf courses will be accounted for under IFRS 15.

ii. **IFRS 9, Financial Instruments** replaces IAS 39 and introduces a new classification and measurement model with three classification categories, 'amortized cost', 'fair value' and 'fair value through other comprehensive income', for financial assets, as well as an expected loss impairment model that requires more timely recognition of expected credit losses and a new hedge accounting model.

Impact of adoption

The adoption of IFRS 9 did not result in any adjustments upon transition. Financial assets which include cash and cash equivalents, restricted cash, accounts receivable and agreements receivables were previously classified as Loans and Receivable are now classified as amortized cost. This change in classification did not result in any changes in measurement of financial assets in Melcor, but did require a change to the our Financial Instruments policy (note 3Q).

Melcor was required to revise its impairment methodology under IFRS 9 for its financial assets, to account for expected credit losses. To measure the expected credit loss, financial assets have been grouped based on shared credit risk characteristics, days past due or past due. While our financial assets are subject to the expected credit loss requirements, the identified loss was immaterial.

There was no impact to the measurement, recognition or disclosures of financial liabilities, and Melcor does not apply hedge accounting.

iii. **IAS 40, Investment Properties** clarifies the principles for transfer into, or out of, investment property when there has been a change in use. We have applied the amendments prospectively in accordance with the transitional provisions.

Impact of adoption

The adoption of IAS 40 did not result in any impact on the classification of existing property at January 1, 2018, no reclassifications and no change to the timing of transfers subsequent to January 1, 2018.

Other standards, amendments and interpretations that were effective for the year beginning January 1, 2018 are not material to Melcor.

B. NEW STANDARDS NOT YET ADOPTED

i. **IFRS 16, Leases** was issued in January 2016 by the IASB to replace IAS 17. IFRS 16 includes several changes in the method of accounting for operating leases, including:

(i) All leases will be on the balance sheet of lessees, except those that meet the limited exception criteria;

(ii) Rent expense for leases on the balance sheet will be recorded as depreciation and finance expenses;

(iii) Timing of expenses will change as the finance lease model results in an accelerated recognition of expenses compared to a straight-line operating lease model.

IFRS 16 is required to be applied for annual periods beginning on or after January 1, 2019. We have completed our evaluation of the impact of this standard on our financial statements and concluded that there is no material impact.

ii. **IFRIC 23, Uncertainty over income tax treatments** clarifies the application of the recognition and measurement requirements in AIS12, "Income Taxes" ("IAS 12"), for situations where there is uncertainty over income tax treatments, IFRIC 23 specifically addresses whether;

(i) an entity considers income tax treatments separately;

(ii) assumptions that an entity makes regarding the examination of tax treatments by taxation authorities;

(iii) how an entity determines taxable income or loss, tax basis, unused tax losses or credits, and tax rates;

(iiii) how an entity considers changes in facts and circumstances.

IFRIC 23 does not apply to taxes or levies outside the scope of IAS 12. IFRIC 23 is effective for annual periods beginning on or after January 1, 2019. We are currently evaluating the impact of adopting this interpretation ti the consolidated financial statements.

iii. **IFRS 3, Business combinations** amendments were made to IFRS 3, Business combinations in order to clarify that obtaining control of a business that is a joint operation is a business combination achieved in stages. Amendments to IFRS 3 are effective for annual periods beginning on or after January 1, 2020. We are currently evaluating the impact of adopting the amendments to this standard to the consolidated financial statements.

5. CRITICAL ACCOUNTING ESTIMATES

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. The estimates and assumptions that are critical to the determination of the amounts reported in the financial statements relate to the following:

A. VALUATION OF AGREEMENTS RECEIVABLE

We review our agreements receivable on a regular basis to estimate the risk of default on outstanding balances. Factors such as the related builder's reputation and financial status, the geographic location of the lot, and length of time the agreement receivable has been outstanding are all considered when estimating any impairment on agreements receivable. Refer to note 28A for further information related to credit risk associated with agreements receivable.

B. VALUATION OF INVESTMENT PROPERTIES

The fair value of investment property is dependent on stabilized net operating income or forecasted future cash flows and property specific capitalization or discount rates. The stabilized net operating income or forecasted future cash flows involve assumptions of future rental income, including estimated market rental rates and vacancy rates, estimated direct operating costs and estimated capital expenditures. Capitalization and discount rates take into account the location, size and quality of the property, as well as market data at the valuation date.

Refer to note 29 for further information about methods and assumptions used in determining fair value of investment properties.

C. DETERMINATION OF THE PROVISION FOR LAND DEVELOPMENT COSTS

We estimate the future costs of completing the development of land by preparing internal budgets of costs and reviewing these estimates regularly to determine if adjustments to increase or decrease the provision for land development costs are required. This estimate impacts the measurement of cost of sales reported given that land inventory is sold prior to all costs being committed or known as the nature of land development considers a long-term time frame to complete all municipal requirements.

D. INCOME TAXES

Significant estimates are required in determining our provision for income taxes. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current tax and deferred tax provision.

The deferred tax assets recognized at December 31, 2018 are supported by future profitability assumptions over a five-year horizon. In the event of changes in these profitability assumptions the tax assets recognized may be adjusted.

6. SIGNIFICANT JUDGMENTS

In the process of applying our accounting policies, we make various judgments, apart from those involving estimations, that can significantly impact the amounts recognized in the financial statements. These include:

A. CAPITALIZATION OF BORROWING COSTS

IAS 23, Borrowing Costs, requires the capitalization of borrowing costs to qualifying assets. IAS 23 also requires the determination of whether the borrowings are specific to a project or general in calculating the capitalized borrowing costs. Judgment is involved in identifying directly attributable borrowing costs to be included in the carrying value of qualifying assets and in determining if funds borrowed are for general purposes or specifically for the construction of qualifying assets. We consider our centrally managed treasury function with assessment of the circumstances surrounding individual borrowings in making this judgment. Capitalization to land inventory occurs when the land is classified to land under development and ceases when the land is considered developed and ready for sale. Borrowing costs are capitalized to investment properties when under active development. We have determined that all of our borrowings are general, except project specific financing (note 16C), as the decision on how to deploy operating and acquisition funds is a centrally managed corporate decision.

B. TRANSFER OF LAND TO INVESTMENT PROPERTY

We typically acquire raw land with the intent of developing it in our Community Development division. When development plans are formulated, we may decide that specific land holdings will be developed into investment properties. Once appropriate evidence of a change in use is established, typically on inception of an operating lease for the investment property, the land is transferred to investment properties. At that time, the land is recognized at fair value in accordance with our accounting policy for investment properties, and any gain or loss is reflected in earnings in the period the transfer occurs.

C. CLASSIFICATION OF TENANT INCENTIVES

Payments are often made to tenants of our commercial properties when new leases are signed. When the payments add future value to the space independent of the lease in place, such costs are capitalized to the investment property. If the costs incurred are specific to the lessee, and do not have stand-alone value, these costs are treated as tenant incentives and amortized on a straight-line basis to revenue over the lease term in accordance with SIC 15, Operating leases – incentives.

D. INVESTMENT PROPERTIES

Our accounting policies related to investment properties are described in note 3F. In applying this policy, judgment is required in determining whether certain costs are additions to the carrying amount of an investment property and, for properties under development, identifying the point at which substantial completion of the property occurs.

(in $000s except per share and acre amounts)

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

E. COMPLIANCE WITH REIT EXEMPTION UNDER ITA

Under current tax legislation, a real estate investment trust is not liable for Canadian income taxes provided that its taxable income is fully allocated to unitholders during the year. In order for the Trust to continue to be taxed as a mutual fund trust, we need to maintain its REIT status. At inception, the Trust qualifies as a REIT under the specified investment flow-through ("SIFT") rules in the Canadian Income Tax Act. The Trust's current and continuing qualification as a REIT depends on the Trust's ability to meet the various requirements imposed under the SIFT rules, which relate to matters such as its organizational structure and the nature of its assets and revenues. We apply judgment in determining whether it continues to qualify as a REIT under the SIFT rules. Should the Trust cease to qualify, it would be subject to income tax on its earnings.

7. INTEREST IN MELCOR REIT

As at December 31, 2018 we hold a 53.0% (2017 - 56.7%) ownership interest in the REIT through ownership of all 14,899,325 Class B LP Units of the Partnership.

The publicly held interest in the REIT is presented as a liability in our consolidated financial statements. Refer to note 26 for summary financial information of the REIT at December 31, 2018. As of March 13, 2019 we hold a 53.0% ownership interest in the REIT.

8. ASSET HELD FOR SALE

On January 31, 2018, we disposed of an industrial property previously held for sale for proceeds of $6,732 (net of transaction costs and including tenant incentives of $66 and straight line rent of $24). The sale price was settled through mortgage assumption of $3,662 and cash of $3,070 (note 11).

9. AGREEMENTS RECEIVABLE

Agreements receivable are due in 2019, except for $28,291 due in 2020 (2017 - balance due 2018, except $46,929 due in 2019 and $1,449 due in 2020). Subsequent to the interest adjustment date, which provides an interest relief period to qualifying registered builders, these receivables earn interest at prime plus two percent (5.95% at December 31, 2018) and are collateralized by the specific real estate sold.

Management monitors agreements receivables for indications of impairment on an ongoing basis. Balances are reduced to their estimated net realizable values when there is doubt regarding collection of the full amount of principal and interest in accordance with the expected credit loss model.

At December 31, 2018, promotional programs of $1,388 (2017 - $nil) were offered to promote sales activities and encourage agreements receivable collections. This amount was determined based on management's best estimate and is subject to measurement uncertainty introduced by the impact of the uncertain economic environment. As a result, revisions to this estimate may be required in future periods. Refer to note 28A for further discussion surrounding credit risk.

As at the prior year end, and during the 2018 fiscal year, we had an agreements receivable balance due from one of our registered builders that is currently in receivership. Melcor held title to the lots sold to this builder as specific security against this balance and performed assessments of the collectibility of the underlying security for these agreements, resulting in no impairment. As of December 31, 2018 we no longer have any outstanding balances with this builder, as all lots previously held by this builder have been subsequently sold to separate home builders or collected on.

10. LAND INVENTORY

As at December 31	2018	2017
Raw land held	387,356	383,843
Land under development	136,534	137,872
Developed land	235,050	207,585
	758,940	729,300

A breakdown of our land purchases are as follows:

	2018	2017
Land purchases - acres	200 acres	771 acres
Land purchases - lot/inventory	—	294 lots
Land cost	10,446	59,775
Vendor financing	2,625	17,196
Net cash to close	7,821	42,579

During the year, certain land inventories were reclassified to investment properties, and fair value gains of $1,015 (2017 - $342) were recognized in the consolidated financial statements. For the purposes of segment reporting, this is disclosed as revenue of $3,085 (2017 - $1,868) and cost of sales of $2,070 (2017 - $1,526) for the Community Development division.

The weighted average interest rate used for capitalization of borrowing costs to land under development is 4.34% for the year ended December 31, 2018 (2017 – 3.97%). Borrowing costs capitalized to land inventory during the year were $4,189 (2017 - $3,603).

Land inventory expensed to cost of sales during the year was $97,695 (2017 - $97,588).

The net realizable value exceeds the carrying cost of all land inventories at December 31, 2018 and 2017, such that no provision for impairment is required.

11. INVESTMENT PROPERTIES

Investment properties consists of the following:

As at December 31	2018	2017
Investment properties	965,339	907,310
Properties under development	67,348	68,546
Total	1,032,687	975,856

(in $000s except per share and acre amounts)

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

2018			
As at December 31	Investment properties	Properties under development	Total
Balance - beginning of year	907,310	68,546	975,856
Additions			
Direct acquisition	33,541	—	33,541
Transfer from land inventory	—	2,070	2,070
Direct leasing costs	1,054	803	1,857
Property improvements	3,897	—	3,897
Property development	3	16,574	16,577
Capitalized borrowing costs	—	943	943
Disposals	(13,321)	—	(13,321)
Transfers	29,959	(29,959)	—
Fair value adjustment on investment properties	(7,508)	8,371	863
Foreign currency translation (included in OCI)	10,404	—	10,404
Balance - end of year	965,339	67,348	1,032,687

2017			
As at December 31	Investment properties	Properties under development	Total
Balance - beginning of year	929,299	41,394	970,693
Additions			
Direct acquisition	—	1,526	1,526
Transfer from land inventory	1,117	287	1,404
Direct leasing costs	4,088	—	4,088
Property improvements	73	31,781	31,854
Property development	—	208	208
Capitalized borrowing costs	(10,919)	—	(10,919)
Disposals	10,302	(10,302)	—
Transfers	(12,480)	3,652	(8,828)
Fair value adjustment on investment properties	(6,642)	—	(6,642)
Foreign currency translation (included in OCI)	(7,528)	—	(7,528)
Balance - end of year	907,310	68,546	975,856

ACQUISITIONS:

On September 26, 2018 we purchased an office property in Glendale, AZ consisting of two buildings for $24,532 (US$18,907) (including transaction costs). The acquisition was accounted for as an asset purchase in accordance with our policy.

On December 3, 2018 we purchased two investment properties in Lethbridge, AB. An office building at a purchase price of $6,322 (including transaction costs) and a commercial building at a purchase price of $2,687 (including transaction costs). These acquisitions were accounted for as asset purchases in accordance with our policy.

DISPOSALS:

On April 16, 2018 we sold an investment property for $13,319 (net of transaction costs and including tenant incentives of $434 and straight line rent of $80). Concurrent with the sale we paid off the associated mortgage liability which had a balance of $6,947.

Also during the year, we disposed of two residential units in Arizona for a sales price of $261 and $255 (US$212 and US $199) (net of transaction costs). The sale price was settled through cash.

ACQUISITIONS AND DISPOSALS IN THE COMPARATIVE YEAR:

During 2017 there were no direct acquisitions made. The following dispositions were made from our portfolio:

- On April 27, 2017, we disposed of an industrial property in Lethbridge, Alberta for a sale price of $7,760 (net of transaction costs). The sale price was settled through mortgage assumption of $2,640, issuance of vendor-take-back mortgage of $900, and cash of $4,220. The vendor-take-back (VTB) mortgage bears interest at an annual rate of 6.00%, with interest only payments payable monthly over a 36 month term. The VTB can be prepaid in whole or in part without penalty, as of December 31, 2018 the balance of this VTB is $900.
- On July 11, 2017, we disposed of a parking lot in Edmonton, Alberta for cash consideration of $2,986 (net of transaction costs).
- On November 15, 2017 we disposed of a residential unit in the US for $173 (US$133) cash consideration (net of transaction costs)

In accordance with our policy, as detailed in note 3F, we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized NOI, while development activity on properties under development and leasing activity drive fair value adjustments on properties under development. Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 29.

Properties transferred from property under development to commercial properties during the year totaled $29,959 (2017 - $10,302). Properties transferred is net of tenant incentives of $391 (2017 - $398).

Presented separately from investment properties is $34,243 (2017 - $34,716) in tenant incentives and $11,702 (2017 -$9,648) in straight-line rent adjustments (included in note 13). The fair value of investment properties has been reduced by these amounts.

The weighted average interest rate used for capitalization of borrowing costs to investment properties under development is 4.37% for the year ended December 31, 2018 (2017 – 3.77%).

Our investment properties are leased to tenants primarily under long term operating leases. Rentals are receivable from tenants monthly. Minimum lease payments under non-cancellable operating leases of investment properties are receivable as follows:

	2018	2017
Within one year	63,571	55,788
Later than one year but not later than 5 years	191,847	172,736
Later than 5 years	129,321	109,200
Total	384,739	337,724

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in $000s except per share and acre amounts)

12. PROPERTY AND EQUIPMENT

	Golf Course Assets					
	Land	Buildings	Equipment	Greens and tees	Corporate	Total
January 1, 2018						
Cost	1,293	8,116	8,446	6,517	6,358	30,730
Accumulated depreciation	—	(2,850)	(6,171)	(3,167)	(3,884)	(16,072)
Opening net book value	1,293	5,266	2,275	3,350	2,474	14,658
Additions	—	31	497	84	186	798
Disposals	—	—	(5)	—	(14)	(19)
Depreciation	—	(208)	(550)	(206)	(453)	(1,417)
Net Book Value - December 31, 2018	1,293	5,089	2,217	3,228	2,193	14,020

	Golf Course Assets					
	Land	Buildings	Equipment	Greens and tees	Corporate	Total
January 1, 2017						
Cost	1,293	8,053	8,350	6,498	6,675	30,869
Accumulated depreciation	—	(2,636)	(5,939)	(2,948)	(3,839)	(15,362)
Opening net book value	1,293	5,417	2,411	3,550	2,836	15,507
Additions	—	63	448	19	96	626
Disposals	—	—	(20)	—	(18)	(38)
Depreciation	—	(214)	(564)	(219)	(440)	(1,437)
Net Book Value - December 31, 2017	1,293	5,266	2,275	3,350	2,474	14,658

13. OTHER ASSETS

	2018	2017
Tenant incentives	34,243	34,716
Deposits and prepaids	6,930	3,837
Straight-line rent adjustments	11,702	9,648
Inventory	488	509
	53,363	48,710

During the year we provided tenant incentives of $6,671 (2017 - $4,540) and recorded $6,710 (2017 - $6,304) of amortization expense. In accordance with SIC 15, Operating leases - incentives, amortization of tenant incentives are recorded on a straight-line basis over the term of the lease against rental revenue. We also disposed of a property which included $434 in tenant incentives and $80 in straight-line rent adjustments (note 11).

14. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2018	2017
Trade accounts payable	14,389	21,674
Distribution payable	743	630
Other payables	28,114	28,151
Provision for decommissioning obligation	1,579	1,524
	44,825	51,979

As described in note 3R distributions on trust units are recognized in the period in which they are approved and are recorded as an expense. As at December 31, 2018, distribution payable pertains to the December 2018 monthly distribution which was subsequently paid on January 15, 2019 (2017 - December 2017 monthly distribution paid on January 15, 2018).

Decommissioning obligation relates to one of our commercial properties held by the REIT. The total decommissioning obligation is estimated based on the future obligation and timing of these expenditures to be incurred. We estimate the net present value of the obligation based on an undiscounted total future provision of $2,014 (December 31, 2017 - $2,014). At December 31, 2018, a discount rate of 4.00% (December 31, 2017 - 4.00%) and an inflation rate of 2.00% (December 31, 2017 - 2.00%) were used to calculate the net present value of the obligation. Due to uncertainty surrounding the nature and timing of this obligation, amounts are subject to change.

15. PROVISION FOR LAND DEVELOPMENT

	2018	2017
Balance - beginning of year	87,139	91,584
New development projects	114,482	86,160
Changes to estimates	(5,371)	(4,037)
Costs incurred	(118,592)	(86,568)
Balance - end of year	77,658	87,139

16. GENERAL DEBT

As at ($000s)		2018	2017
Melcor - revolving credit facilities	a	46,529	76,529
REIT - revolving credit facility	b	—	—
Project specific financing	c	62,639	20,926
Secured vendor take back debt on land inventory	d	40,842	64,891
Debt on investment properties and golf course assets	e	454,342	444,807
REIT - convertible debentures	f	55,204	54,775
Total general debt		659,556	661,928
Less: Liabilities held for sale (note 8)		—	(3,670)
General debt		659,556	658,258

A. MELCOR - REVOLVING CREDIT FACILITIES

We have available credit facilities with approved loan limits of $200,103 (2017 - $205,603) with a syndicate of major chartered banks. The portion of these loan limits that pertain solely to Melcor is $120,000 (2017 - $120,000) with the remaining balance pertaining to specific joint arrangements.

(in $000s except per share and acre amounts)

The amount of the total credit facilities currently used is $46,529 (2017 - $76,529). We have pledged agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral for our credit facilities. The carrying value of assets pledged as collateral is $288,745 (2017 - $364,181).

The facilities mature on July 31, 2020, renewable one year in advance of expiry.

Depending on the form under which the credit facilities are accessed, rates of interest will vary between prime plus 0.75% to prime plus 2.25% or banker's acceptance rate plus a 3.00% stamping fee resulting in interest rates ranging from 4.70% to 6.20% at December 31, 2018 (2017 - 3.95% to 5.45%). The agreements also bear a standby fee of 0.50% for the unused portions of the facilities. The weighted average effective interest rate on borrowings, based on year end balances, is 5.16% (December 31, 2017 - 4.52%).

B. REIT - REVOLVING CREDIT FACILITY

On June 1, 2018 we entered into the first amendment on the REIT revolving credit facility agreement with our existing lenders. Under the terms of the amending agreement the REIT maintains an available credit limit based upon the carrying value of specific investment properties to a maximum of $35,000 for general corporate purposes and acquisitions, including a $5,000 swingline sub-facility. An additional $10,000 is available by way of an accordion feature, subject to lender approval. Depending on the form under which the new facility is accessed, rates of interest will vary between prime plus 1.25% or bankers' acceptance plus 2.25% stamping fee. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. Interest payments are due and payable based upon the form of the facility drawn upon, and principal is due and payable upon maturity. The agreement also bears a standby fee of 0.45% for the unused portion of the new facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the new facility. The facility matures June 1, 2021.

As at December 31, 2018, the carrying value of pledged properties was $54,547 (December 31, 2017 - $56,258).

As at December 31, 2018 we had $nil (December 31, 2017 - $nil) drawn from the facility; and posted letters of credit of $150 (December 31, 2017 - $nil). The weighted average effective interest rate on borrowings as at December 31, 2018 was 3.95% (2017 - 3.48%).

C. PROJECT SPECIFIC FINANCING

	2018	2017
Project specific debt on land, with interest rates between 4.95% and 9.48% (2017 - 4.58% to 5.70%)	31,828	8,709
Project specific debt on investment properties under development, with interest rates between 4.25% and 4.45% (2017 - 3.50% to 3.70%)	30,811	12,217
	62,639	20,926

As at December 31, 2018 $19,791 (2017 - $nil) of debt was payable in US dollars (2018 - US $14,507 and 2017 - US $nil). The debts mature from 2019 to 2029.

Land inventory and agreements receivable with a December 31, 2018 carrying value of $80,241 (2017 - $22,173) have been pledged as collateral on project specific debt on land. The debts are due on demand by the lenders. The weighted average interest rate on the above debts, based on year end balances, is 6.67% (2017 - 4.94%). Specific investment properties under development with a December 31, 2018 carrying value of $54,375 (2017 - $40,715), have been pledged as collateral on project specific debt on investment properties under development.

The change in project specific financing during the year is summarized as follows:

	2018	2017
Balance - beginning of year	20,926	5,213
Cash movements		
Loan repayments	(11,629)	(3,554)
New project financing	52,319	19,267
Non-cash movements		
Foreign currency translation included in OCI	1,023	—
Balance - end of year	62,639	20,926

D. SECURED VENDOR TAKE BACK DEBT ON LAND INVENTORY

	2018	2017
Agreements payable with interest at the following contractual rates:		
Fixed rates of 3.00% - 5.95% (2017 - 3.00% to 6.00%)	36,460	58,318
Variable rate of 5.95% (2017 - 5.20%)	4,382	6,573
	40,842	64,891

As at December 31, 2018 there was no debt payable in US dollars (2017 - $10,622 and US$8,467).

Land inventory with a December 31, 2018 carrying value of $84,757 (2017 - $131,440), has been pledged as collateral for the above debt. The weighted average effective interest rate for the above debts, based on year end balances, is 4.69% (2017 – 5.04%).

The minimum contractual principal payments due within each of the next five years are as follows:

2019	20,377
2020	18,671
2021	1,434
2022	360
Thereafter	—
	40,842

(in $000s except per share and acre amounts)

The change in secured vendor take back debt on land inventory during the year is as follows:

	2018	2017
Balance - beginning of year	64,891	65,408
Cash movements		
Principal repayments		
Scheduled amortization on debt	(26,742)	(16,407)
Non-cash movements		
New secured vendor take back debt	2,625	17,195
Amortization of non-cash interest	(280)	(402)
Foreign currency translation included in OCI	348	(903)
Balance - end of year	40,842	64,891

E. DEBT ON INVESTMENT PROPERTIES AND GOLF COURSE ASSETS

	2018	2017
Variable rate mortgages amortized over 10 to 30 years at variable interest rates of 2.85% - 5.57% (2017 - 2.85% to 4.70%)	55,589	57,602
Mortgages amortized over 15 to 25 years at fixed interest rates of 2.54% - 5.35% (2017 - 2.54% to 6.16%)	401,865	390,285
	457,454	447,887
Fair value adjustment for interest rate swaps	(803)	(1,057)
Unamortized deferred financing fees	(2,309)	(2,023)
	454,342	444,807
Interest rate ranges	(2.54% -5.57%)	(2.48% -6.16%)

As at December 31, 2018 $71,247 (2017 - $52,362) of debt was payable in US dollars (2018 - US $52,226 and 2017 - US $41,739). The debts mature from 2019 to 2029.

Specific investment properties and golf courses with a carrying value of $860,461 (2017 - $708,720) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above debt. The weighted average effective interest rate for the above debts, based on year end balances, is 3.47% (2017 – 3.42%).

The minimum contractual principal payments due within each of the next five years and thereafter are as follows:

2019	61,604
2020	66,976
2021	73,381
2022	35,220
2023	75,429
Thereafter	144,844
	457,454

The change in debt on investment properties and golf course assets during the year is as follows:

	2018	2017
Balance - beginning of year	444,807	455,189
Cash movements		
Principal repayments		
Scheduled amortization on mortgages	(15,964)	(18,796)
Mortgage repayments	(51,909)	(23,076)
New mortgages	75,918	37,507
Non-cash movements		
Mortgage payable disposed through sale during the year (note 8)	(3,662)	(2,640)
Deferred financing fees capitalized	(627)	(195)
Amortization of deferred financing fees	341	548
Change in derivative fair value swap	254	(1,145)
Foreign currency translation included in OCI	5,184	(2,585)
Balance - end of year	454,342	444,807

F. REIT - CONVERTIBLE DEBENTURES

On December 3, 2014, the REIT issued a 5.50% extendible convertible unsecured subordinated debenture (“REIT debenture”) to the public for gross proceeds of $34,500, including $4,500 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 can be converted into trust units at the holders’ option at any point prior to the maturity date at a conversion price of $12.65 per unit (the “Conversion Price”). On and from December 31, 2017, and prior to December 31, 2018, the REIT debenture may be redeemed by the REIT, in whole at any time, or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume weighted-average trading price of the trust units for a specified period (the “Current Market Price”) preceding the date on which notice of redemption is given is not less than 125% of the Conversion Price. On and from December 31, 2018, and prior to the maturity date, the REIT debenture may be redeemed by the REIT, in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest. Subject to regulatory approval and other conditions, the REIT may, at its option, elect to satisfy its obligation to pay the principal amount of the REIT debenture on redemption or at maturity, in whole or in part, by delivering that number of freely tradeable trust units obtained by dividing the principal amount of the REIT debenture being repaid by 95% of the Current Market Price on the date of redemption or maturity. The issuance was qualified under a short form prospectus dated November 25, 2014.

On December 21, 2017, the REIT issued a 5.25% extendible convertible unsecured subordinated debentures (the “2017 Debentures”) to the public for gross proceeds of $23,000, including $3,000 issued pursuant to the exercise of an over-allotment option. Transaction costs related to the issuance were $1,457 for net proceeds of $21,543. The 2017 Debentures bear interest at an annual rate of 5.25% payable semi-annually in arrears on June 30 and December 31 in each year commencing June 30, 2018. The maturity date of the 2017 Debentures is December 31, 2022. The 2017 Debentures can be converted into trust units at the holders’ option at any point prior to the maturity date at a conversion rate of 86.9565 trust units per one thousand principal amount of convertible debentures (the “Conversion Price”). On and from December 31, 2020, and prior to December 31, 2021, the 2017 Debentures may be redeemed by the REIT, in whole at any time, or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume weighted-average trading price of the trust units for a specified period (the "Current Market Price") preceding the date on which notice of redemption is given is not less than 125% of the Conversion Price. On and from December 31, 2021, and prior to the maturity date, the 2017 Debentures may be redeemed by the REIT, in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest. Subject to regulatory approval and other conditions, the REIT may, at its option, elect to satisfy its obligation to pay the principal amount of the convertible debenture on redemption or at maturity, in whole or in part, by delivering that number of freely tradeable trust units obtained by dividing the principal amount of the 2017 Debentures being repaid by 95% of the Current Market Price on the date of redemption or maturity.

The fair value of the host instruments component was calculated using a market interest rate for an equivalent non-convertible, non-extendible bond. The conversion feature components are separated and recognized at its fair value and presented as a liability.

A reconciliation of the convertible debentures is as follows:

	Host Instruments	Conversion Features	Total
Balance at December 31, 2016	32,749	61	32,810
Convertible debenture issued	22,205	795	23,000
Transaction costs	(1,457)	—	(1,457)
Amortization of discount and transaction costs	549	—	549
Fair value adjustment on conversion feature	—	(127)	(127)
Balance at December 31, 2017	54,046	729	54,775
Amortization of discount and transaction costs	971	—	971
Fair value adjustment on conversion feature	—	(542)	(542)
Balance at December 31, 2018	55,017	187	55,204

During the year ended December 31, 2018, we recognized $3,100 of interest expense related to the convertible debentures which is included in finance costs (note 21) (2017 - $1,931).

At December 31, 2018 we remeasured the conversion features to fair value resulting in a fair value gain of $542 for the year (2017 - fair value gain of $127). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 29.

17. SHARE CAPITAL

A. COMMON SHARES

2018	Number of Shares Issued (# of shares)	Amount ($000s)
Common shares, beginning of the year	33,389,451	72,729
Share options exercised	14,200	217
Shares purchased for cancellation	(57,156)	(125)
Common shares, end of the year	33,346,495	72,821

2017	Number of Shares Issued (# of shares)	Amount ($000s)
Common shares, beginning of the year	33,350,898	72,137
Share options exercised	38,553	592
Shares purchased for cancellation	—	—
Common shares, end of the year	33,389,451	72,729

Authorized:

- Unlimited common shares
- Unlimited common shares, non-voting
- Unlimited first preferred shares
- Unlimited first preferred shares, non-voting

We announced a Normal Course Issuer Bid (NCIB) on March 29, 2017 which expired March 30, 2018. Under this bid, we were allowed to purchase up to 1,667,704 common shares (approximately 5% of issued and outstanding) with a daily repurchase restriction of 2,158 common shares. No shares were purchased under this bid.

On March 29, 2018 we announced a new NCIB commencing March 31, 2018 and ending March 30, 2019. Under the bid, we may acquire up to 1,669,782 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,262 common shares.

During the year, there were 57,156 common shares purchased for cancellation by Melcor pursuant to the new NCIB at a cost of $761 (2017 - $nil common shares purchased for cancellation). As at December 31, 2018, 1,612,626 additional common shares may be repurchase by Melcor under the current NCIB.

B. STOCK-BASED COMPENSATION PLANS

On September 28, 2000, Melcor's Board of Directors approved a stock-based compensation plan (the "2000 Plan"). This plan was canceled effective May 10, 2018.

On February 23, 2007 Melcor's Board of Directors approved a stock-based compensation plan (the "2007 Plan"). Under the 2007 Plan, Melcor may grant options to full-time, salaried employees and designated contractors after one year of service. The 2007 Plan requires that the option price shall not be less than the weighted average trading price for the 20 consecutive days during which shares traded on the TSX immediately prior to the granting of the stock option. At the discretion of the board, the options vest over a period of three years and expire no longer than seven (7) years from the date of issuance. The 2007 Plan was approved by Melcor's shareholders at the Shareholders Annual Meeting in April 2007. Melcor has 1,792,000 shares reserved for issuance under the 2007 Plan (2017 – 1,616,013).

On May 10, 2018 Melcor's Board of Directors approved an amendment to the 2007 Plan that will allow participants to purchase common shares of Melcor and benefit from their appreciation through a cashless exercise option feature. The cashless exercise right allows for surrender of all or part of the option to Melcor in consideration of a payment of the in-the-money amount. Upon this exercise Melcor shall satisfy the payment of the in-the-money amount by delivering to the participant the net number of shares.

On May 10, 2018 shareholders of Melcor approved the grant of Restricted Share Units (RSUs). Each RSU will give the participant the right to receive, upon the vesting date, the payout amount with respect to the RSUs which have vested. Payout shall be satisfied by issuing or transferring to the participant one common share for each RSU vested. Except as otherwise provided by the RSU plan, the number of RSUs subject to each grant, how the payout amount is satisfied and other terms and conditions relating to each such RSU shall be determined by Melcor's Board of Directors. When dividends are paid by Melcor, each holder of an RSU shall be entitled to additional RSUs (each a "Dividend Restricted Share Unit") equal to (a) the product of the aggregate number or RSUs held by the participant on record for such dividend multiplied by the per common share amount of such dividend divided by (b) the fair market value of a common share calculated as of the date on which the dividend is paid. Restricted share units granted shall vest and become available for redemption between 34 and 36 months from the grant date, the vesting date shall be set forth in the grant agreement. Melcor's Board of Directors may establish additional performance criteria which may be a condition precedent to the vesting of any RSU, performance criteria will be set forth in the grant agreement.

(in $000s except per share and acre amounts)

The introduction of the RSU plan and the amendment to the 2007 Plan increased the total number of common shares cumulatively reserved for issuance under either plan, when combined with common shares reserved for issuance to a maximum of 3,300,000.

C. STOCK OPTIONS OUTSTANDING AND AVAILABLE FOR GRANTING UNDER THE 2007 PLAN

	2018	2017
Stock options available, beginning of the year	637,566	854,666
Stock option plan amendment	190,187	—
Stock options granted	(220,500)	(276,300)
Stock options expired / canceled	144,100	59,200
Stock options available, end of the year	751,353	637,566

2018		
	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of the year	978,447	16.00
Stock options granted to employees	220,500	9.96
Stock options exercised	(14,200)	13.62
Stock options expired / canceled	(144,100)	18.98
Stock options outstanding, end of the year	1,040,647	14.08

2017		
	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of the year	799,900	16.44
Stock options granted to employees	276,300	14.94
Stock options exercised	(38,553)	13.73
Stock options expired / canceled	(59,200)	18.43
Stock options outstanding, end of the year	978,447	16.00

The weighted average share price at the date of exercise was $15.24 (2017 - $14.99).

D. UNITS AVAILABLE FOR GRANTING UNDER THE RSU PLAN

2018	
	Number of Units
RSUs outstanding, beginning of the year	—
Implementation of the RSU plan	1,500,000
RSUs granted to employees	(67,400)
RSUs outstanding, end of the year	1,432,600

E. STOCK OPTIONS OUTSTANDING AND EXERCISABLE UNDER THE 2007 PLAN

2018			
Stock Option Expiry Date	Outstanding Stock Options (#)	Exercise Price Per Share ($)	Stock Options Exercisable
December 19, 2019	158,700	21.35	158,700
December 21, 2020	158,747	14.05	158,747
December 13, 2021	229,900	13.21	148,000
December 12, 2022	272,800	14.94	91,400
December 12, 2023	220,500	13.01	—
	1,040,647		556,847

F. RESTRICTED SHARE UNITS OUTSTANDING AND REDEEMABLE

2018			
Restricted Share Unit Expiry Date	Outstanding RSUs Options (#)	Exercise Price Per Unit ($)	RSUs Vested
December 31, 2021	67,400	13.01	—
	67,400		—

G. STOCK BASED COMPENSATION EXPENSE

The following assumptions were used in the Black-Scholes option pricing model for options granted. Expected volatility was based on historical volatility.

i) 2007 Option Plan

	2018	2017
Expected volatility	23%	25%
Risk-free interest rate	2.05%	1.61%
Annual dividend rate	4.00%	3.49%
Expected life of options in years	3.86	3.86

The weighted average fair value of stock options granted during the year was $1.62 (2017 - $2.21) per stock option. Current year vesting of options resulted in a $433 (2017 - $408) charge to stock based compensation expense and corresponding credit to contributed surplus.

(in $000s except per share and acre amounts)

ii) RSU Plan

The weighted average fair value of RSUs granted during the year was $13.01 (2017 - n/a) per RSU. Current year compensation expense related to the RSU plan resulted in a $17 (2017- $nil) charge to stock based compensation expense and corresponding credit to contributed surplus.

18. PER SHARE AMOUNTS

(# of shares)	2018	2017
Basic weighted average common shares outstanding during the year	**33,393,743**	33,361,144
Dilutive effect of options and restricted share units	**—**	19,884
Diluted weighted average common shares	**33,393,743**	33,381,028

For the year ended December 31, 2018, there were 1,040,647 stock options excluded from the calculation of diluted earnings per share (2017 - 570,400) as their impact would be anti-dilutive.

Diluted earnings per share was calculated based on the following:

	2018	2017
Profit attributable to shareholders	**64,273**	38,525
Profit for computation of diluted earnings per share	**64,273**	38,525

19. ACCUMULATED OTHER COMPREHENSIVE INCOME

	2018	2017
Balance, beginning of the year	**16,948**	25,190
Other comprehensive income (loss) net of tax	**12,181**	(8,242)
Balance, end of the year	**29,129**	16,948

The other comprehensive income represents the net unrealized foreign currency translation gain on our net investment in our foreign operations.

20. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, we issue letters of credit as collateral for the completion of obligations pursuant to development agreements signed with municipalities. As at December 31, 2018 we had $31,784 (December 31, 2017 - $40,256) in letters of credit outstanding and recorded a net liability of $77,658 (December 31, 2017 - $87,139) in provision for land development costs in respect of these development agreements.

Normally, obligations collateralized by the letters of credit diminish as the developments proceed, through a series of staged reductions over a period of years (average of three to four years) and are ultimately extinguished when the municipality has issued final completion certificates.

We enter into joint arrangements and, in doing so, may take on risk beyond our proportionate interest in the joint arrangement. These situations generally arise where preferred financing terms can be arranged on the condition that the strength of our company's covenant will backstop that of the other joint arrangement participant(s) who also provide similar guarantees. We will have to perform on our guarantee only if a joint arrangement participant was in default of their guarantee. At December 31, 2018 we had guaranteed $9,171 (December 31, 2017 - $10,051) in credit facilities in excess of the amount recognized as a liability. We also guaranteed $12,512 (December 31, 2017 - $12,534) in excess of our share of letters of credit posted with the municipalities.

The loan guarantees include those which are ongoing, as they relate to the relevant lines of credit, and those which have staged reductions as they relate to the financing of specific assets or projects such as infrastructure loans, short-term land loans or mortgages.

To mitigate the possibility of financial loss, we are diligent in our selection of joint arrangement participants. As well, we have remedies available within the joint arrangement agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint arrangement participants.

We also enter into lease agreements with tenants which specify tenant incentive payments upon completion of the related tenant improvements. Incentive payments of approximately $1,599 (2017 - $440) may be required from lease agreements entered during the year.

21. FINANCE COSTS

	2018	2017
Interest on Melcor - revolving credit facilities	**3,108**	2,549
Interest on REIT - revolving credit facility	**225**	776
Interest on REIT convertible debenture	**3,100**	1,931
Interest on general debt	**19,649**	18,959
Financing costs and bank charges	**1,225**	1,284
Gain on debt settlement	**—**	(690)
Non cash financing costs	**1,466**	414
	28,773	25,223
Less: capitalized interest	**(4,205)**	(3,811)
	24,568	21,412

Cumulative interest capitalized on land inventory at the end of the year is $43,256 (2017 - $41,279). Finance costs paid during the year was $27,174 (2017 - $24,956).

22. REVENUE AND EXPENSE BY NATURE

A. REVENUE

The components of revenue are as follows:

Revenue from contracts with customers	2018	2017
Sale of land	**162,257**	153,234
Operating cost recoveries	**17,847**	17,891
Golf course revenue	**7,543**	7,784
Total	**187,647**	178,909

Other revenue	2018	2017
Lease revenue	**75,642**	74,758
Management fees	**4,145**	4,283
Total	**79,787**	79,041
Total Revenue	**267,434**	257,950

(in $000s except per share and acre amounts)

The timing of recognition for revenue from contracts with customers is as follows:

2018					
	Community Development	Investment Property	Recreational Properties	REIT	Total
Timing of Revenue Recognition					
At a point in time	162,257	—	6,807	—	169,064
Over time	—	5,055	736	12,792	18,583
Revenue from contracts with customers	162,257	5,055	7,543	12,792	187,647

2017					
	Community Development	Investment Property	Recreational Properties	REIT	Total
Timing of Revenue Recognition					
At a point in time	153,234	—	6,950	—	160,184
Over time	—	4,820	834	13,071	18,725
Revenue from contracts with customers	153,234	4,820	7,784	13,071	178,909

B. COST OF SALES

The components of cost of sales are as follows:

	2018	2017
Cost of land sold	97,695	97,588
Investment property direct operating expenses	38,933	38,044
Direct golf course expenses	4,631	4,514
Golf course asset depreciation	964	996
Total	142,223	141,142

C. GENERAL AND ADMINISTRATIVE EXPENSE

The components of general and administrative expenses are as follows:

	2018	2017
Employee salary and benefits		
Salaries, wages and retirement allowance	11,451	12,964
Employee benefits	923	813
Stock based compensation	450	408
Corporate asset depreciation	453	440
Marketing	1,484	1,806
Other	8,668	8,922
Total	23,429	25,353

Included in employee salary and benefits is the compensation of key management. Key management includes our directors and members of the executive management team. Compensation awarded to key management includes:

	2018	2017
Salaries, wages and retirement allowance	2,837	4,690
Employee benefits	45	47
Stock based compensation	247	238
Total	3,129	4,975

D. FAIR VALUE ADJUSTMENT ON INVESTMENT PROPERTIES

The components of the fair value adjustment are as follows:

	2018	2017
Land transferred to investment properties	1,015	342
Property under development	7,356	3,310
Commercial and residential properties	(7,508)	(12,480)
Total	863	(8,828)

23. INCOME TAX

Components of tax expense:

	2018	2017
Current tax expense		
Current year	22,245	11,559
Adjustment to prior years	216	1,036
	22,461	12,595
Deferred tax expense		
Origination and reversal of temporary differences	(3,482)	3,613
Change in tax rates	(11)	(1,048)
	(3,493)	2,565
Total tax expense	18,968	15,160

Reconciliation of effective tax rate:

	2018	2017
Income before taxes	83,241	53,685
Statutory rate	27%	27%
	22,475	14,495
Taxable (non-taxable) portion of capital gains, fair value adjustments and recovery on REIT transfer	(664)	932
Non-taxable portion of REIT income	(1,524)	(1,324)
Impact of different tax rates in US subsidiary	(138)	(343)
Non-deductible expenses	2,563	2,297
Non-taxable fair value adjustments on REIT units	(3,733)	151
Change in tax rates	(11)	(1,048)
Total tax expense	18,968	15,160

(in $000s except per share and acre amounts)

Movement in deferred tax balances during the year:

	2018			
	Opening	Recognized in profit or loss	Recognized in OCI	Closing
Investment property and capital assets	60,576	(846)	204	59,934
Reserves for tax purposes	12,671	(1,342)	—	11,329
Capitalized interest	(3,357)	(1,356)	(44)	(4,757)
Provision for decommissioning obligation	(233)	7	—	(226)
Convertible debenture	169	44	—	213
Deferred tax liability	69,826	(3,493)	160	66,493

	2017			
	Opening	Recognized in profit or loss	Recognized in OCI	Closing
Investment property and capital assets	59,430	1,343	(197)	60,576
Reserves for tax purposes	11,356	1,315	—	12,671
Capitalized interest	(3,215)	(142)	—	(3,357)
Provision for decommissioning obligation	(223)	(10)	—	(233)
Convertible debenture	110	59	—	169
Deferred tax liability	67,458	2,565	(197)	69,826

No deferred tax liability has been recognized in respect of the net unrealized foreign currency exchange gain in accumulated other comprehensive income. Income tax paid during the year was $6,022 (2017 - $21,672).

24. JOINT ARRANGEMENTS

The table below discloses our proportionate share of the assets, liabilities, revenue, and earnings of 29 arrangements (2017 – 30) that are recorded in these financial statements as follows:

Joint Venture	Interest	Principle activity	Country of incorporation
Anders East Developments	33%	Active land development with investment property	Canada
Anders East Two Communities	50%	Non-active land development	Canada
Blackmud Communities	39%	Active land development	Canada
Capilano Investments	50%	Investment property	Canada
Chestermere Communities	50%	Active land development with investment property	Canada
Country Hills Communities	50%	Active land development	Canada
Highview Communities	60%	Active land development	Canada
HV Nine Joint Venture	7%	Active land development	Canada
Jagare Ridge Communities	50%	Active land development and recreational property	Canada
Jesperdale Communities	50%	Active land development	Canada
Kimcor Communities	50%	Active land development	Canada
Kinwood Communities	50%	Active land development	Canada
Lakeside Communities	50%	Non-active land development	Canada
Larix Communities	50%	Active land development	Canada
Lewis Estates Communities	60%	Active land development and recreational property	Canada
Mattson North Communities	50%	Active land development	Canada
MMY Properties	33%	Investment property	Canada
Rosenthal Communities	50%	Active land development	Canada
South Shepard Communities	50%	Non-active land development	Canada
Stonecreek Shopping Centre	30%	Investment property	Canada
Sunset Properties	60%	Active land development	Canada
Terwillegar Pointe Communities	50%	Non-active land development	Canada
Watergrove Developments	50%	Manufactured home community	Canada
Westmere Properties	50%	Investment property	Canada
Whitecap Communities	50%	Active land development	Canada
Windermere Communities	50%	Active land development	Canada
Windermere at Glenridding Communities	35%	Active land development	Canada
Winterburn Developments	50%	Active land development	Canada
Villeneuve Communities	60%	Active land development	Canada

The following summarizes financial information about our share of assets, liabilities, revenue and earnings of our interest in joint arrangements that are recorded in our accounts for the year ended December 31, 2018.

	2018	2017
Assets	455,808	444,378
Liabilities	169,308	169,740
Revenue	82,811	82,046
Net Earnings	27,126	22,280

Contingent liabilities arising for liabilities of other joint arrangement participants are disclosed in note 20.

25. SEGMENTED INFORMATION

In the following schedules, segment earnings has been calculated for each segment by deducting from revenues of the segment all direct costs and administrative expenses which can be specifically attributed to the segment, as this is the basis for measurement of segment performance. Common costs, which have not been allocated, include finance costs, foreign exchange gains, adjustments to REIT units and income tax expense.

The allocation of these costs on an arbitrary basis to the segments would not assist in the evaluation of the segments' contributions. Inter-segment transactions are entered into under terms and conditions similar to those with unrelated third parties.

(in $000s except per share and acre amounts)

Community Development
This division is responsible for purchasing and developing land to be sold as residential, industrial and commercial lots.

Property Development
This division develops high-quality retail, office and industrial revenue-producing properties on serviced commercial sites developed primarily from our community development division. Once substantial completion of construction and leasing are complete, these properties are transferred to our investment property division at fair value (refer to note 11).

Investment Property
This division owns 21 leasable commercial, retail and residential properties (2017 – 25 properties) and other rental income producing assets such as parking lots and land leases.

REIT
This division owns 37 leasable commercial and retail properties (2017 – 37 properties) and other rental income producing assets such as residential property, parking lots and land leases.

Recreation Property
This division owns and manages three 18-hole golf course operations (one of which is 60% owned), and has a 50% ownership interest in one 18-hole golf course.

US Operations
Melcor has a wholly owned subsidiary with operations in the US, which includes a Community Development division and an Investment Property division. The subsidiary's related balances are below.

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

(in Canadian dollars)	External Revenue		Total Assets at December 31	
	2018	2017	2018	2017
United States	**46,322**	24,297	**272,537**	203,687
Canada	**221,112**	233,653	**1,750,539**	1,787,296
Total	**267,434**	257,950	**2,023,076**	1,990,983

2018	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue (note 22)	168,336	30,751	32,545	70,173	8,391	—	310,196	(42,762)	267,434
Cost of sales (note 22)	(99,765)	(30,350)	(13,236)	(28,097)	(6,013)	—	(177,461)	35,238	(142,223)
Gross profit	68,571	401	19,309	42,076	2,378	—	132,735	(7,524)	125,211
General and administrative expense (note 22)	(9,501)	(2,406)	(2,439)	(2,884)	(2,298)	(6,980)	(26,508)	3,079	(23,429)
Fair value adjustment on investment properties (note 11, 22 and 29)	—	7,356	447	(11,385)	—	—	(3,582)	4,445	863
Gain (loss) on sale of assets	—	—	—	—	14	(8)	6	—	6
Interest income	905	27	8	137	—	214	1,291	—	1,291
Segment Earnings (loss)	59,975	5,378	17,325	27,944	94	(6,774)	103,942	—	103,942
Foreign exchange gain									429
Finance costs (note 21)									(24,568)
Adjustments related to REIT units (note 26)									3,438
Income before income taxes									83,241
Income tax expense (note 23)									(18,968)
Net income for the year									64,273

2017	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue (note 22)	158,285	11,015	34,792	66,613	8,650	—	279,355	(21,405)	257,950
Cost of sales (note 22)	(99,114)	(10,700)	(13,876)	(26,500)	(5,889)	—	(156,079)	14,937	(141,142)
Gross profit	59,171	315	20,916	40,113	2,761	—	123,276	(6,468)	116,808
General and administrative expense (note 22)	(8,908)	(2,065)	(3,197)	(2,718)	(2,183)	(9,418)	(28,489)	3,136	(25,353)
Fair value adjustment on investment properties (note 11, 22 and 29)	—	3,308	(2,668)	(12,800)	—	—	(12,160)	3,332	(8,828)
Gain (loss) on sale of assets	—	—	—	—	35	(18)	17	—	17
Interest income	906	16	33	62	—	112	1,129	—	1,129
Segment Earnings (loss)	51,169	1,574	15,084	24,657	613	(9,324)	83,773	—	83,773
Foreign exchange loss									(591)
Finance costs (note 21)									(21,412)
Adjustments related to REIT units (note 26)									(8,085)
Income before income taxes									53,685
Income tax expense (note 23)									(15,160)
Net income for the year									38,525

(in $000s except per share and acre amounts)

26. NON-CONTROLLING INTEREST IN MELCOR REIT

In accordance with our policy, as detailed in notes 3R and 29, we account for the 47.0% publicly held interest in the REIT as a financial liability measured at fair value through profit or loss ("FVTPL"). As at December 31, 2018 the REIT units had a fair value of $98,374 (2017 - $94,898). We recorded adjustments related to REIT units for the year of $3,438 (2017 - $8,085).

On January 12, 2018 the REIT completed the issuance of 2,035,500 trust units in exchange for subscription receipts previously issued and outstanding as of December 31, 2017. Subscription receipts had been issued at $8.50 for gross proceeds of $17,302, including $2,257 issued pursuant to the exercise of an over-allotment option. The funds were used to help the REIT finalize a purchase of five commercial properties from Melcor for a total sales price of $80,875 ("Melcor Acquisition"). The sales price was settled through the REIT's assumption of $31,038 in mortgages payable; issuance of 1,331,167 Class C LP units, representing $13,312 in Retained Debt by Melcor; issuance of 283,447 Class B LP Units at a price of $8.82, representing $2,500; and cash of $34,025. The transaction costs directly related to the unit issuance were $1,488 and are included in income as part of adjustments related to REIT units. As at December 31, 2018 Melcor owns 53.0% interest in the REIT through ownership o f Class B LP Units. We have assessed and concluded that Melcor continues to retain control of the REIT in accordance with IFRS 10, Consolidated Financial Statements.

A reconciliation of the subscription receipts is as follows:

	Amount
Gross proceeds	17,302
Accrued interest payable for distribution	114
Transaction costs	(793)
	16,623

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

	2018	2017
Fair value adjustment on REIT units	13,827	(558)
Distributions to REIT unitholders	(8,901)	(7,527)
Transaction costs on REIT unit issuance		
Capitalized against REIT trust units	(1,190)	—
Capitalized to investment properties	(298)	—
Adjustments related to REIT units	3,438	(8,085)

The following tables summarize the financial information relating to Melcor's subsidiary, the REIT, that has material non-controlling interest (NCI), before intra-group eliminations (presented at 100%).

	2018	2017
Assets	709,603	676,237
Liabilities	400,094	378,405
Net assets	309,509	297,832
Cost of NCI	103,959	103,959
Fair value of NCI	98,374	94,898

	2018	2017
Revenue	70,173	66,613
Net income and comprehensive income	17,610	732
Cash flows from operating activities	11,870	13,605
Cash flows (used in) from investing activities	(26,700)	1,905
Cash flows from financing activities, before distributions to REIT unitholders	13,011	2,576
Cash flows used in financing activities - cash distributions to REIT unitholders	(8,789)	(7,527)
Net (decrease) increase in cash and cash equivalents	(10,608)	10,559

27. MANAGEMENT OF CAPITAL RESOURCES

We define capital as share capital, contributed surplus, accumulated other comprehensive income, retained earnings and general debt. Our objective when managing capital is to utilize debt to improve our performance, support the growth of our assets, and finance capital requirements arising from the cyclical nature of our business. Specifically, we plan to utilize shorter term debt for financing infrastructure, land inventory, receivables and development activities and to utilize longer term debt and equity for the purchase of property and land assets.

We manage the capital structure through adjusting the amount of long-term debt, credit facilities, the amount of dividends paid, and through normal course issuer bids.

There were no changes to the way we define capital, our objectives, and our policies and processes for managing capital from the prior fiscal period.

We are subject to financial covenants on our $120,000 (2017 - $120,000) Melcor revolving credit facility. The covenants include a maximum debt to total capital ratio of 1.25, a minimum interest coverage ratio of 3.00, and a minimum net book value of shareholders' equity of $300,000. As at December 31, 2018, and throughout the period, we were in compliance with our financial covenants.

In addition, we are subject to financial covenants on our $35,000 REIT revolving credit facility. The covenants include a maximum debt to total capital ratio of 60% (excluding convertible debentures), a minimum debt service coverage ratio of 1.50, and a minimum adjusted unitholders' equity of $140,000. As at December 31, 2018, and throughout the period, the REIT was in compliance with its financial covenants.

We also have financial covenants on certain mortgages for investment properties. At December 31, 2018, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

(in $000s except per share and acre amounts)

28. RISK MANAGEMENT

We are exposed to the following risks as a result of holding financial instruments:

A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents, restricted cash, accounts receivable, and agreements receivable. Our maximum exposure to credit risk is the carrying amount of these instruments.

We invest our cash in bank accounts and short-term deposits with a major Canadian chartered bank. Accounts receivable balances include amounts due from other joint arrangement participants for their portion of management fees due to us as well as other various smaller balances due from municipal governments, other developers and tenants.

We manage our credit risk in the Investment Property and REIT Divisions through careful selection of tenants and look to obtain national tenants or tenants in businesses with a long standing history, or perform financial background checks including business plan reviews for smaller tenants. We manage our concentration risk in the Investment Property Division by renting to an expansive tenant base, with no dependency on rents from any one specific tenant.

Accounts receivables are significantly low risk due to their individual immaterial balances, the nature of the party they are due from (including joint venture participants under management by Melcor), and the overall lack of historical write offs. No lifetime expected losses are considered necessary.

Agreements receivable are collateralized by specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region. We manage credit risk by selling to certain qualified registered builders. Concentration risk is low as we sell to a large builder base, and no receivables are concentrated to one specific builder and Melcor maintains an approved builder list containing those builders which have a long standing track record, good volumes, positive perception in the industry, and strong history of repayment. At December 31, 2018, 89% of agreements receivable are due from approved builders (2017 – 93%).

	Current	0-6 months past due	Greater than 6 months past due	Total
As at December 31, 2018				
Expected loss rate	0.06%	0.18%	0.18%	
Agreements receivable	125,274	948	346	126,568
Loss allowance	75	2	1	78

Total loans included in agreements receivable that would have otherwise been past due at December 31, 2018, but whose terms have been renegotiated is $9,019 (2017 - $1,821). In order to address current market conditions, we have provided extensions on our standard terms to relieve liquidity pressure on builders. At December 31, 2018, we have identified $1,216 (2017 - $2,866) in agreements receivable which are in arrears.

B. LIQUIDITY RISK

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We manage liquidity risk to ensure that we have sufficient liquid financial resources to finance operations and meet long-term debt repayments. We monitor rolling forecasts of our liquidity, which includes cash and cash equivalents and the undrawn portion of the operating loan, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against loan covenant requirements and maintain ongoing debt financing plans. We believe that we have access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

Refer to note 16 for the maturity analysis of general debt and details on the bank indebtedness. Accounts payable and accrued liabilities are expected to be repaid in the next twelve months.

C. MARKET RISK

We are subject to interest rate cash flow risk as our operating credit facilities and certain of our general debt bear interest at rates that vary in accordance with prime borrowing rates in Canada. For each 1% change in the rate of interest on loans subject to floating rates, the change in annual interest expense is approximately $1,691 (2017 - $1,551) based upon applicable year end debt balances. We are not subject to other significant market risks pertaining to our financial instruments.

29. FAIR VALUE MEASUREMENT

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

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

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, agreements receivable and accounts payable and accrued liabilities approximate their fair values based on the short term maturities of these financial instruments.
- fair values of general debt and derivative financial liabilities - interest rate swaps are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of derivative financial liabilities - conversion features on the REIT's convertible debentures are estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of REIT units are estimated based on the closing trading price of the REIT's trust units (Level 1).

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

(in $000s except per share and acre amounts)

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

2018	Fair Value hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
Non-financial assets					
Investment properties	Level 3	1,032,687	—	1,032,687	1,032,687
Asset held for sale	Level 3	—	—	—	—
Financial liabilities					
General debt, excluding derivative financial liability	Level 3	—	604,352	604,352	589,890
REIT - Convertible debenture	Level 2		55,017	55,017	56,738
Liability held for sale	Level 3	—	—	—	—
Derivative financial liabilities					
Interest rate swaps	Level 3	(803)	—	(803)	(803)
Conversion features on convertible debentures	Level 3	187	—	187	187
REIT units	Level 1	98,374	—	98,374	98,374

2017	Fair Value hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
Non-financial assets					
Investment properties	Level 3	975,856	—	975,856	975,856
Asset held for sale	Level 3	6,732	—	6,	6,732
Financial liabilities					
General debt, excluding derivative financial liability	Level 3	—	603,483	603,483	576,920
REIT - Convertible debenture	Level 2	—	54,046	54,046	57,289
Liability held for sale	Level 3	—	3,670	3,670	3,670
Derivative financial liabilities					
Interest rate swaps	Level 3	(1,057)	—	(1,057)	(1,057)
Conversion features on convertible debentures	Level 3	729	—	729	729
REIT units	Level 1	94,898	—	94,898	94,898

The prior table analyzes assets and liabilities carried at fair value in the consolidated statement of financial position, by the levels in the fair value hierarchy. The fair value hierarchy categorizes fair value measurement into three levels based upon the inputs to the valuation technique, which are defined as follows:

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

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

INVESTMENT PROPERTIES

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

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

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

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

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items. For properties under development forecasted net operating income is based on location, type and quality of the property, supported by the terms of actual or anticipated future leasing
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;
- Terminal capitalization rate - taking into account assumptions regarding vacancy rates and market rents;
- Estimated costs to complete for properties under development - based on expected completion dates considering development and leasing risks specific to each property and the status of approvals and/or permits; and
- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

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

(in $000s except per share and acre amounts)

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

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

Investment properties were valued by Melcor's internal valuation team as at December 31, 2018 of which 32 investment properties (of 82 legal phases valued) with a fair value of $420,145 were valued by qualified independent external valuation professionals during the year which resulted in fair value gains of $863 recorded as fair value adjustment on investment properties in the statements of income and comprehensive income (2017 - investment properties were valued by Melcor Development Ltd.'s internal valuation team of which 48 investment properties (of 81 legal phases valued) with a fair value of $688,267 were valued by qualified independent external valuation professionals during the year which resulted in fair value losses of $8,828).

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

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

Weighted average stabilized net operating income for investment properties is $1,506 (2017 - $1,484). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	Investment Properties			Properties under Development		
December 31, 2018	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.50%	6.66%	6.00%	6.50%	6.23%
Terminal capitalization rate	5.75%	9.00%	6.76%	6.25%	6.25%	6.25%
Discount rate	6.50%	9.75%	7.66%	7.00%	7.00%	7.00%

	Investment Properties			Properties under Development		
December 31, 2017	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.60%	5.75%	6.50%	6.07%
Terminal capitalization rate	5.75%	9.00%	6.75%	6.00%	6.25%	6.07%
Discount rate	6.00%	9.75%	7.67%	6.75%	7.00%	6.93%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $56,215 (2017 - $56,320). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $65,343 (2017 - $65,115).

GENERAL DEBT, EXCLUDING DERIVATIVE FINANCIAL LIABILITIES

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

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

REIT UNITS

REIT units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the REIT units at the period end date. At December 31, 2018 the fair value of the REIT units was $98,374 (2017 - $94,898). During the year a fair value gain of $13,827 (2017 - loss of $558) was recognized in the statement of income and comprehensive income, and was included in adjustments related to REIT units.

(in $000s except per share and acre amounts)

DERIVATIVE FINANCIAL LIABILITIES

Our derivative financial liabilities are comprised of floating for fixed interest rate swaps on mortgages (level 2) and the conversion features on our convertible debentures (level 3).

The fair value of the interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at December 31, 2018 the fair value of interest rate swap contracts was $803 (2017 - $1,057).

The conversion features on the convertible debentures was valued by qualified independent external valuation professionals at December 31, 2018. This resulted in a fair value gain of $542 (2017 - fair value gain of $127) being recognized in income. The significant unobservable inputs used in the fair value measurement of the conversion features on the REIT convertible debentures as at December 31, 2018 are as follows:

- Volatility - expected volatility as at December 31, 2018 was derived from the historical prices of the REIT's trust units. As the REIT was formed on May 1, 2013, we have used the entire historical data up until December 31, 2018. Volatility was 17.80% (2017 - 21.70%).
- Credit spread - the credit spread of the convertible debentures was imputed from the traded price of the convertible debentures as at December 31, 2018. The credit spread used was 3.92% (2017 - 2.81%).

30. SUBSEQUENT EVENTS

DISTRIBUTIONS ON REIT TRUST UNITS:

On January 15, 2019 we declared a distribution of $0.05625 per unit for the months of January, February and March 2019. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
January 2019	January 31, 2019	February 15, 2019	$0.05625 per unit
February 2019	February 28, 2019	March 15, 2019	$0.05625 per unit
March 2019	March 29, 2019	April 15, 2019	$0.05625 per unit

DIVIDEND DECLARED:

On March 13, 2019, our board of directors declared a quarterly dividend of $0.13 per share payable on March 29, 2019 to shareholders of record on March 22, 2019.