



Condensed Interim Consolidated Financial Statements

For the three and six-months ended June 30, 2018

(Unaudited, in thousands of Canadian dollars)

## Condensed Interim Consolidated Statement of Income (Loss)

Unaudited (\$'000s)	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Revenue (note 8)	42,793	46,955	87,207	85,522
Cost of sales	(22,058)	(24,860)	(43,519)	(44,668)
Gross profit	20,735	22,095	43,688	40,854
General and administrative expense	(6,026)	(6,192)	(11,838)	(12,107)
Fair value adjustment on investment properties (note 6 and 12)	(1,790)	947	283	(12,857)
Adjustments related to REIT units (note 11)	(3,809)	(5,897)	(2,135)	(8,225)
Gain on sale of assets	5	14	5	14
Operating earnings	9,115	10,967	30,003	7,679
Interest income	379	335	701	655
Finance costs	(6,117)	(4,936)	(11,637)	(10,454)
Net finance costs	(5,738)	(4,601)	(10,936)	(9,799)
Income before income taxes	3,377	6,366	19,067	(2,120)
Income tax expense	(1,746)	(2,439)	(2,789)	(2,956)
Net income (loss) for the period	1,631	3,927	16,278	(5,076)
Income (loss) per share:				
Basic earnings (loss) per share	0.05	0.12	0.49	(0.15)
Diluted earnings (loss) per share	0.05	0.12	0.49	(0.15)

See accompanying notes to these condensed interim consolidated financial statements.

## Condensed Interim Consolidated Statement of Comprehensive Income (Loss)

Unaudited (\$'000s)	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net income (loss) for the period	1,631	3,927	16,278	(5,076)
Other comprehensive income (loss)				
Items that may be reclassified subsequently to net income (loss):				
Currency translation differences	3,012	(3,219)	6,792	(3,951)
Comprehensive income (loss)	4,643	708	23,070	(9,027)

See accompanying notes to these condensed interim consolidated financial statements.

## Condensed Interim Consolidated Statement of Financial Position

Unaudited (\$000s)	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Cash and cash equivalents	31,620	42,505
Restricted cash	—	16,956
Accounts receivable	9,549	17,384
Income taxes recoverable	3,358	8,933
Agreements receivable	108,912	129,949
Land inventory (note 5)	765,391	729,300
Investment properties (note 6 and 12)	983,271	975,856
Property and equipment	14,391	14,658
Other assets	54,982	48,710
Assets held for sale (note 4)	—	6,732
	<b>1,971,474</b>	<b>1,990,983</b>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	36,792	51,979
Provision for land development costs	98,565	87,139
General debt (note 7)	639,315	658,258
Deferred income tax liabilities	65,024	69,826
REIT units (note 11 and 12)	108,395	94,898
Subscription receipts	—	16,623
Liability held for sale (note 4)	—	3,670
	<b>948,091</b>	<b>982,393</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 9)	72,946	72,729
Contributed surplus	3,128	2,939
Accumulated other comprehensive income (AOCI)	23,740	16,948
Retained earnings	923,569	915,974
	<b>1,023,383</b>	<b>1,008,590</b>
	<b>1,971,474</b>	<b>1,990,983</b>

See accompanying notes to these condensed interim consolidated financial statements.



## Condensed Interim Consolidated Statement of Cash Flows

Unaudited (\$000's)	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
<b>CASH FLOWS FROM (USED IN)</b>				
<b>OPERATING ACTIVITIES</b>				
Net income (loss) for the period	1,631	3,927	16,278	(5,076)
Non cash items:				
Amortization of tenant incentives	1,595	1,931	3,255	3,155
Depreciation of property and equipment	455	459	652	658
Stock based compensation expense	107	114	212	212
Non-cash finance costs	637	(195)	1,207	171
Straight-line rent adjustment	(505)	(224)	(1,218)	(522)
Fair value adjustment on investment properties (note 6 and 12)	1,790	(947)	(283)	12,857
Fair value adjustment on REIT units (note 11 and 12)	1,583	4,015	(3,804)	4,461
Loss (gain) on sale of assets	(5)	(14)	(5)	(14)
Deferred income taxes	(98)	16	(4,897)	(1,040)
	7,190	9,082	11,397	14,862
Agreements receivable	12,206	10,380	21,037	22,285
Development activities	(14,646)	(1,404)	(21,032)	(1,352)
Purchase of land inventory (note 5)	(91)	(23,451)	(1,066)	(25,130)
Payment of tenant lease incentives and direct leasing costs	(1,931)	(1,604)	(3,738)	(2,398)
Operating assets and liabilities	(5,322)	4,756	(8,342)	3,101
	(2,594)	(2,241)	(1,744)	11,368
<b>INVESTING ACTIVITIES</b>				
Additions to investment properties (note 6)	(7,110)	(7,003)	(12,333)	(9,415)
Net proceeds from disposal of investment properties (note 6)	—	4,220	516	4,220
Net proceeds from disposal of asset held for sale (note 4 and 6)	13,389	—	16,459	—
Purchase of property and equipment	(311)	(184)	(405)	(192)
Proceeds on disposal of property and equipment	24	16	24	24
	5,992	(2,951)	4,261	(5,363)
<b>FINANCING ACTIVITIES</b>				
Proceeds from issuance of trust units (note 11)	—	—	17,302	—
Revolving credit facilities	(8,297)	(945)	(26,399)	7,102
Proceeds from general debt	23,022	10,160	42,106	10,160
Repayment of general debt	(15,183)	(16,059)	(38,387)	(26,237)
Dividends paid	(4,342)	(4,336)	(8,683)	(8,672)
Share capital issued	108	25	194	78
	(4,692)	(11,155)	(13,867)	(17,569)
<b>FOREIGN EXCHANGE GAIN (LOSS) ON CASH HELD IN A FOREIGN CURRENCY</b>	672	(649)	465	(872)
<b>DECREASE IN CASH AND CASH EQUIVALENTS DURING THE PERIOD</b>	(622)	(16,996)	(10,885)	(12,436)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD</b>	32,242	44,452	42,505	39,892
<b>CASH AND CASH EQUIVALENTS, END OF THE PERIOD</b>	31,620	27,456	31,620	27,456
<b>Total income taxes paid</b>	680	4,854	1,144	8,954
<b>Total interest paid</b>	5,752	5,806	11,662	11,704

See accompanying notes to these condensed interim consolidated financial statements.

## 1. DESCRIPTION OF THE BUSINESS

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

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 June 30, 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 August 2, 2018, 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”.

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

## 2. BASIS OF PRESENTATION

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

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS as issued by the IASB.

These condensed interim consolidated financial statements were approved for issue by the Board of Directors on August 2, 2018.

## 3. SIGNIFICANT ACCOUNTING POLICIES AND NEW STANDARDS ADOPTED

The accounting policies followed in these condensed interim consolidated financial statements are consistent with those of the previous financial year, except as described below. Beginning January 1, 2019 IFRS 16, Leases, will be in effect. We are in the process of assessing the impact of this new standard on our financial statements.

We have adopted the following new IFRS standards effective January 1, 2018

- a) **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 be 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 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 disclosures to the interim financial statements to distinguish between those revenues related to lease components or service revenues (note 8).

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.

### *Accounting Policies Adopted From January 1, 2018*

Revenue is generated from the sale of developed land, rental of investment properties, management fees, and the operation of golf courses.

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.

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.

Tenant 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.

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.

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.

Revenue from contracts related to golf courses (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.

- b) 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.

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.

#### *Accounting Policies Adopted From January 1, 2018*

##### 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.

#### 4. 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.

#### 5. LAND INVENTORY

	June 30, 2018	December 31, 2017
Raw land held	383,145	383,843
Land under development	143,995	137,872
Developed land	238,251	207,585
	<b>765,391</b>	<b>729,300</b>

During the six-month period ended June 30, 2018, we purchased 1.64 acres of land at a cost of \$1,066.

During the comparative six-month period ended June 30, 2017, we purchased 424.49 acres of land and 294 lots at a cost of \$35,752 and received vendor financing of \$10,622.

#### 6. INVESTMENT PROPERTIES

Investment properties consists of the following:

	June 30, 2018	December 31, 2017
Investment properties	915,856	907,310
Properties under development	67,415	68,546
Total	<b>983,271</b>	<b>975,856</b>

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

	Six months ended June 30, 2018		
	Investment Properties	Properties under Development	Total
Balance - beginning of period	907,310	68,546	975,856
Additions			
Transfer from land inventory	—	2,070	2,070
Direct leasing costs	465	524	989
Property improvements	2,108	—	2,108
Development costs	—	9,887	9,887
Capitalized borrowing costs	—	338	338
Disposals	(13,391)	—	(13,391)
Transfers	19,767	(19,767)	—
Fair value adjustment on investment properties	(5,534)	5,817	283
Foreign currency translation (included in OCI)	5,131	—	5,131
Balance - end of period	<b>915,856</b>	<b>67,415</b>	<b>983,271</b>

Year ended  
December 31, 2017

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

In accordance with our policy we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized net operating income ("NOI"). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 12.

### Disposals

During the six-month period ended June 30, 2018, 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.

On April 16, 2018 we sold an investment property for proceeds of \$13,389 (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.

## 7. GENERAL DEBT

	June 30, 2018	December 31, 2017
Melcor - revolving credit facilities	50,130	76,529
REIT - revolving credit facility	—	—
Project specific financing	58,313	20,926
Secured vendor take back debt on land inventory	41,938	64,891
Debt on investment properties and golf course assets	433,680	444,807
REIT - convertible debentures	55,254	54,775
Total general debt	639,315	661,928
Less: Liability held for sale (note 4)	—	3,670
General debt	639,315	658,258

**8. REVENUE**

(\$000s) Total Revenues	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Revenue from contracts	23,127	27,635	48,225	46,602
Revenue from other sources	19,666	19,320	38,982	38,920
	42,793	46,955	87,207	85,522

(\$000s) Timing of contract revenue recognition	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
At a point in time	18,297	22,793	38,702	37,177
Over time	4,830	4,842	9,523	9,425
	23,127	27,635	48,225	46,602

**9. SHARE CAPITAL**

Issued and outstanding common shares at June 30, 2018 are 33,403,651 (December 31, 2017 – 33,389,451). During the three and six months ended June 30, 2018, there were 8,000 and 14,200 options exercised (Q2-2017 – 1,700 and 5,553).

**10. SEGMENTED INFORMATION**

**Geographic Analysis**

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

External Revenues	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
United States	3,524	3,642	11,767	7,236
Canada	39,269	43,313	75,440	78,286
Total	42,793	46,955	87,207	85,522

Total Assets As at	June 30, 2018	December 31, 2017
	United States	248,789
Canada	1,722,685	1,787,296
Total	1,971,474	1,990,983

## 10. SEGMENTED INFORMATION (continued)

### Divisional Analysis

Our divisions reported the following results:

For the three months ended June 30, 2018	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Segment revenue	16,790	3,750	8,098	17,537	3,788	—	49,963	(7,170)	42,793
Cost of sales	(11,204)	(3,650)	(3,328)	(6,924)	(2,080)	—	(27,186)	5,128	(22,058)
Gross profit	5,586	100	4,770	10,613	1,708	—	22,777	(2,042)	20,735
	—	—	—	—	—	—		—	
General and administrative expense	(2,320)	(587)	(597)	(709)	(829)	(1,815)	(6,857)	831	(6,026)
Fair value adjustment on investment properties	—	2,062	(1,649)	(3,414)	—	—	(3,001)	1,211	(1,790)
Gain on sale of assets	—	—	—	—	12	(7)	5	—	5
Interest income	290	5	1	29	—	54	379	—	379
Segment Earnings (Loss)	3,556	1,580	2,525	6,519	891	(1,768)	13,303	—	13,303
Finance costs									(6,117)
Adjustments related to REIT units									(3,809)
Income before tax									3,377
Income tax expense									(1,746)
Net income for the period									1,631

For the three months ended June 30, 2017	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Segment revenue	22,089	49	8,670	16,559	3,703	—	51,070	(4,115)	46,955
Cost of sales	(14,945)	—	(3,586)	(6,526)	(1,999)	—	(27,056)	2,196	(24,860)
Gross profit	7,144	49	5,084	10,033	1,704	—	24,014	(1,919)	22,095
									—
General and administrative expense	(2,368)	(517)	(663)	(625)	(804)	(2,043)	(7,020)	828	(6,192)
Fair value adjustment on investment properties	—	983	(878)	(249)	—	—	(144)	1,091	947
Interest income	291	12	1	14	—	17	335	—	335
Segment Earnings (Loss)	5,067	527	3,544	9,173	914	(2,026)	17,199	—	17,199
Finance costs									(4,936)
Adjustments related to REIT units									(5,897)
Income before tax									6,366
Income tax expense									(2,439)
Net income for the period									3,927

For the six months ended	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
June 30, 2018									
Segment revenue	39,441	20,043	15,733	35,554	3,935	—	<b>114,706</b>	(27,499)	<b>87,207</b>
Cost of sales	(23,808)	(19,850)	(6,332)	(14,262)	(2,590)	—	<b>(66,842)</b>	23,323	<b>(43,519)</b>
Gross profit	15,633	193	9,401	21,292	1,345	—	<b>47,864</b>	(4,176)	<b>43,688</b>
General and administrative expense	(4,793)	(1,206)	(1,180)	(1,455)	(1,203)	(3,551)	<b>(13,388)</b>	1,550	<b>(11,838)</b>
Fair value adjustment on investment properties	—	4,803	(3,731)	(3,415)	—	—	<b>(2,343)</b>	2,626	<b>283</b>
Gain on sale of assets	—	—	—	—	12	(7)	<b>5</b>	—	<b>5</b>
Interest income	516	11	4	64	—	106	<b>701</b>	—	<b>701</b>
Segment Earnings (Loss)	11,356	3,801	4,494	16,486	154	(3,452)	<b>32,839</b>	—	<b>32,839</b>
Finance costs									<b>(11,637)</b>
Adjustments related to REIT units									<b>(2,135)</b>
Income before tax									<b>19,067</b>
Income tax expense									<b>(2,789)</b>
Net income for the period									<b>16,278</b>

For the six months ended	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
June 30, 2017									
Segment revenue	36,836	130	17,418	33,559	3,864	—	<b>91,807</b>	(6,285)	<b>85,522</b>
Cost of sales	(24,739)	—	(6,891)	(13,343)	(2,502)	—	<b>(47,475)</b>	2,807	<b>(44,668)</b>
Gross profit	12,097	130	10,527	20,216	1,362	—	<b>44,332</b>	(3,478)	<b>40,854</b>
General and administrative expense	(4,313)	(962)	(1,271)	(1,314)	(1,158)	(4,649)	<b>(13,667)</b>	1,560	<b>(12,107)</b>
Fair value adjustment on investment properties	—	2,703	(770)	(16,708)	—	—	<b>(14,775)</b>	1,918	<b>(12,857)</b>
Interest income	583	13	2	20	—	37	<b>655</b>	—	<b>655</b>
Segment Earnings (Loss)	8,367	1,884	8,488	2,214	218	(4,612)	<b>16,559</b>	—	<b>16,559</b>
Finance costs									<b>(10,454)</b>
Adjustments related to REIT units									<b>(8,225)</b>
Income before tax									<b>(2,120)</b>
Income tax expense									<b>(2,956)</b>
Net loss for the period									<b>(5,076)</b>

## 11. NON-CONTROLLING INTEREST IN MELCOR REIT

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 to the REIT for a total sales price of \$80,875. 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 price of \$8.82, representing \$2,500; and cash of \$34,025. As at June 30, 2018 Melcor owns a 53.0% interest in the REIT through ownership of 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.

In accordance with our policy, we account for the remaining 47.0% publicly held interest in the REIT as a financial liability measured at fair value through profit or loss ("FVTPL"). As at June 30, 2018 the REIT units had a fair value of \$108,395. We recorded adjustments related to REIT units for the three and six months ended June 30, 2018 of \$3,809 and \$(2,135) (Q2-2017 - \$5,897 and \$8,225).

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

	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Fair value adjustment on REIT units (note 12)	(1,583)	(4,015)	3,804	(4,461)
Transaction costs on REIT unit issuance				
Capitalized against REIT trust units	—	—	(1,190)	—
Capitalized to investment properties	—	—	(298)	—
Distributions to REIT unitholders	(2,226)	(1,882)	(4,451)	(3,764)
<b>Adjustments related to REIT units</b>	<b>(3,809)</b>	<b>(5,897)</b>	<b>(2,135)</b>	<b>(8,225)</b>

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

As at	June 30, 2018	December 31, 2017
Assets	711,545	676,237
Liabilities	396,097	378,405
<b>Net assets</b>	<b>315,448</b>	<b>297,832</b>
Cost of NCI	118,819	102,707
<b>Fair value of NCI</b>	<b>108,395</b>	<b>94,898</b>

	For the three months ended		For the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Revenue	17,537	16,559	35,554	33,559
Net income (loss) and comprehensive income (loss)	(1,768)	(1,792)	7,776	(15,282)
Cash flows from operating activities	1,679	2,701	5,376	5,528
Cash flows from (used in) investing activities	12,252	3,411	(19,036)	3,198
Cash flows from (used in) financing activities, before distributions to REIT unitholders	(9,822)	(3,046)	8,951	(4,420)
Cash flows used in financing activities - cash distributions to REIT unitholders	(2,130)	(1,882)	(4,243)	(3,764)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,979</b>	<b>1,184</b>	<b>(8,952)</b>	<b>542</b>

## 12. FAIR VALUE MEASUREMENT

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

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

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

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

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

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

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

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

	June 30, 2018					December 31, 2017	
	Fair Value Hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
<b>Non-financial assets</b>							
Investment properties	Level 3	983,271	—	983,271	983,271	975,856	975,856
Assets held for sale	Level 3	—	—	—	—	6,732	6,732
<b>Financial liabilities</b>							
General debt, excluding convertible debenture and derivative financial liability	Level 3	—	585,152	585,152	571,108	603,483	576,920
Convertible debenture	Level 1	—	54,525	54,525	57,500	54,046	58,018
Liabilities held for sale	Level 3	—	—	—	—	3,670	3,670
<b>Derivative financial liability</b>							
Interest rate swaps	Level 3	(1,091)	—	(1,091)	(1,091)	(1,057)	(1,057)
Conversion feature on convertible debenture	Level 3	729	—	729	729	729	729
REIT units	Level 1	108,395	—	108,395	108,395	94,898	94,898

### Investment properties

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

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

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

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

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

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

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

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

Investment properties were valued by Melcor's internal valuation team as at June 30, 2018 of which 18 investment properties (of 82 legal phases) with a fair value of \$214,233 were valued by qualified independent external valuation professionals during the period. Valuations performed during the period resulted in fair value gains of \$283. As at December 31, 2017 Melcor's internal valuation team valued investment properties 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. Valuations performed during 2017 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 unobservable inputs	Relationship between inputs and fair value
Investment properties	Direct capitalization or discounted cash flows	- Capitalization rate - Discount rate - Terminal rate - Stabilized NOI - Cash flows	Inverse relationship between capitalization, discount and terminal rates and fair value (higher rates result in decreased fair value); whereas higher stabilized NOI or cash flows results in increased fair value.
Properties under development	Direct capitalization less cost to complete	- Capitalization rate - Stabilized NOI - Costs to complete	Inverse relationship between capitalization rate and fair value (higher capitalization rate results in lower fair value); whereas higher stabilized NOI results in increased fair value.
Properties under development - undeveloped land	Direct comparison	- Comparison to market transactions for similar assets	Land value reflects market value.

Weighted average annual stabilized net operating income for investment properties as at June 30, 2018 is \$1,498 (December 31, 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		
	Min	Max	Weighted Average	Min	Max	Weighted Average
<b>June 30, 2018</b>						
Capitalization rate	5.50%	8.75%	6.62%	6.00%	6.50%	6.22%
Terminal capitalization rate	5.75%	9.00%	6.73%	6.25%	6.25%	6.25%
Discount rate	6.75%	9.75%	7.66%	6.22%	6.25%	7.00%

	Investment Properties			Properties under Development		
	Min	Max	Weighted Average	Min	Max	Weighted Average
<b>December 31, 2017</b>						
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 capitalization rates by 50 basis points would decrease the fair value and carrying amount of investment properties by \$55,028 (December 31, 2017 - \$56,320). A decrease in capitalization rates by 50 basis points would increase the fair value and carrying amount of investment properties by \$64,015 (December 31, 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 and convertible debenture have been calculated by discounting the expected cash flows of each loan using a discount rate specific to each individual loan. The discount rate is determined using the bond yield for similar instruments of similar maturity adjusted for each individual project's specific credit risk. In determining the adjustment for credit risk, we consider current market conditions and other indicators of credit worthiness.

### Derivative financial liabilities

Our derivative financial liabilities are comprised of floating for fixed interest rate swaps on mortgages (level 2) and the conversion feature on our REIT 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 June 30, 2018, the fair value of interest rate swap contracts was \$1,091 (December 31, 2017 - \$1,057).

The significant unobservable inputs used in the fair value measurement of the conversion feature on the REIT convertible debenture as at June 30, 2018 are as follows:

- Volatility - expected volatility as at June 30, 2018 was derived from the historical prices of the REIT's trust units. As the REIT was formed on May 1, 2013, price history is limited and we have used the entire historical data up until June 30, 2018. Volatility was 21.70% (December 31, 2017 - 21.70%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at June 30, 2018. The credit spread used was 2.81% (December 31, 2017 - 2.81%).

### 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 June 30, 2018 the fair value of the REIT units was \$108,395, resulting in a fair value gain during the quarter of \$1,583 and \$3,804 (2017 - loss of \$4,015 and \$4,461) in the statement of income and comprehensive income for the period ended June 30, 2018 (note 11).

## 13. CREDIT RISK

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

As at June 30, 2018, we have agreements receivable balances of \$2,769 due from one of our registered builders that is currently in receivership, of which \$2,196 is overdue as of June 30, 2018. We hold title to the lots sold to this builder as specific security against this balance. Management has performed an assessment of the collectibility and of the underlying security for these agreements, and has concluded that no impairment is required as at June 30, 2018. We will continue to monitor our exposure to impairment as we work to settle the outstanding amounts.

## 14. EVENTS AFTER THE REPORTING PERIOD

### Distributions on REIT trust units

On July 16, 2018 the REIT declared a distribution of \$0.05625 per unit for the months of July, August and September 2018. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
July 2018	July 31, 2018	August 15, 2018	\$0.05625 per unit
August 2018	August 31, 2018	September 17, 2018	\$0.05625 per unit
September 2018	September 28, 2018	October 15, 2018	\$0.05625 per unit

### Dividends declared

On August 2, 2018 our board of directors declared a dividend of \$0.13 per share payable on September 28, 2018 to shareholders of record on September 14, 2018.