

Madison Pacific Properties Inc.

Consolidated Financial Statements

For the Years Ended August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars)



November 20, 2015

Independent Auditor's Report

To the Shareholders of Madison Pacific Properties Inc.

We have audited the accompanying consolidated financial statements of Madison Pacific Properties Inc. and its subsidiaries, which comprise the consolidated balance sheets as at August 31, 2015 and August 31, 2014 and the consolidated statements of changes in equity, income and comprehensive income, and cash flows for the years ended August 31, 2015 and August 31, 2014, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Madison Pacific Properties Inc. and its subsidiaries as at August 31, 2015 and August 31, 2014 and its financial performance and its cash flows for the years ended August 31, 2015 and August 31, 2014 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

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Madison Pacific Properties Inc.

Consolidated Balance Sheets

As at August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars)

	2015 \$	2014 \$
Assets		
Non-current assets		
Investment properties (note 4)	385,409	368,153
Deferred income tax assets (note 15)	-	1,944
Other non-current assets (note 6)	23,135	20,657
	<u>408,544</u>	<u>390,754</u>
Current assets		
Cash and cash equivalents	4,106	1,039
Amounts receivable and other current assets (note 7)	4,218	3,065
Income taxes receivable (note 15)	208	205
Assets held for sale (notes 4 and 5)	17,613	-
	<u>26,145</u>	<u>4,309</u>
Total assets	<u>434,689</u>	<u>395,063</u>
Liabilities		
Non-current liabilities		
Debt on investment properties (note 8)	148,801	152,223
Deferred income tax liabilities (note 15)	6,671	2,690
	<u>155,472</u>	<u>154,913</u>
Current liabilities		
Bank indebtedness (note 10)	7,252	21,854
Current portion of debt on investment properties (note 8)	51,892	20,780
Accounts payable and accrued liabilities (note 9)	9,247	7,877
	<u>68,391</u>	<u>50,511</u>
Total liabilities	<u>223,863</u>	<u>205,424</u>
Equity		
Equity attributable to shareholders of the Company		
Share capital (note 11)	67,472	67,472
Contributed surplus	921	721
Retained earnings	134,138	112,145
	<u>202,531</u>	<u>180,338</u>
Non-controlling interests	<u>8,295</u>	<u>9,301</u>
Total equity	<u>210,826</u>	<u>189,639</u>
Total liabilities and equity	<u>434,689</u>	<u>395,063</u>

Subsequent events (note 23)

Approved by the Board of Directors

"Marvin Haasen" Director

"Sam Grippo" Director

The accompanying notes are an integral part of these consolidated financial statements.

Madison Pacific Properties Inc.
Consolidated Statements of Changes in Equity
For the Years Ended August 31, 2015 and August 31, 2014
(expressed in thousands of Canadian dollars)

	<u>Attributable to shareholders of the Company</u>				Non- controlling interests	Total equity
	Share capital \$	Contributed surplus \$	Retained earnings \$	Total \$	\$	\$
Balance – August 31, 2013	67,472	375	102,835	170,682	360	171,042
Stock-based compensation	-	346	-	346	-	346
Net income and comprehensive income	-	-	15,460	15,460	541	16,001
Dividends (note 12)	-	-	(6,150)	(6,150)	-	(6,150)
Non-controlling interests (note 4)	-	-	-	-	8,600	8,600
Distributions to non-controlling interests	-	-	-	-	(200)	(200)
Balance – August 31, 2014	67,472	721	112,145	180,338	9,301	189,639
Stock-based compensation	-	200	-	200	-	200
Net income and comprehensive income	-	-	28,143	28,143	2,551	30,694
Dividends (note 12)	-	-	(6,150)	(6,150)	-	(6,150)
Distributions to non-controlling interests	-	-	-	-	(3,557)	(3,557)
Balance – August 31, 2015	67,472	921	134,138	202,531	8,295	210,826

The accompanying notes are an integral part of these consolidated financial statements.

Madison Pacific Properties Inc.

Consolidated Statements of Income and Comprehensive Income

For the Years Ended August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars, except per share data)

	2015 \$	2014 \$
Property revenues (note 13)	30,363	30,198
Property operating expenses (note 14)	<u>7,798</u>	<u>7,818</u>
	22,565	22,380
General and administrative expenses (note 14)	<u>2,711</u>	<u>2,924</u>
	19,854	19,456
Net gain on fair value adjustment on investment properties (note 4)	25,029	8,491
Equity earnings of associate (note 6)	<u>239</u>	<u>540</u>
	45,122	28,487
Interest income (note 17)	940	950
Interest expense	8,765	8,827
Loss on fair value adjustment on interest rate swaps (note 8)	<u>681</u>	<u>13</u>
Income before income taxes	36,616	20,597
Income taxes (note 15)	<u>5,922</u>	<u>4,596</u>
Net income and comprehensive income	<u>30,694</u>	<u>16,001</u>
Net income and comprehensive income attributable to:		
Shareholders of the Company	28,143	15,460
Non-controlling interests	<u>2,551</u>	<u>541</u>
	30,694	16,001
Income per share (note 16)		
Basic	<u>\$0.48</u>	<u>\$0.26</u>
Diluted	<u>\$0.48</u>	<u>\$0.26</u>

The accompanying notes are an integral part of these consolidated financial statements.

Madison Pacific Properties Inc.

Consolidated Statements of Cash Flows

For the Years Ended August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars)

	2015 \$	2014 \$
Cash flows from operating activities		
Net income	30,694	16,001
Items not affecting cash		
Net gain on fair value adjustment on investment properties	(25,029)	(8,491)
Amortization	175	394
Equity earnings of associate	(239)	(540)
Stock-based compensation	200	346
Loss on fair value adjustment on interest rate swaps (note 8)	626	13
Accretion of recoverable benefit	-	(12)
Recognition of rental revenue on a straight-line basis	(330)	(671)
Deferred income taxes	5,925	4,500
	12,022	11,540
(Increase) in amounts receivable and other assets	(4,007)	(1,534)
(Increase) in income taxes receivable	(3)	(892)
Increase in accounts payable and accrued liabilities	335	246
	8,347	9,360
Cash flows used by investing activities		
Acquisition of investment properties	(4,824)	(45,336)
Additions to investment properties and property development costs	(2,254)	(273)
Other investment property expenditures	(396)	(1,861)
Net proceeds from disposition of investment properties	-	14,147
Advances and other loans (notes 6 and 17)	614	(372)
	(6,860)	(33,695)
Cash flows from financing activities		
Net proceeds from debt on investment properties	64,068	21,402
Bank indebtedness, net	(14,602)	12,489
Repayment of debt on investment properties	(38,179)	(14,756)
Funding from non-controlling interests (note 4)	-	8,600
Distributions to non-controlling interests	(3,557)	(200)
Dividends paid	(6,150)	(6,150)
	1,580	21,385
Increase (decrease) in cash and cash equivalents	3,067	(2,950)
Cash and cash equivalents - beginning of year	1,039	3,989
Cash and cash equivalents - end of year	4,106	1,039
Supplemental cash flow information		
Interest received	223	886
Interest paid	9,578	9,047
Income taxes paid	-	987
Significant non-cash investing and financing transactions		
Assumed debt on acquisition of investment properties (notes 4 and 8)	2,360	28,882
Acquisition date fair value adjustments on assumed debt (notes 4 and 8)	(144)	(667)
Debt assumed by purchaser on sale of investment properties (notes 4 and 8)	-	3,800

The accompanying notes are an integral part of these consolidated financial statements.

Madison Pacific Properties Inc.

Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

1. General information

Madison Pacific Properties Inc. (the “Company”) owns, develops and operates office, industrial, and commercial real estate properties located in British Columbia, Alberta, Ontario, and Quebec. The Company is incorporated and domiciled in Canada. The head office of the Company is located at 389 West 6th Avenue, Vancouver, British Columbia, V5Y 1L1 and its registered office is located at 25th Floor, Toronto-Dominion Bank Tower, 700 West Georgia Street, Vancouver, British Columbia, V7Y 1B3.

2. Summary of significant accounting policies and critical accounting estimates

a. Basis of presentation

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). IFRS comprises International Financial Reporting Standards, International Accounting Standards (“IAS”) and interpretations issued by the IFRS Interpretations Committee (“IFRIC”) and the former Standing Interpretations Committee (“SIC”).

These consolidated financial statements were approved by the Board of Directors for issue on November 19, 2015.

b. Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for investment properties and financial derivatives, which are measured at fair value.

c. New accounting standards and amendments

On September 1, 2014, the Company adopted the following new accounting standards and amendments and changed its accounting policies accordingly. The retrospective adoption of these standards and amendments did not result in the restatement of prior period comparative balances in order to comply with their implementation.

- Amendment to IAS 32, *Financial Instruments Presentation*, amends IAS 32 to clarify the requirements for offsetting financial assets and liabilities on the balance sheet. The amendment to this standard did not have a significant effect on the Company’s consolidated financial statements.
- Amendment to IAS 36, *Impairment of Assets*, amends IAS 36 and addresses the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. The amendment to this standard did not have a significant effect on the Company’s consolidated financial statements.
- IFRIC 21, *Levies*, sets out the accounting for an obligation to pay a levy that is not income tax. The interpretation addresses what the obligating event is that gives rise to pay a levy and when a liability should be recognized. This standard did not have a significant effect on the Company’s consolidated financial statements.

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- The IASB issued Annual Improvements to IFRSs 2010-2012 Cycle which included improvements and amendments to IFRS 2, *Share-based Payment*, IFRS 3, *Business Combinations*, IFRS 8, *Operating Segments*, IFRS 13, *Fair Value Measurements*, IAS 16, *Property, Plant and Equipment*, IAS 24, *Related Party Disclosures*, and IAS 38, *Intangible Assets*. The Company reviewed the amendments to these standards and they did not have a significant effect on the Company's consolidated financial statements.
- The IASB issued Annual Improvements to IFRSs 2011-2013 Cycle which included improvements and amendments to IFRS 3, *Business Combinations*, IFRS 13, *Fair Value Measurements*, and IAS 40, *Investment Property*. The Company reviewed the amendments to these standards and they did not have a significant effect on the Company's consolidated financial statements.

d. Principles of consolidation

Subsidiaries

These consolidated financial statements incorporate the assets and liabilities of all entities controlled by the Company and the results of all controlled entities. Controlled entities are those entities over which the Company has i) the power to govern the financial and operating policies, ii) the right to receive benefits from that entity and iii) the ability to use its operating decisions to alter the benefits received. These criteria are met by having a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. In addition, for consolidation purposes, factors may exist where an entity may consolidate without having more than 50% of the voting power through ownership or agreements, or in the circumstances of enhanced minority rights, as a consequence of *de facto* control. *De facto* control is control without the legal right to exercise unilateral control, and involves decision making abilities that are not shared with others and the ability to give direction with respect to the operating and financial policies of the entity concerned. Where control of a subsidiary ceases during a financial year, its results are included up to the point in the year when control ceases. Where control of an entity is acquired during a financial year, its results are included in the consolidated statement of income and comprehensive income from the date on which control commences.

The Company's subsidiaries are Metro Vancouver Properties Corp., MP Western Properties Inc., 1073774 Properties Inc., 3530639 Canada Inc., 801325 B.C. Ltd., the MPW Properties Partnership, the MT Properties LP and MT Management Inc.

All inter-company balances, transactions and unrealized profits resulting from inter-company transactions are eliminated.

Non-controlling interests

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Changes in the parent company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

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Joint arrangements

The Company classifies its interests in joint arrangements as either a joint venture or a joint operation. A joint arrangement is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control. A joint arrangement is classified as a joint venture when the parties to the joint arrangement have rights over the net assets of the joint arrangement whereas a joint arrangement is classified as a joint operation when the arrangement provides rights to assets and obligations for liabilities for the parties sharing joint control. Joint ventures are accounted for using the equity method of accounting and joint operations are accounted for by using the proportionate consolidation method whereby the Company's share of assets, liabilities, income, expenses and cash flows of jointly controlled operations are combined with the equivalent items in the results on a line-by-line basis.

Associates

Associates are entities over which the Company has significant influence but not control. Investments in associates are accounted for using the equity method as follows:

- Investments are initially recognized at cost.
- Investments in associates include goodwill and intangible assets identified on acquisition, net of any accumulated impairment loss.
- The Company's share of its associate's post-acquisition profits or losses is recognized in the consolidated statement of income and comprehensive income.
- Dividends and distributions receivable from associates reduce the carrying amount of the investment.
- The Company's liability with respect to its associates is limited to its net investment where it has no obligation to fund any subsequent losses should they arise. There is no obligation beyond the initial investment.

e. Investment properties

Investment properties are held to earn rental income, for capital appreciation or for both. Investment properties also include properties being constructed or developed for future use, including existing investment properties which undergo redevelopment for continued future use. Property interests held under operating leases are not treated as investment properties.

Where property is acquired, management considers the substance of the assets and activities of the acquired entity in determining whether the acquisition represents the acquisition of a property or a business combination. The basis of the judgement is set out in note 2(p)(ii).

An investment property is initially measured at its cost, which includes the cost of the acquisition, property transfer taxes, due diligence costs and standard closing costs.

After initial recognition, investment properties are carried at fair value. Fair value represents the estimated amount at which the properties could be exchanged between a knowledgeable and willing buyer and seller in an arm's length transaction at the date of valuation. Valuations are prepared by management based primarily on assumptions relating to cash flow from current leases, rental income from future leases in light of current market conditions and capitalization rates. The capitalization rates used are generally based on ranges provided by external valuers. These assumptions are further compared against information obtained from

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

independent industry experts. Adjustments are made to the fair values of the investment properties when changes in the underlying valuation assumptions occur. Changes in fair values are recognized in the consolidated statement of income and comprehensive income.

Fair value measurement on property under construction is only applied if the fair value is considered to be reliably measurable.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that the Company will receive future economic benefits associated with the expenditures and the fair value of the investment property exceeds its carrying amount plus subsequent expenditures. All other repair and maintenance costs are expensed when incurred.

For investment properties being constructed, developed or redeveloped for future use, all direct expenditures incurred in connection with the construction or development are capitalized during the development period. This period begins from the date that activities commence to prepare the property for its intended use and ends when such activities are substantially complete.

Depreciation is not taken on investment properties.

Investment properties are derecognized either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss arising on the derecognition of an investment property is recognized as a net gain on fair value adjustment on investment properties in the consolidated statement of income and comprehensive income in the period in which the investment property is derecognized.

Investment properties are classified as held for sale when the criteria in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, are met. The resulting gain or loss from the sale is recognized when title passes to the purchaser, all or substantially all of the proceeds have been received or are receivable and all material conditions of the sales agreement have been met.

f. Leases

The Company has retained substantially all of the risks and benefits of ownership of its revenue properties and therefore accounts for leases with its tenants as operating leases. Properties leased out under operating leases are included in investment properties in the consolidated balance sheet.

When a tenant lease provides for free rent periods and/or periodic increases in base rent over the lease term, the total amount of net rental revenue to be received from these leases is accounted for on a straight-line basis over the term of the applicable lease. Accordingly, a non-current asset is recorded for the current difference between the straight-line rent recorded as rental revenue and the rent that is contractually due from the tenant. As the lease term progresses and the step-rate increase is received, the asset is drawn down. The asset is included in the carrying amount of the related investment property.

Tenant incentives include costs incurred to make leasehold improvements to tenants' space and are included in the carrying amount of the related investment property. Such incentives are recognized as a reduction of rental income on a straight-line basis over the term of the applicable lease.

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Leasing commissions are fees paid in connection with negotiating lease contracts with lessees. Such fees are included in the carrying amount of the related investment property and are amortized on a straight-line basis over the term of the applicable lease.

g. Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less.

h. Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- i. Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. Derivatives, including interest rate swaps, are also included in this category unless they are designated as hedges.
- ii. Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current, unless the investment matures within 12 months, or management expects to dispose of it within 12 months.

Dividends on available-for-sale equity instruments are recognized in the consolidated statement of income and comprehensive income as part of other gains and losses when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the consolidated statement of income and comprehensive income.

- iii. Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise loans receivable, cash and cash equivalents, and amounts receivable. The current portion of loans receivable, cash and cash equivalents, and amounts receivable are included in current assets due to their short-term nature. The balance of loans receivable are included in non-current assets. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

- iv. Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, bank indebtedness drawn on the line of credit and debt on investment properties. Accounts payable and accrued liabilities and bank indebtedness drawn on the line of credit are recognized at the amount required to be paid. Debt on investment properties is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

i. Derivative financial instruments

The Company enters into interest rate swaps from time to time to manage interest rate risk. Interest rate swaps are financial derivatives and are classified as carried at fair value through profit and loss. The fair value of an interest rate swap is included in the consolidated balance sheet within accounts payable and accrued liabilities if the fair value of the interest rate swap results in an unrealized loss, and the fair value of an interest rate swap is included within other current assets if the fair value of the interest rate swap results in an unrealized gain. Gains and losses on re-measurement are included in the consolidated statement of income and comprehensive income (note 8).

j. Revenue recognition

Property revenues include rental revenue and property management revenue.

Rental revenue from operating leases is recognized on a straight-line basis over the applicable lease term. The cost of tenant incentives is recognized over the term of the applicable lease as a reduction in rental revenue.

Rental revenue includes the recovery of certain operating expenses and property taxes.

Unearned revenue represents deposits received in advance of rent being earned and property taxes recovered prior to their due date.

Property management revenue is recorded monthly as earned.

k. Stock-based compensation

Pursuant to the terms of employment contracts entered into in 2013, certain executives of the Company are granted a specified number of shares of a significant shareholder of the Company on the anniversary dates of their employment. The Company expenses the fair value of these stock awards. The Company determines the fair value of these stock awards at the date of grant using the Black-Scholes option pricing model and recognizes the fair value over the vesting period as stock-based compensation expense with a corresponding adjustment to contributed surplus.

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l. Provisions

Provisions for restructuring costs, warranties and legal claims, where applicable, are recognized in other liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material.

m. Income taxes

The Company follows the asset and liability method of accounting for income taxes whereby deferred income tax assets and liabilities are recognized for differences between the bases of assets and liabilities used for financial statement and income tax purposes. Deferred income tax assets and liabilities are calculated using substantively enacted tax rates for the period in which the differences are expected to reverse. Deferred income tax assets are recognized only to the extent that management determines that it is more likely than not that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

n. Income per share

Basic income per share is calculated by dividing the net income or loss for the year attributable to shareholders of the Company by the weighted average number of Class B voting and Class C non-voting common shares outstanding during the year.

Diluted income per share is calculated by adjusting the weighted average number of Class B voting and Class C non-voting common shares outstanding for dilutive instruments.

o. Fair value

Fair value measurements recognized in the consolidated balance sheet are categorized in accordance with the following levels:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement in its entirety.

p. Critical accounting estimates and judgements

The preparation of financial statements requires management to use judgement in applying its accounting policies and to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

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Notes to the Consolidated Financial Statements

For the Years Ended August 31, 2015 and August 31, 2014

(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

Significant areas requiring the use of management judgements, estimates, and assumptions relate to:

i. Fair value of investment properties

After initial recognition, valuations of investment properties are prepared by management based primarily on assumptions relating to cash flows from current leases, rental income from future leases in light of current market conditions and capitalization rates. The capitalization rates used are based on ranges provided by external valuers. These assumptions are further compared against information obtained from independent industry experts. Adjustments are made to the carrying values of the investment properties when changes in the underlying valuation assumptions occur.

ii. Asset acquisitions

The Company acquires investment properties in its normal course of business. At the time of acquisition, the Company considers whether or not the investment property acquisition represents the acquisition of an asset or a business. The Company accounts for an acquisition as a business combination where an integrated set of activities is acquired in addition to the investment property. More specifically, consideration is made to the extent to which significant processes are acquired. When the acquisition of a property does not represent a business, it is accounted for as an acquisition of a group of assets and liabilities. The cost of the acquisition, including transaction costs, is allocated to the assets and liabilities acquired based upon their relative fair values, and no goodwill or deferred tax is recognized.

All acquisitions of investment properties by the Company to date have been determined to be asset acquisitions.

iii. Income taxes

Management has estimated the income tax provision and deferred income tax balances in accordance with its interpretation of the various income tax laws and regulations. It is possible, due to the complexity inherent in estimating income taxes, that the tax provision and deferred income tax balances could change.

In accordance with IAS 12, *Income Taxes*, the Company has recognized income tax losses and undeducted expenditures as deferred income tax assets. At this time, management has estimated that there will be sufficient future taxable income to utilize the losses and expenditures.

The Company has unrecognized investment tax credits. At this time, management has estimated that the recoverability is still in doubt as the Company has not established when it will be in a taxable position.

Management uses judgement based on underlying facts and assumptions when determining whether a provision for a tax liability or derecognition of a deferred income tax asset is required for tax positions in dispute with tax authorities.

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iv. Allocation of purchase price on investment property acquisitions

On the acquisition of an investment property, the Company is required to make an allocation for the building component of the property in order to calculate depreciation for income tax purposes.

v. Stock-based compensation

The Company determines the fair value of the stock options and other stock awards at the date of grant using the Black-Scholes option pricing model.

vi. Assets held for sale

The Company makes estimates and assumptions about the fair values and selling costs of assets held for sale in determining their carrying amounts. The classification of an investment property as an asset held for sale requires the use of judgement regarding whether the criteria are met for this classification as at the date of the consolidated financial statements.

3. Accounting standards and amendments issued but not effective

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*. IFRS 15 establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2017, with early adoption permitted. The Company has not reviewed the effect, if any, of IFRS 15 on its consolidated financial statements.

In July 2014, the IASB issued the final version of IFRS 9, *Financial Instruments*, which addresses the classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. In addition, IFRS 7, *Financial Instruments – Disclosures*, has been amended to require additional disclosures on transition from IAS 39 to IFRS 9. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. The Company has not reviewed the effect, if any, of IFRS 9 on its consolidated financial statements.

In September 2014, the IASB published amendments to IFRS 10, *Consolidated Financial Statements*, and IAS 28, *Investments in Associates and Joint Ventures*. The amendments clarify the accounting treatment for sales or contribution of assets between an investor and its associates or joint ventures. The amended standard is effective for annual periods beginning on or after January 1, 2016. The Company does not expect that these amendments will have a significant effect on its consolidated finance statements.

In September 2014 the IASB issued Annual Improvements to IFRSs 2012 – 2014 Cycle, which included improvements and amendments to IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 7, *Financial Instruments: Disclosures*, IAS 19, *Employee Benefits*, and IAS 34, *Interim*

Madison Pacific Properties Inc.

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Financial Reporting. The amended standards are effective for annual periods beginning on or after January 1, 2016. The Company has not reviewed the effect, if any, of these amendments on its consolidated financial statements.

In December 2014, the IASB issued amendments to in IAS 1, *Presentation of Financial Statements*, to clarify guidance on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The amended standard is effective for annual periods beginning on or after January 1, 2016. The Company has not reviewed the effect, if any, of these amendments on its consolidated financial statements.

The IASB has amended IFRS 11, *Joint Arrangements*, to provide specific guidance on accounting for the acquisition of an interest in a joint operation that is a business. The amended standard is effective for annual periods beginning on or after January 1, 2016. The Company does not expect that the amendment will have a significant effect on its consolidated financial statements.

4. Investment properties

	August 31, 2015 \$	August 31, 2014 \$
Balance at beginning of year	368,153	299,938
Additions:		
Acquisitions (note 4(b))	7,328	74,885
Other additions	2,566	1,497
Dispositions (note 4(c))	-	(17,836)
Recognition of rental revenue on a straight-line basis	330	671
Tenant improvements	420	872
Amortization of tenant improvements	(654)	(653)
Leasing commissions	74	514
Amortization of leasing commissions	(224)	(226)
Net gain on fair value adjustment	25,029	8,491
	<u>403,022</u>	<u>368,153</u>
Assets held for sale (note 5)	<u>(17,613)</u>	<u>-</u>
Balance at end of year	<u>385,409</u>	<u>368,153</u>

a. Valuations

The fair value of the Company's investment properties is considered to be at level 3 in the fair value hierarchy (note 2(o)), as significant unobservable inputs are required to determine fair value.

b. Investment property acquisitions

On March 25, 2015, the Company acquired a 50% interest in a 1.82 acre vacant land site in Burnaby, British Columbia for \$1,159 plus standard closing costs and property transfer taxes of \$33. The Company is co-developing an industrial building on this site with a third party. This development property is included in

Madison Pacific Properties Inc.

Notes to the Consolidated Financial Statements

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

investment properties in the consolidated balance sheet at its fair value of \$1,285. Interest capitalized to the cost of the development was \$9 as at August 31, 2015.

On March 9, 2015, the Company acquired a 50% interest in a 1.87 acre vacant land site in Burnaby, British Columbia for \$1,593 plus standard closing costs and property transfer taxes of \$39. The Company is co-developing an industrial building on this site with a third party. This development property is included in investment properties in the consolidated balance sheet at its fair value of \$1,749. Interest capitalized to the cost of the development was \$3 as at August 31, 2015.

On January 21, 2015, the Company exercised the buy-sell provision of the co-ownership agreement for the co-owned property located at 11251 Dyke Road, Richmond, British Columbia and acquired its partner's 50% interest in this property for \$4,350 plus standard closing costs of \$9, resulting in 100% ownership of the property by the Company. The purchase price was paid by assuming 50% of the mortgage debt on the property of \$2,360 and the balance with cash. The mortgage debt assumed carried an interest rate higher than market interest rates at the date of acquisition and accordingly the debt assumed has been adjusted by \$144 to record it at fair value with a corresponding increase to the cost of the property (note 8).

On April 25, 2014, the Company exercised its option to acquire one acre of undeveloped land in Richmond, British Columbia for \$1,564, including standard closing costs. This retail property is currently under development and its fair value of \$5,472 is included in investment properties in the consolidated balance sheet.

On November 1, 2013, the Company purchased two commercial properties located at West 6th Avenue in Vancouver, British Columbia. The total purchase price for the properties was \$3,100, plus standard closing costs of \$69.

On September 26, 2013, the Company purchased a commercial property located at West 5th Avenue and Alberta Street in Vancouver, British Columbia. The total purchase price for the property was \$6,550 plus standard closing costs and property transfer taxes of \$162. The purchase price for the properties was settled for cash and the assumption of a mortgage of \$3,800 bearing a rate of interest of 3.83%. As the stated interest rate of the assumed mortgage differed from the market rate on the date of acquisition, an amount of \$74 was determined to adjust the assumed mortgage to fair value and has been included in the calculation of the cost of the acquisition (note 8).

On September 12, 2013, the Company acquired, through a newly formed limited partnership (the "MT Properties LP"), a portfolio of 12 investment properties (the "MT Investment Properties") for \$62,100 plus acquisition and closing costs of \$553. The portfolio includes approximately 98 acres of land and 538,600 square feet of building space located in British Columbia, Alberta, Ontario, and Quebec. The Company made a \$13,400 equity investment for a 60.9% controlling interest in the MT Properties LP with other investors contributing \$8,600, representing the non-controlling interests in the MT Properties LP. Concurrent with the acquisition, first mortgages on the MT Investment Properties totalling \$25,082 were assumed. The mortgages assumed had interest rates ranging from 4.15% to 4.40%. As the stated interest rates on the assumed mortgages differed from the market rate of interest at the date of acquisition, an amount of \$741 was determined to adjust the assumed mortgages to fair value and has been included in the determination of the cost of this acquisition (note 8). The Company had provided guarantees for the assumed mortgages which subsequently were repaid fully following a refinancing of the portfolio.

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Notes to the Consolidated Financial Statements

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c. Investment property dispositions

On April 17, 2014, the Company disposed of a commercial property located at West 5th Avenue and Alberta Street in Vancouver, British Columbia for \$6,792 less closing costs. This property was sold to the Company's equity investee, Grant Street Properties Inc. (note 17). This disposition included the assumption of debt of \$3,800 on the investment property by the purchaser. The Company was required to continue to provide a guarantee on the debt for which it earned a fee. Subsequent to year-end, the guarantee requirement was removed.

On February 26, 2014, the Company disposed of a property located at 850 West Kent Avenue in Vancouver, British Columbia for \$11,500 less closing and selling costs.

d. Sensitivity

The following table provides a sensitivity analysis for the weighted average capitalization rate applied at August 31, 2015, excluding properties under development and assets held for sale:

Capitalization rate increase (decrease)	Weighted average capitalization rate	Fair value of investment properties (at Company's ownership) \$	Fair value variance \$	% Change
(0.75%)	4.98%	434,997	58,094	15.4%
(0.50%)	5.24%	413,688	36,785	9.8%
(0.25%)	5.50%	394,419	17,516	4.6%
August 31	5.75%	376,903	-	-
0.25%	6.01%	360,906	(15,997)	(4.2%)
0.50%	6.26%	346,234	(30,669)	(8.1%)
0.75%	6.51%	332,728	(44,175)	(11.7%)

5. Assets held for sale

Investment properties are reclassified to assets held for sale when the criteria set out in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, are met. Investment properties held for sale are classified as current assets in accordance with IFRS 5.

The carrying values of assets held for sale are established to be the lower of their carrying values or their estimated fair values less selling costs.

As at August 31, 2015, properties located at 7198 Progress Way in Delta, British Columbia and 21771 Fraserwood Way in Richmond, British Columbia were classified as assets held for sale (note 23).

As at August 31, 2014, no investment properties were classified as held for sale.

Madison Pacific Properties Inc.

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

6. Other non-current assets

	August 31, 2015 \$	August 31, 2014 \$
Loans receivable (note 17(c))	12,992	13,061
Deposits	7,762	5,457
Investment in associate	2,079	1,840
Other	302	299
	<u>23,135</u>	<u>20,657</u>

Loans receivable include \$12,650 (August 31, 2014 - \$12,650) in long-term advances to a 50% related joint venture which bear interest at 6.875%, mature May 2, 2023, are secured and may be converted into equity of the borrower. The other 50% joint venture partner is a significant shareholder of the Company. Loans receivable also include unsecured loans to tenants of \$342 (August 31, 2014 - \$411) with interest at fixed rates up to 6.0% (August 31, 2014 - 7.5%).

Deposits include amounts paid for income tax reassessments in dispute (note 15).

The investment in an associate includes an equity investment made in June 2013 of \$1,250 for an 18.4% interest in Grant Street Properties Inc., a private company that owns and manages commercial and industrial properties. The Company has also provided a limited bank loan guarantee of \$496 for bank debt the associate has. This investment has been accounted for using the equity basis of accounting and includes equity earnings for the year of \$239 (year-ended August 31, 2014 - \$540). The Company's 18.4% share of assets, liabilities, revenue and other income, and expenses as at and for the year ended August 31, 2015 is \$3,543, \$1,463, \$406 and \$167, (August 31, 2014 - \$3,320, \$1,480, \$703 and \$163) respectively.

7. Amounts receivable and other current assets

	August 31, 2015 \$	August 31, 2014 \$
Accounts receivable	249	316
Interest receivable and current portion of loans receivable (notes 6 and 17(c))	1,598	624
Prepaid expenses, deposits and other	<u>2,371</u>	<u>2,125</u>
	<u>4,218</u>	<u>3,065</u>

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8. Debt on investment properties

	August 31, 2015 \$	August 31, 2014 \$
Balance at beginning of year	173,003	140,991
Net proceeds from debt issuances	64,068	21,402
Amortization of deferred finance costs	251	295
Assumed debt on acquisitions (note 4)	2,360	28,882
Acquisition date fair value adjustments on assumed debt (note 4)	144	667
Amortization of acquisition date fair value adjustments on assumed debt	(954)	(678)
Debt assumed by purchaser on sale of investment properties	-	(3,800)
Repayment of debt	(38,179)	(14,756)
Balance at end of year	200,693	173,003
Less: current portion	51,892	20,780
Non-current portion	148,801	152,223

Mortgage and construction loans are secured by charges against the related properties and corporate guarantees. Of the total mortgage and construction loans (before the netting of deferred financing costs and fair value adjustments to assumed debt), \$198,710 (August 31, 2014 - \$169,091) bears interest at fixed rates ranging from 2.40% to 5.68% (August 31, 2014 - 3.10% to 5.68%) per annum and \$1,873 (August 31, 2014 - \$2,855) bears interest at bank prime rate plus 0.70% (August 31, 2014 - bank prime rate plus 1.35%) per annum. The weighted average interest rate on fixed rate debt as at August 31, 2015 was 4.06% (August 31, 2014 - 4.58%).

See note 20 for minimum principal repayments.

Interest rate swaps

The Company has entered into interest rate swaps with Canadian chartered banks on two mortgages to reduce the impact of fluctuating interest rates and fix the Company's interest rates on some of its mortgages. The swaps have notional amounts as at August 31, 2015 of \$8,545 and \$47,891, fixed swap rates of 3.14% and 2.93%, and maturity dates of June 2020 and July 2020, respectively. The total notional amount of the interest rate swaps represented 27.2% as at August 31, 2015 (August 31, 2014 - 5.2%) of the total debt on investment properties (before the netting of deferred financing costs and fair value adjustments to assumed debt) and bank indebtedness. The Company anticipates holding the mortgages and interest rate swap contracts until maturity.

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The total fair value of the interest rate swaps and net realized and unrealized losses on those contracts are as follows:

	Fair value liabilities		Net losses on interest rate swaps	
	August 31,		Year ended August 31,	
	2015	2014	2015	2014
	\$	\$	\$	\$
Interest rate swaps	639	13	681	13

9. Accounts payable and accrued liabilities

	August 31, 2015	August 31, 2014
	\$	\$
Trade payables	1,020	569
Dividends payable	3,075	3,075
Accrued interest payable	595	733
Fair value liabilities on interest rate swaps (note 8)	639	13
Other accrued liabilities	1,154	773
Tenant deposits	1,004	943
Unearned revenue	1,760	1,771
	9,247	7,877

10. Bank indebtedness

The Company has a line of credit of up to \$20,000 (August 31, 2014 - \$20,000) bearing interest at bank prime rate plus 1% or at the Bankers Acceptance rate (August 31, 2014 - bank prime rate plus 1% or at the Bankers Acceptance rate) with a Canadian chartered bank. As at August 31, 2015, \$7,252 (August 31, 2014 - \$6,855) had been drawn against this line of credit. The amount available under this line of credit varies with the fair value of investment properties pledged, up to a maximum of \$20,000. Second mortgages against certain of the Company's investment properties, assignments of rents and insurance, as well as general security agreements creating floating charges over all of the Company's assets, have been provided as security. Amounts advanced under this line of credit are repayable on demand. The line of credit agreement contains the following financial ratios which must be maintained, for which the Company was in compliance as at August 31, 2015:

- Not permit the debt service coverage ratio to be less than 1.25 to 1.00;

Madison Pacific Properties Inc.

Notes to the Consolidated Financial Statements

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- Not permit the ratio of EBITDA to interest expense on all debt secured by the investment properties pledged to be less than 1.50 to 1.00;
- Not permit the aggregate amount of all outstanding borrowings secured by the investment properties pledged to exceed 65% of their appraised values; and
- Not permit the tangible net worth of the Company to be at any time less than \$125,000.

On July 25, 2015, the Company's subsidiary, the MT Properties LP, refinanced its portfolio of properties with mortgage debt. Part of the proceeds from this refinancing was used to repay and extinguish its line of credit, which had a balance of \$14,610 on extinguishment (August 31, 2014 - \$14,999).

11. Share capital

Authorized and issued

The authorized share capital of the Company consists of an unlimited number of Class A non-voting preferred shares without par value, an unlimited number of Class B voting common shares without par value and an unlimited number of Class C non-voting common shares without par value.

The following table summarizes the issued share capital as at August 31, 2015 and August 31, 2014:

	Class B common shares		Class C common shares		Total	
	Number	Amount \$	Number	Amount \$	Number	Amount \$
Balance – August 31, 2015 and August 31, 2014	7,255,500	7,720	51,315,089	59,752	58,570,589	67,472

No shares were issued or cancelled in the year ended August 31, 2015.

12. Dividends

On July 9, 2015, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on September 3, 2015.

On January 13, 2015, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on February 25, 2015.

On July 10, 2014, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on September 4, 2014.

On January 24, 2014, the Company declared a dividend of \$0.0525 per Class B common share and Class C common share payable on February 25, 2014.

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13. Property revenues

The following table summarizes the components of property revenues for the year ended:

	August 31, 2015 \$	August 31, 2014 \$
Rental revenue	29,607	29,379
Property management revenue	756	819
	<u>30,363</u>	<u>30,198</u>

Future minimum rental commitments on non-cancellable tenant operating leases on a calendar year basis beginning January 1, 2016 are summarized in the following table:

	\$
Not later than 1 year	21,399
Later than 1 year and not later than 5 years	63,596
Later than 5 years	<u>44,678</u>
	<u>129,673</u>

14. Property operating and general and administrative expenses

For the year ended August 31, 2015, property operating expenses consist of property taxes of \$5,755 (year ended August 31, 2014 - \$5,619) and other property related expenses of \$2,043 (year ended August 31, 2014 - \$2,199). Property operating expenses that relate to investment property vacancies amounted to \$161 (year ended August 31, 2014 - \$180).

For the year ended August 31, 2015, general and administrative expenses consist of employee compensation and benefits of \$1,665 (year ended August 31, 2014 - \$1,861), professional fees of \$544 (year ended August 31, 2014 - \$664) and other administrative expenses of \$502 (year ended August 31, 2014 - \$399).

The following table summarizes employee compensation and benefits expense for the year ended:

	August 31, 2015 \$	August 31, 2014 \$
Salaries and short-term employee benefits	1,465	1,515
Stock-based compensation	<u>200</u>	<u>346</u>
	<u>1,665</u>	<u>1,861</u>

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Notes to the Consolidated Financial Statements

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15. Income taxes

The following table provides the components of income taxes for the year ended:

	August 31, 2015 \$	August 31, 2014 \$
Current income tax (recovery) expense	(3)	96
Deferred income tax expense	5,925	4,500
	<u>5,922</u>	<u>4,596</u>

Income taxes vary from the amount that would be expected if computed by applying the Canadian federal and provincial statutory income tax rates to the Company's income before income taxes as shown in the following table for the year ended:

	August 31, 2015		August 31, 2014	
	\$		\$	
Income before income taxes	36,616		20,597	
	\$	%	\$	%
Expected income taxes at statutory rates	9,497	25.9	5,343	25.9
Adjustments				
Non-taxable portion of realized and unrealized capital gains	(3,248)	(8.9)	(807)	(3.9)
Other items	(327)	(0.9)	60	0.3
Income taxes	<u>5,922</u>	<u>16.1</u>	<u>4,596</u>	<u>22.3</u>

Deferred income tax assets and liabilities are as follows:

	August 31, 2015 \$	August 31, 2014 \$
Deferred income tax assets		
Benefit of non-capital losses carried forward	-	5,806
Benefit of capital losses carried forward	-	207
Undeducted expenditures	-	9,300
Investment properties	-	(11,271)
Tenant improvements and leasing costs	-	(1,538)
Straight-line rental revenue in excess of base rents	-	(560)
	<u>-</u>	<u>1,944</u>

Madison Pacific Properties Inc.

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Deferred income tax liabilities		
Benefit of non-capital losses carried forward	(5,914)	-
Benefit of capital losses carried forward	(1,859)	(1,652)
Undeducted expenditures	(9,300)	-
Valuation allowance	946	946
Investment properties	20,644	3,326
Tenant improvements and leasing costs	1,478	40
Straight-line rental revenue in excess of base rents	676	30
	<u>6,671</u>	<u>2,690</u>

The entire change in deferred income tax assets and liabilities for the years ended August 31, 2015 and August 31, 2014 has been recognized in net income for those respective years.

As at August 31, 2015, the Company had approximately \$35,846 of scientific research and development expenditures available for unlimited carry forward, approximately \$8,730 of federal investment tax credits which begin to expire in 2017, approximately \$1,073 of provincial investment tax credits which begin to expire in 2015 and approximately \$22,792 of non-capital losses which begin to expire in 2026, which may be used to reduce future Canadian income taxes otherwise payable. The Company has not recognized the value of the federal or provincial investment tax credits as there is no certainty the credits will be utilized prior to expiration.

The federal investment tax credits and non-capital losses expire as follows:

	Federal investment tax credits	Non-capital losses carried forward
	\$	\$
2017	631	-
2018	690	-
2019	602	-
2020	679	-
2021	625	-
2022	880	-
2023	1,048	-
2024	934	-
2025	865	-
2026	727	1,005
2027	689	8,144
2028	360	5,780
2030	-	7,863
	<u>8,730</u>	<u>22,792</u>

In addition, the Company has capital losses carried forward of approximately \$14,302 which may be used to reduce future taxable capital gains in Canada and do not expire.

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Contingencies

In July 2014, the Company received from the Canada Revenue Agency (“CRA”), tax notices of reassessment relating to the 2009, 2011 and 2013 taxation years. The reassessments deny the application and usage of capital losses arising from years prior to 2009. The reassessments increase taxable income by \$7,540, \$1,157 and \$3,773 for the respective taxation years of 2009, 2011 and 2013. In addition, the CRA is disallowing unused carry-forward capital losses of \$12,705. As a result, additional taxes payable for the reassessed years, including interest, is \$4,162. The Company has filed notices of objection to the reassessments with the CRA and subsequently a notice of appeal to the Tax Court of Canada. To object to the reassessments, the Company was required to make a deposit of \$2,082 for a portion of the taxes and interest the CRA has claimed are owed. The Company made this deposit in July 2014 and it is included in other non-current assets. Additional interest accruing on the unpaid portion of the reassessments was approximately \$117 as at August 31, 2015.

In June 2013, 1073774 Properties Inc., a subsidiary of the Company, received from the CRA, tax notices of reassessment relating to the taxation years 2008 to 2010. The reassessments deny the application and usage of non-capital losses, deductions and credits arising from years prior to 2008. The reassessments increase taxable income by \$3,281, \$15,359 and \$4,293 for the respective taxation years of 2008, 2009 and 2010. As a result, additional taxes payable for the reassessed years, including interest, is \$8,159. The Company has filed notices of objection to the reassessments with the CRA and subsequently a notice of appeal to the Tax Court of Canada. To object to the reassessments, the Company was required to make a deposit of \$3,375 for a portion of the taxes and interest the CRA has claimed are owed. The Company made this deposit in July 2013 and it is included in other non-current assets. Additional interest accruing on the unpaid portion of the reassessments was approximately \$537 as at August 31, 2015.

In April 2015, Metro Vancouver Properties Corp., a subsidiary of the Company, received from the CRA and Alberta Tax and Revenue Administration (“ATRA”), tax notices of reassessment for the taxation years 2011 to 2014. The reassessments deny the application and usage of non-capital losses and capital losses arising from prior years. The reassessments increase total taxable income by \$14,930 for the taxation years 2011 to 2014. In addition, the CRA and ATRA are disallowing unclaimed carry-forward losses of \$26,138, carry-forward scientific research and development expenditures of \$35,846 and investment tax credits of \$10,213. As a result, additional taxes payable for the reassessed years, including interest, are \$4,610. The Company has filed notices of objection to the reassessments with the CRA and ATRA. To object to the reassessments, the Company was required to make deposits totalling \$2,305 for a portion of the taxes and interest the CRA and ATRA have claimed are owed. The Company made these deposits and they are included in other non-current assets. Additional interest accruing on the unpaid portion of the reassessments was approximately \$30 as at August 31, 2015.

The Company and its counsel believe that its filing positions for the companies described above are appropriate and in accordance with the law. It intends to vigorously defend such positions as required. Accordingly, the Company has not recorded a liability in these consolidated financial statements for the reassessed taxes payable and related interest described above nor has it reduced the carrying value of deferred income tax assets recorded for unused carry-forward amounts. If the Company is ultimately successful in defending its positions, deposits made plus applicable interest will be refunded to the Company. There is no assurance that the Company’s objections and appeals will be successful. If the CRA and ATRA are successful, the Company will be required to pay the balance of taxes reassessed plus applicable interest and derecognize deferred income tax assets related to the carry-forward amounts.

Madison Pacific Properties Inc.

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16. Income per share

	Year ended August 31,	
	2015	2014
Net income attributable to shareholders of the Company	\$28,143	\$15,460
Weighted average number of common shares outstanding	58,570,589	58,565,679
Basic and diluted income per share	\$0.48	\$0.26

17. Related party transactions

The following transactions occurred in the normal course of operations and are measured at the exchange amounts, which are the amounts agreed upon by the related parties.

a. Transactions with related parties

The Company has engaged the services of a landscaping company owned by a related party. In the year ended August 31, 2015, landscaping expenses paid to this company were \$140 (year ended August 31, 2014 - \$108).

See note 4(c) regarding the disposition in 2014 of an investment property to Grant Street Properties Inc., an equity investee (note 6).

During the year, the Company paid interest on short-term advances of \$nil (year ended August 31, 2014 - \$36) to Grant Street Properties Inc. No advances were outstanding at year-end.

b. Transactions and balances with affiliates

During the year ended August 31, 2015, rental revenues of \$1,859 (year ended August 31, 2014 - \$1,787) were received from tenants that are companies controlled by a shareholder of the Company.

During the year ended August 31, 2015, the Company paid management consulting fees of \$166 to a shareholder and a party related to a shareholder of the Company (year ended August 31, 2014 - \$171).

c. Transactions and balances with joint ventures

As at August 31, 2015, the Company has advances and interest receivable of \$14,130 (August 31, 2014 - \$13,195) due from a 50% related joint venture. The short-term advances bear interest at prime rate plus 3.875% and long-term advances bear interest at 6.875%, mature May 2, 2023, are secured, and may be converted into equity of the borrower. The other 50% joint venture partner is a significant shareholder of the Company. Interest earned for the year ended August 31, 2015 was \$897 (year ended August 31, 2014 - \$888).

Madison Pacific Properties Inc.

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d. Key management personnel

Key management personnel include the Company's directors and officers. The following table summarizes compensation awarded to key management personnel for the year ended:

	August 31, 2015 \$	August 31, 2014 \$
Salaries and short-term employee benefits	1,079	1,017
Stock-based compensation	200	346
	<u>1,279</u>	<u>1,363</u>

18. Interests in joint operations

The Company's interests in investment properties owned through joint operations accounted for using proportionate consolidation are as follows:

Location	Description	Ownership interest as at	
		August 31, 2015	August 31, 2014
Richmond, British Columbia			
3351 Jacombs Road	Industrial	50%	50%
11388 No. 5 Road	Industrial	50%	50%
11251 Dyke Road (note 4(b))	Industrial	100%	50%
Burnaby, British Columbia			
7700 Riverfront Gate	Industrial	50%	50%
7765 North Fraser Way (note 4(b))	Industrial	50%	-
8155 North Fraser Way (note 4(b))	Industrial	50%	-
Vancouver, British Columbia			
3 rd Avenue and 1855 Fir Street	Retail	50%	50%

For these joint operations, the fair value of investment properties and debt on those investment properties, at 50%, was \$23,721 and \$12,035, respectively, as at August 31, 2015 (August 31, 2014 - \$23,412 and \$12,905). The Company is contingently liable for the obligations of its joint operations. Management believes that the assets of its joint operations are available and sufficient for the purpose of satisfying such obligations.

19. Segment information

The Company's chief executive officer and chief financial officer examined the Company's performance and have concluded that the Company has one reportable segment - that being the rental of office, industrial, and commercial real estate properties located in Canada. Although properties are in different Canadian regions and in different asset classes, they have reasonably similar returns and risks.

Madison Pacific Properties Inc.

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(expressed in thousands of Canadian dollars, except number of shares and per share amounts)

20. Financial instruments

Financial assets and liabilities

The Company classifies its financial instruments as follows:

	Loans and receivables	Other financial liabilities	Financial assets and (liabilities) at fair value through profit or loss
August 31, 2015	\$	\$	\$
Other non-current financial assets	20,754	-	-
Cash and cash equivalents	4,106	-	-
Amounts receivable and other current financial assets	1,847	-	-
Debt on investment properties	-	(200,693)	-
Accounts payable and accrued liabilities	-	(8,608)	-
Bank indebtedness	-	(7,252)	-
Fair value liabilities on interest rate swaps	-	-	(639)
Total	26,707	(216,553)	(639)

	Loans and receivables	Other financial liabilities	Financial assets and (liabilities) at fair value through profit or loss
August 31, 2014	\$	\$	\$
Other non-current financial assets	18,518	-	-
Cash and cash equivalents	1,039	-	-
Amounts receivable and other current financial assets	940	-	-
Debt on investment properties	-	(173,003)	-
Accounts payable and accrued liabilities	-	(7,864)	-
Bank indebtedness	-	(21,854)	-
Fair value liability on interest rate swap	-	-	(13)
Total	20,497	(202,721)	(13)

Credit risk

The Company's credit risk is limited to the carrying amount of its cash and cash equivalents, amounts receivable and long-term receivables.

a. Cash and cash equivalents

Deposits of cash are made with major Canadian banks and only with counterparties meeting certain credit criteria.

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b. Amounts receivable

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments or repay loans advanced to assist them with leasehold improvements.

The Company follows a program of credit evaluations of tenants and limits the amount of credit extended when deemed necessary. The Company maintains provisions for potential credit losses, and any such losses to date have been within management's expectations.

Additionally, the Company mitigates tenant credit risk through staggered lease maturities and diversification of revenue sources resulting from a large tenant base and avoids dependence on any single tenant by ensuring no individual tenant contributes a significant percentage of the Company's gross revenue.

As at August 31, 2015, excluding revenue and leases related to properties under development and assets held for sale:

- No one tenant accounted for more than 18.06% (August 31, 2014 – 18.29%) of the Company's rental revenue.
- Lease maturities were staggered such that no more than 23.77% (August 31, 2014 – 22.21%) of the rental space was subject to renewal in any one year.

Interest rate risk

Borrowings under the Company's operating line of credit and certain debt on investment properties bear interest at variable rates. The majority of mortgages bear interest at fixed rates, and therefore, the Company is not exposed to significant interest rate risk on those fixed rate mortgages. As at August 31, 2015, \$7,252 (August 31, 2014 - \$21,854) had been drawn on the line of credit and the Company had \$1,873 (August 31, 2014 - \$2,855) in variable rate mortgages and construction loans. These variable rate borrowings represent 4.39% (August 31, 2014 – 12.68%) of the Company's total borrowings. The impact of a 1% change in the Company's variable rate borrowings would increase or decrease interest expense or pre-tax earnings for the year by \$91 (year ended August 31, 2014 - \$251). Additionally, the Company earns interest on its cash and cash equivalent balances at variable rates.

Liquidity risk

The Company manages liquidity by maintaining adequate cash balances and by having an appropriate line of credit available. In addition, the Company regularly monitors and reviews both actual and forecasted cash flows. Refinancing risks are minimized by ensuring debt on investment properties has a balanced maturity schedule. Management does not anticipate any difficulty in refinancing debt on investment properties as the debt matures.

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The following table details the minimum principal repayments for debt on investment properties. The amount in 2016 includes demand loans totalling \$5,819 on certain properties. Principal repayments on these demand loans are made monthly until their maturities between 2017 and 2020.

	\$
2016	51,668
2017	19,011
2018	19,312
2019	25,777
2020	73,830
2021 and thereafter	10,985
	<u>200,583</u>

Fair value

Cash and cash equivalents, amounts receivable, bank indebtedness, and accounts payable and accrued liabilities have fair values that approximate their carrying values. The estimated fair value of debt on investment properties is \$207,566 (August 31, 2014 - \$178,343). The fair value of outstanding interest rate swaps is disclosed in note 8.

The estimated fair values of debt on investment properties and interest rate swaps are based on values derived using market interest rates of similar instruments and incorporate assumptions regarding current market interest rates, terms, and the related risk. Accordingly, changes in these assumptions would result in a variance in the fair value estimates.

21. Commitments

At August 31, 2015, future minimum commitments with respect to the Company's direct commitment on a land lease and contingent commitments on space subleased to others are as follows:

	Direct commitment on land leases \$	Contingent commitments on subleased space \$
2016	88	58
2017	88	-
2018	88	-
2019	88	-
2020	88	-
2021 and thereafter	2,591	-

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22. Capital management

The primary objective of the Company's capital management is to ensure that it maintains adequate capital resources in order to support its business and maximize shareholder value. The Company manages its capital structure with the goal of minimizing risk to the stability of cash flows from properties. Other goals include maintaining debt service coverage, interest coverage, and debt to equity ratios as well as maintaining minimum amounts of shareholders' equity as required by the Company's line of credit agreements. The Company's capital includes mortgage loans, construction loans, a line of credit and equity.

The Company's principal source of financing is from mortgage loans. The ability to obtain a mortgage loan is dependent on the value of a specific property and the cash flows the property generates and the availability of funds from time to time from lending institutions. The Company expects to renew mortgage loans as they become due.

There have not been any changes in the Company's approach to capital management in the year ended August 31, 2015.

The calculation of the total capital, excluding the undrawn line of credit, is summarized as follows:

	August 31, 2015 \$	August 31, 2014 \$
Fixed rate mortgage loans	198,710	169,091
Variable rate mortgages and construction loans	1,873	2,855
Balance drawn on line of credit	7,252	6,855
Balance drawn on the MT Properties LP line of credit	-	14,999
	<u>207,835</u>	<u>193,800</u>
Equity	<u>202,531</u>	<u>180,338</u>
	<u>410,366</u>	<u>374,138</u>

23. Subsequent events

- On September 16, 2015, the Company sold a property located at 21771 Fraserwood Way in Richmond, British Columbia, for \$9,300.
- On October 1, 2015, the Company sold a property located at 7198 Progress Way in Delta, British Columbia, for \$8,850.