

# MANAGEMENT'S DISCUSSION AND ANALYSIS

As of December 14, 2011

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## OVERVIEW

Consolidated HCI Holdings Corporation ("CHCI" or the "Company") is an Ontario based, publicly traded real estate development company trading on the Toronto Stock Exchange under the symbol CXA.B. The following discussion and analysis of the financial condition of the Company and the results of its operations for the two years ended September 30, 2011 and 2010 are the views of management and should be read in conjunction with the consolidated financial statements including related notes in the 2011 and 2010 audited consolidated financial statements.

The Company's activities in the real estate industry are conducted with others at varying participation rates in co-tenancies and joint ventures. The consolidated financial statements include these ventures on a proportionate consolidation basis. The activities of the Company include the redevelopment of an existing industrial property in Vaughan, Ontario for industrial and commercial uses to lease to others and until its sale on February 2, 2011, the ownership of land and another commercial building, both in Mississauga, Ontario, leased to other parties. The Company also conducts activities through various ventures in the building and selling of new homes on land purchased from others. The Company also invests in syndicated mortgage loans, which are secured by real property developments of other land developers and builders.

## RESPONSIBILITY OF MANAGEMENT AND THE BOARD OF DIRECTORS

Management is responsible for the information disclosed in this MD&A, and has in place information systems, procedures and controls to ensure that information used internally by management and disclosed externally is materially complete and reliable. In addition, the Company's Audit Committee and Board of Directors provide an oversight role with respect to all public financial disclosures by the Company, and have reviewed and approved this MD&A and the consolidated financial statements as at September 30, 2011 and 2010.

## CONTROLS AND PROCEDURES

At September 30, 2011, the Chief Executive Officer and the Chief Financial Officer ("certifying officers") of the Company have designed disclosure controls and procedures ("DC&P") to provide reasonable assurance that information required to be disclosed in its various reports is recorded, processed, summarized and reported accurately and have designed internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of its consolidated financial statements for external purposes in accordance with Canadian generally accepted accounting principles ("GAAP"). All internal controls over financial reporting are either completed or reviewed by the Chief Financial Officer. Other than the Chief Financial Officer, the Company has only one employee who is engaged in accounting and recordkeeping functions and who is directly supervised by the Chief Financial Officer.

The certifying officers have limited the scope of the design of DC&P and ICFR to exclude controls, policies and procedures of the Company's non-publicly accountable proportionately consolidated entities ("the entities"). Management of the entities is distinct from that of the Company and, as such, the Company does not have sufficient access to the entities to design and evaluate controls, policies and procedures carried out by these entities. The Company is satisfied that, considering its own review and analysis of financial information provided by the entities and discussion with the entities' management, material errors or omissions in the entities' financial reporting for consolidation purposes would come to the attention of the Company's management and be corrected prior to consolidation.

The following summary of financial information as at September 30, 2011 and 2010 and for the years then ended relates to the Company's proportionately consolidated entities, comprising all its investments in its income-producing properties and residential construction segments:

	September 30	
	2011	2010
Assets	\$ 18,833	\$ 22,288
Liabilities	5,854	7,330
	\$ 12,979	\$ 14,958

	Year ended September 30	
	2011	2010
Revenue	\$ 11,177	\$ 15,510
Expenses	9,947	14,067
Earnings	\$ 1,230	\$ 1,443

	Year ended September 30	
	2011	2010
Cash provided by (used in)		
Operating activities	\$ 637	\$ (1,286)
Investing activities	22	(733)
Financing activities	19	(127)

The certifying officers have evaluated the design and operating effectiveness of the Company's DC&P and ICFR for the year ended September 30, 2011 and have concluded that such DC&P and ICFR were appropriately designed and were operating effectively.

The certifying officers have determined there were no changes in the Company's ICFR that occurred during the year ended September 30, 2011 that have significantly affected, or are reasonably likely to significantly affect, the Company's ICFR.

## FORWARD-LOOKING STATEMENTS

In various places in the MD&A, there are forward-looking statements reflecting management's current expectations regarding future economic conditions, results of operations, financial performance and other matters affecting the Company. Forward-looking statements include information regarding possible or assumed future results or transactions as well as statements preceded by, followed by, or that include the words "believes," "expects," "anticipates," "estimates," "intends" or similar expressions. Important factors, in addition to those discussed in this document, could affect the future results of the Company and could cause those results to differ materially from those expressed in any forward-looking statements.

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## REVIEW OF FINANCIAL RESULTS

Financial data presented herein is expressed in Canadian dollars and is in accordance with GAAP.

### Results of operations

Three-year summary of operating results  
(in thousands of dollars, except per share amounts)

	2011	2010	2009
Continuing operations			
Total revenue	\$ 13,843	\$ 18,337	\$ 38,399
Earnings before income taxes	\$ 2,853	\$ 2,764	\$ 5,322
Provision for (recovery of) income taxes	(198)	(1,248)	1,719
Net earnings for the year from continuing operations	3,051	4,012	3,603
Net earnings for the year from discontinued operations – net of income taxes of \$473 (2010 – \$93, 2009 – \$130)	2,446	201	264
Net earnings for the year	\$ 5,497	\$ 4,213	\$ 3,867
Basic and diluted earnings per share			
From continuing operations	\$ 0.15	\$ 0.20	\$ 0.18
From discontinued operations	0.12	—	0.01
Total	\$ 0.27	\$ 0.20	\$ 0.19

Total revenue from continuing operations decreased in 2011 by \$4.49 million compared to the revenue recorded for the same period in 2010, the result of decreases in housing sales of \$3.96 million, rental revenue of \$0.07 million and interest and other income of \$0.78 million partially offset by an increase in land sales of \$0.32 million.

Total revenue from continuing operations decreased in 2010 by \$20.06 million compared to the revenue recorded for the same period in 2009, the result of a decrease in housing sales of \$18.74 million and a decrease in interest and other income of \$1.81 million, partially offset by an increase in land sales of \$0.43 million and an increase in rental revenue of \$0.06 million.

On February 2, 2011, the Company completed the sale of its income-producing properties in Mississauga, Ontario. The net earnings from these properties including the gain on sale in 2011 are shown above as net earnings from discontinued operations, net of income taxes and are presented in greater detail in note 14 to the September 30, 2011 consolidated financial statements. Net earnings from discontinued operations in 2009 also include recoveries of rental operating expenses of \$0.1 million in excess of management's estimates recorded at the time of sale on income-producing properties sold in 2007.

As mentioned in previous years, the nature of the Company's business does not allow for a consistent year-to-year volume of sales. Revenue is comprised of sales in specific projects as the marketplace dictates and buyers become available.

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### Land development operations

(in thousands of dollars)

	2011	2010	2009
Revenue from land sales	\$ 750	\$ 430	\$ —
Cost of land sold	158	134	—
Gross profit from land sales	\$ 592	\$ 296	\$ —

The Company's 2011 land sale represents the sale of its 25% interest in a 2.5 acre parcel of serviced vacant land in Mississauga, Ontario.

During 2010, the Company recorded the sale of two residential lots remaining from a residential subdivision completed in a previous year, which were previously not able to be sold due to restrictions imposed by the municipality which were lifted in 2010.

During 2009 the Company had no land sales.

The rate of profit on land sales is a function of the projects sold, stage of the development and economic circumstances.

### House building operations

(in thousands of dollars)

	2011	2010	2009
Revenue from housing sales	\$ 10,611	\$ 14,571	\$ 33,311
Housing cost of sales	9,410	13,518	31,334
Gross profit from housing sales	\$ 1,201	\$ 1,053	\$ 1,977

The Company's share of revenue from housing sales as recorded by its joint ventures for 2011 decreased to \$10.6 million from the \$14.6 million recorded in 2010. This revenue decrease is primarily the result of there being fewer units sold as a result of the Company no longer acquiring any new lots and no new projects being started as existing inventory was being completed and sold.

The Company's share of revenue from housing sales as recorded by its joint ventures for 2010 decreased to \$14.6 million from the \$33.3 million recorded in 2009. This revenue decrease is primarily the result of there being fewer units sold. In 2009, the Company acquired no new lots and no new projects were started as existing inventory was being completed and sold. As well, two projects, which contributed \$1.7 million to 2009 sales, were sold out by September 30, 2009.

The gross margin percentage on housing sales is a function of the projects sold. Margins vary widely from project to project and are influenced by many factors including market demand in the project's location, the proximity of competing product, the mix of product within the project, the cost of land, the stage in a project when construction cost increases hit the market and the length of time it takes for a project to sell out resulting in higher carrying costs.

The gross margin percentage on housing sales across all projects for 2011 increased to 11.3% from the 7.2% achieved in 2010. In 2009, the gross margin was 5.9%. The gross margin increase in 2011 was primarily the result of the sale of more higher margin product in 2011 compared to 2010 and the Company having recorded upward adjustments to cost estimates of prior periods with the availability of new information in the third quarter of 2010.

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**Rental operations**

(in thousands of dollars)

	2011	2010	2009
Continuing operations			
Rental revenues	\$ 517	\$ 589	\$ 530
Rental operating expenses	172	187	235
	345	402	295
Discontinued operations			
Rental revenues	106	313	313
Rental operating expenses (recoveries)	5	13	(87)
	101	300	400
Net operating income*	\$ 446	\$ 702	\$ 695

\* Net operating income is an important measure used by management to evaluate the operating performance of the income-producing properties; however, it is not defined by GAAP, does not have a standard meaning and may not be comparable with other companies.

Rental revenue changes from January 1, 2008, the date the Company's Vaughan, Ontario income-producing property was transferred from property under development, to September 30, 2011 are primarily the result of occupancy changes in the property's rental building. Rental revenue decreased from 2010 to 2011 as a result of the tenant from which the Company purchased its Vaughan, Ontario income-producing property vacating the premises at the end of its lease in the third quarter of 2010 and the space remaining vacant throughout 2011. This loss of rental revenue was partly offset by the leasing of 42,000 square feet of roof surface for a solar panel installation and the leasing of other vacant space in the building to two tenants on a short-term basis.

Rental revenue increased again in 2010 compared to 2009 with the October 1, 2009 commencement of two new tenancies but the increase was partially offset by the effect of the tenant referred to above not renewing at the end of its lease term in the third quarter of 2010 leaving the space vacant for the remainder of the year.

See "ASSETS – Income-producing properties" below for further information on the level of the property's occupancy.

**Interest and other income**

The Company's interest and other income is primarily earned from investments in short-term bank issued securities and syndicated mortgage loans. Income from these investments decreased from \$2.7 million in 2010 to the \$2.0 million recorded in 2011. This decrease was primarily due to the Company having greater investment in low interest rate cash and short-term money market instruments and substantially reduced investment in higher interest rate syndicated mortgage loans during 2011 compared to 2010. After December 31, 2008, other than fulfilling funding commitments and participating in renewals or extensions on existing syndicated mortgage loans, the Company ceased investing in new syndicated mortgage loans with a view to accumulating cash to pay future dividends, which were ultimately paid on January 13, 2010 and March 4, 2011.

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### **Interest expense**

The interest expense incurred by the Company to finance its house building operations is capitalized to land and housing under development and expensed through housing cost of sales as housing units are sold. The Company incurred interest expense in its rental operations in 2011 of \$0.22 million compared to \$0.21 million for 2010. This increase is a result of an increase in the floating rate interest paid on the mortgage loan on its Vaughan, Ontario income-producing property, partially offset by reduced interest expense resulting from scheduled principal repayments.

### **General and administrative expenses**

General and administrative expenses decreased by \$0.14 million from the \$1.03 million recorded in 2010 to the \$0.89 million recorded in 2011.

As previously disclosed in the Company's Management Information Circular dated February 23, 2011, for the years ended September 30, 2011 and 2010, the terms of the Management Agreement provided for management fees of 3% of pre-tax earnings subject to a minimum of \$0.3 million. For both years the management fee of \$0.3 million, calculated in accordance with the agreement, was accrued at year-end and included in general and administrative expenses. See "TRANSACTIONS WITH RELATED PARTIES".

### **Depreciation and amortization expense**

The Company recorded depreciation of \$0.13 million on its Vaughan, Ontario income-producing property for both 2011 and 2010.

### **Income taxes**

The 2011 income tax provision of \$0.1 million, computed by applying the average statutory Canadian federal and provincial income tax rates to earnings before income taxes was offset by the reversal of a \$1.3 million provision for tax exposures recorded in a prior year and no longer considered necessary net of \$0.3 million for other items.

The 2010 income tax provision of \$0.2 million, computed by applying the average statutory Canadian federal and provincial income tax rates to earnings before income taxes was offset by the reversal of a \$1.2 million provision for tax exposures recorded in a prior year and no longer considered necessary and \$0.4 million for other items. Management has determined that potential unrecorded future income tax benefits of approximately \$10.9 million may be available to the Company under certain circumstances. Due to uncertainty as to whether these benefits will be realized, such benefits will be recognized in the accounts of the Company only as and when the realization of the benefits is confirmed.

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**Selected quarterly consolidated financial information (unaudited)**

(in thousands of dollars, except per share amounts)

	2011				2010			
	4 <sup>th</sup> Qtr	3 <sup>rd</sup> Qtr	2 <sup>nd</sup> Qtr	1 <sup>st</sup> Qtr	4 <sup>th</sup> Qtr	3 <sup>rd</sup> Qtr	2 <sup>nd</sup> Qtr	1 <sup>st</sup> Qtr
Revenue	\$ 2,445	\$ 2,180	\$ 4,758	\$ 4,460	\$ 3,099	\$ 4,904	\$ 4,507	\$ 5,887
Net earnings								
Continuing operations	\$ 94	\$ 1,450	\$ 818	\$ 689	\$ 2,374	\$ 384	\$ 445	\$ 809
Discontinued operations	(15)	—	2,407	54	50	50	51	50
Total	\$ 79	\$ 1,450	\$ 3,225	\$ 743	\$ 2,424	\$ 434	\$ 496	\$ 859
Basic and diluted earnings per share								
Continuing operations	\$ —	\$ 0.07	\$ 0.04	\$ 0.03	\$ 0.12	\$ 0.02	\$ 0.02	\$ 0.04
Discontinued operations	—	—	0.12	—	—	—	—	—
Total	\$ —	\$ 0.07	\$ 0.16	\$ 0.03	\$ 0.12	\$ 0.02	\$ 0.02	\$ 0.04

(Due to the impact of rounding, the sum of quarterly earnings per share may not equal the total for the year.)

Fluctuations in the quarterly results over the two-year period shown above are mainly due to the timing of land and housing sales, the timing of the recognition of adjustments to housing cost of sales as discussed earlier in this MD&A and the reversal of tax provisions no longer considered necessary in the third quarter of 2011 and the fourth quarter of 2010.

Fluctuations in revenue by quarter comparing 2011 quarters to the corresponding quarters in 2010 are primarily the result of fluctuations in housing revenues for the reasons outlined above.

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## FINANCIAL CONDITION

(in thousands of dollars)

	2011	2010	2009
Income-producing properties	\$ 7,107	\$ 8,210	\$ 7,419
Land and housing under development	5,755	10,051	13,101
Cash and cash equivalents	8,456	7,175	34,004
Restricted cash	322	344	540
Amounts receivable	7,400	7,459	7,828
Investments in marketable securities	16,874	20,451	2,211
Investments in syndicated mortgage loans	11,022	17,126	25,583
Deposits on land purchases	—	30	597
Income taxes recoverable	217	497	—
All other assets	241	163	507
Total assets	\$ 57,394	\$ 71,506	\$ 91,790
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Mortgage loans on:			
Income-producing properties	\$ 4,285	\$ 4,520	\$ 4,717
Housing under development	510	733	1,222
Total long-term financial liabilities	\$ 4,795	\$ 5,253	\$ 5,939

## ASSETS

### Income-producing properties

Income-producing properties decreased in 2011 by \$1.1 million, the result of the sale of the Company's Mississauga, Ontario income-producing properties having a carrying value of \$1.0 million and the recording of \$0.1 million of depreciation for the Company's last remaining income-producing property in Vaughan, Ontario.

Income-producing properties increased in 2010 by \$0.8 million, the result of additions of \$0.9 million net of \$0.1 million of depreciation of income-producing properties recorded for the year. The additions comprise the Company's fourth quarter purchase for \$0.8 million of its 50% interest in approximately 1.25 acres of land adjoining its Vaughan, Ontario income-producing property and \$0.1 million of additions during the year to its building on that property. The additional land was acquired to enhance the value of the existing property through ownership of the entire corner property and to provide for future potential development opportunities for the site.

As at September 30, 2009, the Company had achieved a 64% level of occupancy in its Vaughan, Ontario income-producing property. During 2010, the Company leased 17,046 square feet to two new tenants bringing the building occupancy to 73% leased and during the third quarter of 2010, the tenant from which the Company purchased the building in 2005, vacated the premises at the end of its lease leaving the building 49% leased through to September 30, 2010. Other than two short-term tenancies, which commenced in 2011 that are scheduled to terminate by December 31, 2011, no new leases commenced for interior building space in 2011.

During the second quarter of 2011, the Company leased 42,000 square feet of roof surface to a company partly owned by a related party on which the lessee has installed solar panels to provide electricity to the Ontario Power Authority ("OPA") grid. The Company began to collect rent under the lease as of January 19, 2011, the date designated as the Term Commencement Date by the OPA. The lease term is for twenty years with three five-year renewal options.



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During the third quarter of 2011, the Company leased a further 30,903 square feet of space to a national chain of fitness clubs for a twenty-year term with a ten-year renewal option. The lease is scheduled to commence on the earlier of March 1, 2012 or the completion of the tenant's fixturing period, which had not yet begun as at September 30, 2011, and will bring the building to a 65% occupancy level. The Company's share of the cost of landlord's base building work and a cash fixturing allowance to the tenant is expected to total approximately \$0.6 million and will be paid from the Company's own resources.

During the fourth quarter of 2011, the Company entered into an agreement to lease the 50%-owned, 1.25 acre Vaughan, Ontario site referred to above to an international chain for use as a fast food restaurant with drive-through for a fifteen-year term with two five-year renewal options. The tenant is expected to commence operations on the site by July 2012 on the completion of the landlord's site work and the tenant's fixturing period. The Company's share of the landlord's site preparation costs is expected to be approximately \$0.15 million and will be paid from the Company's own resources.

At September 30, 2011, the Company's sole income-producing property consists of its 50% share of the 200,000 square foot industrial/commercial building and adjacent 1.25 acre restaurant site in Vaughan, Ontario referred to above.

#### **Land and housing under development**

Land inventory is comprised of land under development and land and housing under development, which represents land that is being or has been serviced or developed and the inventory of housing under construction of our joint ventures. The Company's inventory of housing under construction decreased from \$9.9 million to \$5.8 million during 2011. This decrease is the result of the timing of projects in relation to the Company's year-end and the fact that no significant new land inventory was acquired during 2011 as 2010 inventory was being sold. The Company's share of the total units under development at September 30, 2011 amounted to 16 units compared to 36 units at the end of 2010. The Company's development land inventory decreased by \$0.15 million with the sale of the Company's development land referred to above.

#### **Investment in syndicated mortgage loans**

The Company's investment in syndicated mortgage loans decreased by \$6.1 million during the year, as a result of the proceeds received on maturities net of further advances to satisfy funding commitments on existing loans. These funds received were, for the most part, reinvested in short-term bank issued securities. Refer to the section "RISK MANAGEMENT – Credit and operational risks" later in this MD&A for further comments regarding the Company's investment in syndicated mortgage loans and related risk and loan impairment considerations.

#### **Cash resources**

Cash and cash equivalents comprise unrestricted cash and term deposits with a maturity of three months or less from the date of acquisition. Restricted cash comprises cash and term deposits required to secure outstanding guarantees and letters of credit.

#### **Amounts receivable**

Amounts receivable decreased in 2011 by \$0.06 million due to the receipt of scheduled principal repayments of \$0.20 million on the vendor take-back mortgage assumed by the Company on the sale in 2008 of its land held for future development in the Collingwood, Ontario area, partially offset by an increase of \$0.15 million of amounts due on the closing of house sales held in trust by the Company's lawyers at the end of 2011, net of a decrease in other items of \$0.01 million. The vendor take-back mortgage bears interest at 6% per annum for the remainder of its term and is payable as to interest only annually, together with \$0.05 million of principal per quarter. The mortgage is secured by land and matured

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on October 10, 2011. On maturity, the mortgage was refinanced to mature on January 31, 2012. The extension agreement provides for interest at 6% per annum calculated and payable quarterly, an extension fee of \$0.025 million payable on or before November 30, 2011, which has been paid, and a principal payment of \$0.25 million payable on January 10, 2012.

Amounts receivable decreased in 2010 by \$0.40 million due to the receipt of scheduled principal repayments of \$0.15 million on the vendor take-back mortgage assumed by the Company on the sale in 2008 of its land held for future development in the Collingwood, Ontario area, the receipt of \$0.30 million of amounts due on the closing of house sales held in trust by the Company's lawyers at the end of 2009, offset by an increase in straight-line rent receivable of \$0.03 million and \$0.02 million of other items.

### **Deposits on land purchases**

The Company's share of deposits on land purchases in its house building joint ventures decreased by \$0.03 million as the Company closed the purchase of all of the lots under contract with developers and no new lot purchases were contracted for in 2011.

## **LIABILITIES**

### **Loans payable**

Loans payable decreased during 2011 by \$1.2 million. With respect to mortgage loans, this decrease was comprised of two components: first, the Company repaid a \$0.73 million mortgage loan on land purchased by its house building joint ventures; and second, the Company paid \$0.20 million of scheduled principal repayments on the mortgage loan on its Vaughan, Ontario income-producing property. With respect to loans from related parties, the Company repaid loans totaling \$0.24 million from related parties as described below under "TRANSACTIONS WITH RELATED PARTIES".

A condition of the mortgage loan on the Company's Vaughan, Ontario income-producing property is that the co-tenancy maintain a long-term debt to tangible equity ratio of 3:1. As at September 30, 2011, with a ratio at that date of 3.04:1, this condition has not been met. The lender may, at its option, demand immediate repayment of the loan and enforce any security under the loan agreement. The lender has neither requested that the Company remedy this breach of covenant nor demanded repayment of the loan. Should such a request be forthcoming, the Company is in a position to inject additional capital, pay down the mortgage loan or, alternatively, refinance the property.

Loans payable decreased during 2010 by \$0.24 million. With respect to mortgage loans, this decrease was comprised of two components: first, the Company repaid a \$1.22 million mortgage loan and assumed a new mortgage loan of \$0.73 on land purchased by its house building joint ventures; and second, the Company paid \$0.2 million of scheduled principal repayments on the mortgage loan on its Vaughan, Ontario income-producing property. With respect to loans from related parties, the Company repaid loans totaling \$0.3 million from co-venturer corporations in its house building segment and received \$0.75 million of loans from related parties as described below under "TRANSACTIONS WITH RELATED PARTIES".

### **Accounts payable and accrued liabilities**

Accounts payable and accrued liabilities decreased in 2011 by \$0.33 million. This decrease was due to a decrease of \$0.40 million in the Company's share of accounts payable in its house building joint ventures offset by other net increases of \$0.07 million.

Accounts payable and accrued liabilities decreased in 2010 by \$0.17 million. This decrease was due to the final \$0.15 million payment under a former employee's severance arrangement accrued in a previous year and \$0.2 million of other items.

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## OUTSTANDING SHARE DATA

At September 30, 2011, the Company's authorized capital stock consists of an unlimited number of Class B, voting shares, without par value, of which 20,575,866 shares are issued and outstanding at a stated value of \$35.9 million.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash flow

(in thousands of dollars)

	2011	2010	2009
Cash provided by (used in)			
Continuing operations			
Operating activities	\$ 4,119	\$ 3,861	\$ 1,445
Investing activities	9,399	(10,637)	15,347
Financing activities	(15,653)	(20,260)	4,461
Increase (decrease) in cash and cash equivalents from continuing operations	(2,135)	(27,036)	21,253
Discontinued operations			
Operating activities	(372)	207	264
Financing activities	3,788	—	—
Increase in cash and cash equivalents from discontinued operations	3,416	207	264
Increase (decrease) in cash and cash equivalents during the year	1,281	(26,829)	21,517
Cash and cash equivalents, beginning of the year	7,175	34,004	12,487
Cash and cash equivalents, end of the year	\$ 8,456	\$ 7,175	\$ 34,004

Cash and cash equivalents increased in 2011 by \$1.3 million. This increase resulted from \$4.3 million of cash generated in the house building segment, \$6.1 million of net maturities in the syndicated mortgage loan segment, \$3.3 million of net maturities of short-term money market instruments, \$4.5 million of proceeds from the sale of income-producing properties, net of the dividend payment of \$15.4 million, \$1.2 million of loan repayments and \$0.3 million of other net cash outflows.

Cash and cash equivalents decreased in 2010 by \$26.8 million. This decrease resulted from the \$18.0 million increased investment in short-term money market instruments, the dividend payment of \$20.6 million offset by net maturities in the syndicated mortgage loan segment of \$8.1 million, \$3.8 million of cash generated in the house building segment and \$0.1 million of other net cash outflows.

The Company continues to use cash flows to fund commitments to additional funding of existing syndicated mortgage loans and to invest in cash equivalent and short-term money market investments and to fund its house building segment. The Company's cash and cash equivalents serve to provide the Company with sufficient liquidity to carry on its business activities.

On February 1, 2011, the Company declared a special dividend of \$0.75 per Class B share payable to shareholders of record at the close of business on February 11, 2011. The dividend, totaling \$15,432 was paid on March 4, 2011.

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On December 10, 2009, the Company declared a special dividend of \$1.00 per Class B share payable to shareholders of record at the close of business on December 29, 2009. The dividend, totaling \$20,576 was paid on January 13, 2010.

Management expects to be able to fund the repayment of the Company's mortgage loans payable as payments fall due or to be able to refinance such loans on their maturity.

## **TRANSACTIONS WITH RELATED PARTIES**

The following is a summary of the Company's related party relationships:

- some lots within the house building joint ventures were acquired from companies partly owned by or related to certain shareholders who are directors and/or officers of the Company. Typically, these lots would be subject to vendor take-back mortgages, as explained in note 9 to the consolidated financial statements;
- certain shareholders, and certain shareholders who are directors and officers or parties related to them, are also participants in all of the house building joint ventures;
- the Company is managed by two shareholders who are also officers and directors under a management agreement;
- a company controlled by an officer and a director provides certain construction contracting services to the Company;
- a director who is also an officer is a partner in a law firm that provides legal services to the Company;
- a director is associated with a law firm that provides legal services to the Company and its joint ventures;
- a director who is also an officer of the Company serves as a director of a Toronto Stock Exchange listed mortgage loan investment corporation. This corporation is a co-investor with the Company in the syndicated mortgage loans described in note 6(a) to the consolidated financial statements. Two directors who are also officers participate as investors in some of the syndicated mortgage loans in which the Company has invested;
- an officer of the Company is related to a principal of a company through which the Company had invested in a syndicated mortgage loan, which was repaid in 2010;
- a director who is also an officer partly owns a company, that has made loans to a house building joint venture in which the Company is a participant;
- three companies, one owned by one co-tenant and the other two owned by another co-tenant of the Company's Vaughan, Ontario income-producing property, lease space in that property; and
- a company owned by a co-tenant of the Company's Vaughan, Ontario income-producing property acts as the manager of that property and is paid management fees.

Related party transactions are recorded at their exchange amounts, which is the consideration agreed to by the parties.

Transactions with related parties during the year were as follows:

	2011	2010
Management fee expense	\$ 321	\$ 344
Legal services	40	54
Rental income	186	175
Interest earned from house building co-venturers	—	11
Construction contracting services	167	307
Interest paid or payable on loans payable	27	4
Land purchases in house building joint ventures	—	3,414

The consolidated balance sheets include the following balances with related parties:

	2011	2010
Accounts payable and accrued liabilities	\$ 302	\$ 355
Loans payable secured by housing under development	—	733
Loans payable	510	750

## RISK MANAGEMENT

### Interest rate risk

The Company is subject to interest rate fluctuations, however, current low and stable interest rates have lessened the risk associated with such fluctuations. The investments in syndicated mortgage loans are repayable in full at the option of the borrower at any time, and are subject to a minimum specified rate of interest or prime plus a specified interest spread if such exceeds the minimum specified rate. The Company's debt comprises project specific house building joint ventures' prime based bank debt, loans from related parties and a mortgage loan payable on an income-producing property.

### Credit and operational risks

The Company's credit risk relates to the potential of financial loss resulting from the failure of a borrower or counterparty to fully honour its financial or contractual obligations, such as to repay principal and/or interest on a syndicated mortgage loan. Fluctuations in real property values may increase the risk of default and may also reduce the net realizable value of the collateral real property to the Company. Credit losses occur when the counterparty fails to meet its obligations to the Company and the value realized on sale of the underlying security deteriorates below the carrying amount of the exposure. Credit risk is mitigated through credit enhancement, which is comprised of excess spread and obtaining sufficient real property collateral, as well as monitoring the level of concentration of credit risk from individual borrowers. Furthermore, the Company leverages the credit risk management objectives, policies and procedures of the mortgage syndicator to help mitigate the credit risk. These policies and procedures govern credit administration and arrears management.

The Company's operational risk relates to the potential of losses on housing under construction resulting from any instability in the real estate sector in the Greater Toronto Area and any reduction in the level of activity in the Company's house building joint ventures.

The Company's maximum exposure to credit risk consists of the carrying values of cash and cash equivalents, amounts receivable, investment in syndicated mortgage loans, marketable securities and deposits on land purchases.

Other than certain of the Company's syndicated mortgage loans, none of the Company's financial assets are either past due or impaired.

At September 30, 2011, a syndicated mortgage loan in the amount of \$3,816 was past due but not impaired. This loan was paid in full subsequent to the year-end.

On another syndicated mortgage loan, in the amount of \$241 and not due until December 31, 2011, the Company has not accrued any interest since March 1, 2010. Subsequent to the year-end the Company received a principal payment of \$25 together with all interest owing to September 30, 2011.

Two impaired syndicated mortgage loans totaling \$2,530 (2010 - \$3,047), net of a \$690 provision, were outstanding at September 30, 2010 and remain outstanding with the provision unchanged at September 30, 2011. A first mortgage in the amount of \$2,662 matures on January 31, 2012 and a second mortgage in the amount of \$227 matured on December 1, 2011. The Company is in the process of finalizing a renewal of the second mortgage. These syndicated mortgage loans are secured by a development in the City of Toronto consisting of street townhouse and multi-level condominium residential housing units. During 2011, the borrower arranged additional financing to complete the project, the Company's share of the commitment being \$653. The Company has been receiving discharge proceeds of principal only as dwelling units are closed with homebuyers. No interest has been paid or accrued on the first mortgage during 2011 or subsequent to September 30, 2011. Interest on the second mortgage is current. The provision on these syndicated mortgage loans was determined based on management's estimate of the shortfall between the principal and accrued interest balance of the syndicated mortgage loan and the estimated net realizable recovery from the real property securing the loan. The estimated net realizable recovery from the real property securing the loan as at September 30, 2011 is \$2,530 (2010 - \$3,047).

### Liquidity risk

Liquidity risk is managed by maintaining cash and cash equivalents in excess of projected needs, which includes the funding of commitments under certain of the Company's syndicated mortgage loan investments amounting to \$195 (September 30, 2009 - \$55).

The following table summarizes the contractual amounts and maturity periods of the Company's financial liabilities on an undiscounted basis:

(in thousands of dollars)

Contractual obligations are due as follows:

	Total	Less than 1 year	1 - 3 years	4 - 5 years	Thereafter
Loans payable	\$ 7,139	\$ 1,303	\$ 860	\$ 813	\$ 4,163
Accounts payable and accrued liabilities	1,057	1,057	—	—	—
Total liabilities	8,196	2,360	860	813	4,163
Further advances under syndicated mortgage loans*	195	195	—	—	—
Liabilities and other contractual obligations	\$ 8,391	\$ 2,555	\$ 860	\$ 813	\$ 4,163

\* Based on management's estimate of the timing of borrowers requesting additional funding as per the terms of the original lending agreement. Any such additional advance will form part of the Company's investment in syndicated mortgage loans.

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### Environmental risks

As an owner of real property, the Company is subject to various federal, provincial and municipal laws relating to environmental matters. Such laws provide that the Company could be liable for costs of removal and remediation of certain hazardous toxic substances released on or in its properties, or disposed of at other locations. The failure to remove or remediate such substances, if any, could adversely affect the Company's ability to sell such real property or to borrow using such real property as collateral and, potentially, could result in claims against the Company. The Company is not aware of any material environmental liabilities at the present time.

### FUTURE ACCOUNTING CHANGES

#### International Financial Reporting Standards ("IFRS")

In January 2006, The Canadian Institute of Chartered Accountants ("CICA") Accounting Standards Board ("ASB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards for public companies are required to comply with IFRS for fiscal years beginning on or after January 1, 2011, with comparative figures presented on the same basis. Accordingly, the Company will first report under IFRS for its fiscal year ending September 30, 2012 with comparative financial information restated to conform to IFRS presentation.

IFRS is premised on a conceptual framework similar to current Canadian GAAP; however, significant differences exist in certain matters of recognition, measurement and disclosure. While the adoption of IFRS will not have a significant impact on the reported cash flows of the Company, it may have a material impact on the Company's consolidated balance sheets and consolidated statements of earnings and comprehensive income. The Company has identified significant accounting policy changes that it expects to apply upon adoption of IFRS, which are significantly different than its current Canadian GAAP policies. The Company continues to evaluate the impact of these IFRS accounting policy changes and is executing its convergence plan with the intent to prepare its first consolidated financial statements in accordance with IFRS for the three-month period ending December 31, 2011. These consolidated financial statements will include comparative results for the periods commencing October 1, 2010.

The Company has substantially completed all phases of its conversion plan between Canadian GAAP and IFRS and has determined there are no significant systems implications or implications impacting the control environment, that is, ICFR and DC&P. The IFRS assessment on reporting results is being overseen by the Company's CFO and will address specific areas of financial reporting and disclosure as the conversion date approaches.

The following table addresses key elements of the conversion plan and an assessment of the Company's progress:

Key Activity	Milestones	Status/Timelines
<b>IFRS Conversion Scoping Phase</b>	Review of current standards vs. IFRS. Identification of significant differences.  Assessment of available resources.  Monitoring of changes to Canadian GAAP and IFRS and their impact on the Company.	Completed and reported to Audit Committee in February 2011.    Ongoing throughout process.

Key Activity	Milestones	Status/Timelines
<b>Decisions on Accounting Policies and IFRS 1</b>	<p>Formal review of differences in each area.</p> <p>Assessment of differences between IFRS and the Company's current practices.</p> <p>Decision on accounting policy choices and IFRS 1 for each assessed area.</p>	Completed and reported to Audit Committee in May 2011.
<b>Information Technology Evaluation</b>	Identification of IT requirements, both hardware and software, for IFRS conversion.	Completed and reported to Audit Committee in February 2011 that there are no significant systems or IT implications.
<b>Control Environment: Internal Control Over Financial Reporting and Disclosure Controls and Procedures</b>	Review and assessment of impact of accounting policy choices and changes relating to IFRS conversion.	Completed and reported to Audit Committee in February 2011 that there are no significant control environment implications.
<b>Financial Impact Analysis for Transactional Areas</b>	Analysis of differences between Canadian GAAP and IFRS that was completed will be quantified. Senior management to review and sign off.	Completed and reported to Audit Committee in December 2011.
<b>Financial Statement Preparation</b>	<p>Identification of transactions impacted by IFRS conversion.</p> <p>An assessment of these transactions, appropriate changes and remapping will be completed.</p> <p>The assessment and remapping will form the skeleton of the IFRS compliant financial statements.</p>	Completed and reported to Audit Committee in December 2011.
<b>Business Activities Impact</b>	<p>Identification of impacts on business activities to be completed.</p> <p>Completion of any renegotiations.</p>	<p>Ongoing throughout process.</p> <p>Report to Audit Committee – ongoing.</p>



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Summarized below are key areas where changes in accounting policies are expected that may impact the Company's consolidated financial statements.

#### **First-time Adoption of IFRS**

The adoption of IFRS requires the application of IFRS 1, First-time Adoption of International Financial Reporting Standards ("IFRS 1"), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS effective at the end of the Company's first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment. The Company expects to apply the following transitional exceptions and exemptions to full retrospective application of IFRS in its preparation of an opening IFRS consolidated balance sheet as at the Company's Transition Date:

##### **(a) Investment properties**

In accordance with IFRS 1, the Company will elect to apply the fair value model in IAS 40, Investment Properties, to account for its investment properties. The carrying values of the properties will be adjusted to their fair value at the Transition Date. The fair value will be determined by independent third party appraisers. The impact of this election will be an increase to investment properties of approximately \$4.0 million, an increase to future income tax liabilities of approximately \$0.7 million and an increase to retained earnings of approximately \$3.3 million at the Transition Date.

##### **(b) Business combinations**

In accordance with IFRS 1, the Company will elect to apply IFRS 3, Business Combinations, prospectively to all business combinations occurring after its Transition Date.

##### **(c) Borrowing costs**

IAS 23, Borrowing Costs, requires the capitalization of borrowing costs that are directly attributable to qualifying assets. In accordance with IFRS 1, the Company will elect to apply the requirements of IAS 23 prospectively from its Transition Date.

##### **(d) Estimates**

In accordance with IFRS 1, the Company will apply the mandatory exemption from full retrospective application of IFRS for estimates. The exemption requires that estimates previously made under Canadian GAAP not be revised due to the application of IFRS, except where necessary to reflect differences in accounting policies.

#### **Investment Properties**

Currently, the Company's investment properties are carried at cost, net of accumulated depreciation and net of any impairment losses. IFRS provides entities with the choice to account for investment properties using the fair value model or the cost-based model. Under a fair value model, depreciation is not recorded and investment properties are adjusted to fair value at each reporting date with changes in fair value recorded directly in the statement of earnings. If the cost-based model is adopted, the investment properties would be carried at cost less accumulated depreciation and any impairment charges; however, disclosure of fair value is required. The Company has decided to account for its investment properties using the fair value model. The impact of this change is a fair value gain of \$0.9 million being recognized in the year ended September 30, 2011 (\$4.0 million in September 30, 2010).

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### **Principles of Consolidation**

Currently, the Company's consolidated financial statements include its proportionate share of the assets, liabilities, revenues and expenses of joint ventures and co-tenancies. Under current IFRS, an entity may account for interests in joint ventures using either the equity method or the proportionate consolidation method. Management has decided to maintain its current method of accounting for its interests in joint ventures and co-tenancy using the proportionate consolidation method.

In May 2011, the International Accounting Standards Board issued IFRS 11 Joint Arrangements, which will require entities to account for their interests in joint ventures using the equity method of accounting. IFRS 11 is effective for fiscal years beginning on or after January 1, 2013 with early adoption permitted. Management is currently assessing whether or not early adoption of IFRS 11 is appropriate.

### **Impairment of Assets**

IFRS uses a one-step approach for both testing for and measuring impairment, with asset carrying values compared directly with the higher of fair value less costs to sell and value in use (which is a discounted cash flow analysis). The Company currently uses a two-step approach: first, comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and then, measuring any impairment by comparing the asset's carrying value with its fair value. The difference in methodology may potentially result in a difference in the asset impairment test results upon transition to IFRS.

### **Income Taxes**

Currently, the Company's future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities. IFRS requires a similar approach to recognizing future income tax assets and liabilities. The adoption of a fair value model of accounting for its investment properties will alter their financial reporting bases. Consequently, the Company's future income tax liability relating to its investment properties will increase by approximately \$0.8 million and \$0.1 million at October 1, 2010 and September 30, 2011, respectively.

### **Discontinued Operations**

Under IFRS, a component of an entity that has been sold or is held-for-sale is only presented as a discontinued operation if it represents a separate major line of business or geographical area of operations. The investment property disposed of in February 2011 does not constitute a major line of business. Consequently, the discontinued operations presented under Canadian GAAP will be reclassified to continuing operations under IFRS.

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## FINANCIAL INSTRUMENTS

(in thousands of dollars)

CICA Section 3862, Financial Instruments – Disclosures, places an emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. In accordance with this section, the financial assets and liabilities are classified within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

- Level 1 – unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, and;
- Level 3 – inputs that are not based on observable market data.

The following table illustrates the classification of the Company's financial instruments within the fair value hierarchy as described above as at September 30, 2011 and September 30, 2010:

September 30, 2011	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 8,778	\$ —	\$ —	\$ 8,778
Marketable securities	16,874	—	—	16,874
	\$ 25,652	\$ —	\$ —	\$ 25,652
Bank advances	\$ 328	\$ —	\$ —	\$ 328

  

September 30, 2010	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 7,519	\$ —	\$ —	\$ 7,519
Marketable securities	20,451	—	—	20,451
	\$ 27,970	\$ —	\$ —	\$ 27,970
Bank advances	\$ 71	\$ —	\$ —	\$ 71

### Fair value

The fair values of investments traded in active markets, such as marketable securities available-for-sale, are based on the quoted bid price on the consolidated balance sheet date.

The fair values of cash and cash equivalents, restricted cash, investments in term deposits, deposits on land purchases, accounts payable and accrued liabilities, and deposits on sales approximate their carrying values due to their short-term maturities.

The fair value of investments in syndicated mortgage loans approximates their carrying value, as they are repayable in full at the option of the borrower at any time and, for the most part, the interest rate is subject to adjustment.

The fair value of the bank advances approximates their carrying value because they bear interest at floating rates.

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## **CRITICAL ACCOUNTING ESTIMATES**

The discussion and analysis of the financial condition and results of operations of the Company is based on the consolidated financial statements, which are prepared in accordance with GAAP. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements. Estimates and assumptions are evaluated on an ongoing basis. Estimates are based on historical experience and other assumptions that management believes are reasonable and appropriate in the circumstances. Actual results could differ from those estimates.

Management believes the most critical accounting estimates are as follows:

### **Capitalized costs and estimated costs to complete**

Land and housing inventory includes costs of acquisition, development, interest, property taxes and directly related expenses. If estimates of costs are significantly different from actual results, cost of sales and earnings may be overstated or understated.

### **Carrying values**

Estimates of cash flows from syndicated mortgage loans are used for determining provisions for impairment of such investments.

### **Income taxes**

Significant judgment is required in determining the Company's provision for income taxes. There are many transactions and calculations where the ultimate tax determination is uncertain and may not be resolved or finalized until several years after such transactions or calculations are made and reported. During the years ended September 30, 2011 and 2010, the ultimate tax determination of certain prior year transactions was finalized resulting in adjustments that reduced the Company's income tax provisions by \$1.3 million and \$1.8 million, respectively. The Company believes it has adequately provided for all tax liabilities.

## **OFF-BALANCE SHEET ARRANGEMENTS**

### **Financial guarantees**

The Company has letters of credit available totaling \$0.3 million (2010 - \$0.3 million), of which \$0.3 million (2010 - \$0.3 million) has been utilized in support of its obligation to complete servicing requirements in connection with various house building projects.

The Company is contingently liable for its associates' share of the obligations in joint ventures and co-tenancy developments. At September 30, 2011, the Company's associates' share of obligations of such entities comprises liabilities of \$8.8 million (2010 - \$9.3 million) and letters of credit of \$0.9 million (2010 - \$1.1 million) in support of obligations to complete servicing requirements in connection with various house building projects. In each case, assets of the joint ventures and co-tenancy developments, consisting primarily of cash and cash equivalents and housing under development, are available to satisfy such obligations.

### **Commitments**

The Company has commitments to make additional advances totaling \$0.2 million under one of the syndicated mortgage loans described above in which it is a co-investor.

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## OUTLOOK

As at September 30, 2011, the Company completed the purchase of all of the lots for which it had previously given deposits in its house building operations and management does not expect to acquire additional lots or continue its house building operations beyond the end of its 2012 fiscal year-end at which time it expects to have completed and sold its three currently active house building projects. The total value of house sales in 2012 is expected to be lower than that of 2011 as the Company will have fewer lots available for sale in 2012 than it delivered to buyers in all of 2011 and the value of 2012 house sales will decline over that in 2011 for the same reason. As well, profit margins on house sales could be adversely affected by increased costs resulting from unforeseen factors in the construction industry or in the economy.

With all of its development land and all but one of its income-producing properties having been sold as of September 30, 2011, the Company's remaining real estate holdings consist of the income-producing properties and adjoining land described above under "Financial Condition – Assets." The Company is continuing with its efforts to complete the leasing of its Vaughan, Ontario income-producing property. Management is continuing to receive expressions of interest to lease space in the building and has been working with prospective tenants with some success as discussed above.

Management continues to closely monitor the Company's investments in syndicated mortgage loans. Syndicated mortgage loans totaling \$2.8 million are not performing to their terms and appropriate steps are being taken by the syndicator with regard to these non-compliant loans. While no actual losses have been realized on any of the Company's investments, management has recorded a provision for potential losses, which it believes to be adequate to deal with current exposures.

Management and the Board of Directors continue to assess the basis for the Company's ongoing operations with a view to maximizing shareholder value.

Additional information relating to the Company has been filed on SEDAR and can be found at [www.sedar.com](http://www.sedar.com).