Consolidated Financial Statements
(In Canadian dollars)

TERRA FIRMA CAPITAL CORPORATION

Years ended December 31, 2013 and 2012

KPMG LLP
Bay Adelaide Centre
333 Bay Street Suite 4600
Toronto ON M5H 2S5
Canada

Telephone (416) 777-8500
Fax (416) 777-8818
Internet www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Terra Firma Capital Corporation

We have audited the accompanying consolidated financial statements of Terra Firma Capital Corporation, which comprise the consolidated statements of financial position as at December 31, 2013, the consolidated statements of income and comprehensive income, changes in shareholders' equity and cash flows for the year then ended, and notes, comprising 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 our 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, we consider 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 is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Terra Firma Capital Corporation as at December 31, 2013, its consolidated financial performance, its consolidated changes in shareholders' equity and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

The consolidated financial statements of Terra Firma Capital Corporation as at and for the year ended December 31, 2012 were audited by another auditor who expressed an unmodified opinion on those statements on April 30, 2013.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

April 14, 2014
Toronto, Canada

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Financial Position
(In Canadian dollars)

December 31, 2013 and 2012

	2013	2012
Assets		
Cash and cash equivalents	$ 7,721,115	$ 3,223,291
Funds held in trust	383,526	–
Amounts receivable and prepaid expenses (note 3)	1,661,352	2,396,180
Loan and mortgage investments (note 4)	55,278,303	31,996,731
Investment properties held in joint operations (note 5)	7,671,452	7,834,576
Portfolio investment (note 6)	954,073	950,000
	$ 73,669,821	$ 46,400,778
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities (note 7)	$ 1,366,708	$ 1,192,616
Provision for discontinued operations (note 8)	321,490	445,957
Unearned income	472,924	16,965
Income taxes payable	82,375	474,297
Deferred income taxes	6,348	15,602
Loans and mortgages payable (note 9)	46,569,921	21,406,070
Convertible debentures (note 10)	10,125,074	10,093,325
	58,944,840	33,644,832
Shareholders' equity:		
Share capital (note 12(a))	10,795,790	10,757,405
Contributed surplus (notes 12(b) and 13)	603,962	573,139
Retained earnings	3,125,229	1,425,402
	14,524,981	12,755,946
Non-controlling interest	200,000	–
	$ 73,669,821	$ 46,400,778

See accompanying notes to consolidated financial statements.

The consolidated financial statements were approved
by the Board on April 14, 2014 and signed on its behalf by:

"John Kaplan" Director

"Seymour Temkin" Director

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Income and Comprehensive Income
(In Canadian dollars)

Years ended December 31, 2013 and 2012

	2013	2012
Revenue:		
Interest and fees	$ 8,454,163	$ 5,156,665
Rental (note 5)	451,335	343,958
	8,905,498	5,500,623
Expenses:		
Property operating costs (note 5)	287,078	129,186
General and administrative	1,476,156	538,978
Share-based compensation (note 15)	39,208	216,840
Interest (note 16)	4,742,023	2,569,006
Fair value adjustment - investment properties (note 5)	78,287	–
	6,622,752	3,454,010
Income from operations before income taxes	2,282,746	2,046,613
Income taxes (note 17)	582,919	562,320
Income from continuing operations	1,699,827	1,484,293
Loss from discontinued operations (note 8)	–	(232,313)
Net income and comprehensive income	$ 1,699,827	$ 1,251,980
Earnings per share (note 14):		
Continuing operations:		
Basic	$ 0.06	$ 0.05
Diluted	0.05	0.05
Discontinuing operations:		
Basic	0.00	(0.01)
Diluted	0.00	(0.01)

See accompanying notes to consolidated financial statements.

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Changes in Shareholders' Equity
(In Canadian dollars)

Years ended December 31, 2013 and 2012

	Share capital				
	Number of shares	Amount	Contributed surplus	Retained earnings	Total
	(note 12(a))		(notes 12(b) and 13)		
Shareholders' equity, December 31, 2011	30,495,000	$ 10,687,105	$ 386,599	$ 173,422	$ 11,247,126
Issuance of common shares under share option plan	200,000	70,300	(30,300)	–	40,000
Share-based compensation	–	–	216,840	–	216,840
Net income and comprehensive income	–	–	–	1,251,980	1,251,980
Shareholders' equity, December 31, 2012	30,695,000	10,757,405	573,139	1,425,402	12,755,946
Issuance of common shares under share option plan	150,000	38,385	(8,385)	–	30,000
Share-based compensation	–	–	39,208	–	39,208
Net income and comprehensive income	–	–	–	1,699,827	1,699,827
Shareholders' equity, December 31, 2013	30,845,000	$ 10,795,790	$ 603,962	$ 3,125,229	$ 14,524,981

See accompanying notes to consolidated financial statements.

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Cash Flows
(In Canadian dollars)

Years ended December 31, 2013 and 2012

	2013	2012
Cash provided by (used in):		
Operating activities:		
Net income from continuing operations	$ 1,699,827	$ 1,484,293
Non-cash items:		
Interest and fees earned	(8,454,163)	(4,781,665)
Interest expense	4,742,023	2,569,006
Stock-based compensation (note 13)	39,208	216,840
Fair value adjustment - investment properties (note 5)	78,287	–
Income tax provision	582,919	562,320
Change in non-cash operating items:		
Decrease (increase) in other receivables	1,343,610	(1,115,033)
Increase in prepaid expenses and deposits	(88,678)	(19,182)
Increase (decrease) in accounts payable and accrued liabilities	(299,001)	1,169,356
Interest and fees received	6,650,694	3,159,570
Interest paid	(4,390,886)	(2,249,749)
Income taxes paid	(984,095)	(82,163)
Cash provided by operating activities - continuing operations	919,745	913,593
Cash used in operating activities - discontinued operations (note 8)	(124,467)	(120,907)
Cash provided by operating activities	795,278	792,686
Financing activities:		
Proceeds from loans and mortgages payable	35,493,200	18,064,746
Repayments of loans and mortgages payable	(10,329,349)	(2,161,030)
Proceeds from issuance of shares under share options plan	30,000	40,000
Cash provided by financing activities	25,193,851	15,943,716
Investing activities:		
Funding of loan and mortgage investments	(40,276,867)	(17,712,826)
Repayments of loan and mortgage investments	19,292,248	3,215,618
Acquisition of investment property (note 5)	–	(2,757,495)
Capital additions to investment properties (note 5)	(119,087)	(4,391,533)
Proceeds from sale of investment property, net	–	311,568
Portfolio investment (note 8)	(4,073)	(950,000)
Increase in funds held in trust	(383,526)	–
Cash used in investing activities	(21,491,305)	(22,284,668)
Increase (decrease) in cash and cash equivalents	4,497,824	(5,548,266)
Cash and cash equivalents, beginning of year	3,223,291	8,771,557
Cash and cash equivalents, end of year	$ 7,721,115	$ 3,223,291

See accompanying notes to consolidated financial statements.

Terra Firma Capital Corporation (the "Company") was incorporated under the Business Corporations Act (Ontario) on July 26, 2007. The common shares of the Company ("Shares") trade on the TSX Venture Exchange (the "Exchange") under the symbol TII. The registered office of the Company is: 5000 Yonge Street, Suite 1502, Toronto, Ontario, M2N 7E9. The principal business of the Company is the arrangement of and participation in real property financings secured by investment properties and commercial and residential real estate developments, throughout Canada.

1. Basis of presentation:

(a) Statement of compliance:

These consolidated financial statements of the Company have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") as well as Interpretation of International Financial Reporting Interpretations Committee ("IFRIC").

(b) Basis of presentation:

The Company holds its interests in certain joint operations and portfolio investment in its subsidiaries which are controlled by the Company. The Company's principal subsidiaries and ownership are Terra Firma MA Ltd. (100% owned), Terra Firma Queen Developments Inc. (100% owned), and Terra Firma Capital (Hill) Corporation (the "Hill")(78.95% owned). The financial statements of these subsidiaries and the Company's proportionate share in joint operations are consolidated with those of the Company and all intercompany transactions and balances between the Company and its subsidiary entities and joint operations have been eliminated upon consolidation. The non-controlling interest in the Hill is recorded in the consolidated statements of financial position to reflect the non-controlling interest's share of the Hill.

(c) Basis of measurement:

These consolidated financial statements have been prepared on a historical cost basis, except for investment properties held in joint operation, portfolio investments, financial instruments classified at fair value through profit or loss and non-controlling interests, which are stated at their fair values.

1. Basis of presentation (continued):

(d) Functional and presentation currency:

These consolidated financial statements have been presented in Canadian dollars, which is the Company's functional currency.

(e) Critical judgements and estimates:

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of income and expenses during the year. Actual results may differ from these estimates.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed separately.

Changes to estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of these consolidated financial statements and the reported amounts of revenue and expenses during the years. Actual results could also differ from those estimates under different assumptions and conditions.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

2. Significant accounting policies:

The Company's accounting policies and its standards of financial disclosure set out below are in accordance with IFRS and have been applied consistently to all years presented in these consolidated financial statements.

(a) Cash and cash equivalents:

Cash and cash equivalents include unrestricted cash and short-term investments. Short-term investments, comprising money market instruments, have a maturity of 90 days or less at their date of purchase and are stated at cost, which approximates net realizable value.

(b) Funds held in trust:

Funds held in trust is comprised of cash balances that are deposited and held in trust within a wholly owned subsidiary of the Company that administers Loans and Mortgages Investments. The restricted deposits are subject to future Loan and Mortgage contractual obligations and are therefore restricted in access until all the contractual payout conditions are met. Funds held in trust is carried at amortized cost which approximates their fair value. The corresponding liability is included in accounts payable and accrued liabilities.

(c) Loan and mortgage investments:

The loan and mortgage investments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, the loan and mortgage investments are measured at amortized costs using the effective interest method ("EIM"). The loans and mortgage investments are de-recognized when the contractual rights to receive cash flows and benefits expire, or where they have been transferred and the Company also transfers the control or substantially all the risks and rewards of ownership.

The loan and mortgage investments are assessed each reporting year to determine whether there is any objective evidence of impairment and are considered to be impaired if one or more loss events that have an impact on the future cash flows of the financial asset after initial recognition of the financial asset and the loss can be reliably measured.

2. Significant accounting policies (continued):

If there is objective evidence of an impairment loss, the loss based on the difference between the carrying amount of the loan and mortgage investment, and the respective estimated future cash flows discounted at the loan and mortgage investment's original effective interest rate and is recorded as an allowance for losses and recognized in the consolidated statements of income and comprehensive income. If, in a subsequent period, the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is reversed to the extent of the impairment amount.

(d) Joint arrangements:

A joint arrangement is a contractual arrangement pursuant to which the Company and other parties undertake an economic activity that is subject to joint control whereby the strategic financial and operating policy decisions relating to the activities of the activities of the joint arrangement require the unanimous consent of the parties sharing control. Joint arrangements are two types - joint ventures and joint operations.

The Company's significant joint arrangements consist of joint operations, which are structured through a direct interest in the joint venture's assets, rather than through the establishment of a separate entity, the arrangement is referred to as joint operations and the Company's proportionate share of joint venture assets, liabilities, revenues and expenses are recognized in the consolidated financial statements and classified according to their nature. When the Company transacts with its joint operations, unrealized profits and losses are eliminated to the extent of the Company's interest in the joint operations. Balances outstanding between the Company and joint operations in which it has an interest are eliminated in the consolidated statements of financial position.

(e) Investments properties:

Investment properties include properties held to earn rental income or for capital appreciation, or for both, and properties that are being constructed or developed for future use as investment properties. On acquisition, investment properties are initially recorded at cost. Subsequent to initial recognition, investment properties are carried at fair value. Gains or losses arising from changes in fair values are recognized in the consolidated statements of income and comprehensive income during the year in which they arise.

2. Significant accounting policies (continued):

(f) 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 de-recognized when the contractual rights to receive cash flows and benefits related to the financial asset expire, or if the Company transfers the control or substantially all the risks and rewards of ownership of the financial asset or significant risks and rewards, along with the unconditional ability to sell or pledge the asset to another party. Financial liabilities are de-recognized when obligations under the contract expire, are discharged or cancelled.

Financial assets and liabilities are offset and the net amount is reported in the consolidated statements of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Upon initial recognition, financial instruments are measured at fair value and classified as either financial assets or financial liabilities at fair value through profit or loss, held-to-maturity investments, available-for-sale assets, loans and receivables, other financial liabilities or as derivatives designated as hedging instruments in an effective hedge.

Financial instruments are included on the consolidated statements of financial position and measured at fair value, except for loans and receivables, held-to-maturity financial assets and other financial liabilities, which are measured at amortized cost using the EIM, less any impairment. Directly attributable transaction costs other than those related to financial instruments classified as fair value through profit or loss, which are expensed as incurred, are capitalized to the carrying amount of the instrument and amortized using the EIM.

Under the EIM, interest income and expense are calculated and recorded using the effective interest rate which is the rate that exactly discounts estimated future cash receipts or payments throughout the expected life of the financial instrument to the fair value at initial recognition.

The Company's financial assets include the cash and cash equivalents, funds held in trust, amounts receivable, portfolio investment and loan and mortgage investments. All of the Company's financial assets other than the portfolio investment which is classified as fair value through profit or loss are classified as loans and receivables.

2. Significant accounting policies (continued):

The Company's financial liabilities include the accounts payable and accrued liabilities, provision for discontinued operations, income taxes payable, loans and mortgages payable and liability component of convertible debentures. All of the Company's financial liabilities are classified as other liabilities.

The Company had neither available-for-sale, nor held-to-maturity instruments as at December 31, 2013 and 2012.

(g) Compound financial instruments:

Compound financial instruments issued by the Company comprise convertible debentures that can be converted to shares of the Company at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value. The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. All transaction costs directly attributable to the issuance of the compound financial instrument are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the EIM. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition. Interest, losses and gains relating to the financial liability are recognized in profit or loss.

(h) Impairment of financial instruments:

An assessment of whether there is objective evidence that a financial asset or a group of financial assets is impaired is performed at each reporting year. A financial asset is considered to be impaired if one or more loss events that have an impact on the future cash flows of the financial asset after initial recognition of the financial asset and the loss can be reliably measured.

2. Significant accounting policies (continued):

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has occurred, the loss is based on the difference between the carrying amount of the financial asset, and the respective estimated future cash flows discounted at the financial instrument's original effective interest rate and is recorded as an allowance for losses and recognized in the consolidated statements of income and comprehensive income. If, in a subsequent period, the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is reversed up to the extent of the original impairment amount.

In the determination of impairment, the Company assesses the existence of certain factors, including; non-payment of interest and or principal or other material default by the borrower, financial difficulty of the underlying secured asset, financial difficulty of the borrower and or guarantor, the Company granting certain concession favorable to the borrower and observable data that there is a measurable decrease in the estimated future cash flows.

(i) De-recognition of financial instruments:

A financial asset is de-recognized if substantially all risks and rewards of ownership and, in certain circumstances, control of the financial asset are transferred. A financial liability is de-recognized when it is extinguished, with any gain or loss on extinguishment to be recognized in other items in the consolidated statements of income and comprehensive income.

(j) Unearned income:

Unearned income includes commitment fees received from borrowers, which are amortized over the contractual terms of the respective loan and mortgage investments.

(k) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a deduction from equity.

2. Significant accounting policies (continued):

(l) Revenue recognition:

(i) Interest and fees earned:

Interest and fees earned is recognized in the consolidated statements of income and comprehensive income using the EIM. The EIM discounts the estimated future cash receipts through the expected life of the loan and mortgage to its carrying amount. When estimating future cash flows, the contractual terms of the mortgage are considered including origination revenue, interest receipts, principal receipts and contractual end of term participation receipts where applicable. Participation receipts that are contingent upon future events such as the profitability of the underlying security are not included in the estimated cash flows. Such amounts are recorded in income when management is reasonably assured of their collection.

(ii) Rental income:

The Company has retained substantially all of the risks and benefits of ownership of its investment properties and, therefore, accounts for its leases with tenants as operating leases. Rental income from these leases is recognized in the consolidated statements of income and comprehensive income on a straight-line basis over the term of the relevant lease.

(m) Share-based compensation:

The Company has a share option plan for grants to eligible directors, officers, senior management and consultants under its share option plan. No awards have been issued to consultants. The expense of equity-settled incentive option plan is measured based on fair value of the options granted of each tranche at the grant date. The expense is recognized on a proportionate basis consistent with the vesting features of each tranche of the grant and is reflected in equity. When share options are exercised, any consideration paid, together with the amount recorded in equity, are recorded in share capital.

2. Significant accounting policies (continued):

(n) Provisions:

Provisions for 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 probable 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 year, and are discounted to present value where the effect is material.

(o) Income taxes:

Income tax comprises current and deferred tax. Income tax is recognized in the consolidated statements of income and comprehensive income except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the reporting year, using tax rates enacted, or substantively enacted, at the end of the reporting year.

Deferred tax is determined based on the temporary differences between the carrying value and the tax basis of the assets and liabilities. Any change in the net amount of deferred income tax assets and liabilities is included in income. Deferred income tax assets and liabilities are determined based on enacted or substantially enacted tax rates and laws which are expected to apply to the Company's taxable income for the year in which the assets and liabilities will be recovered or settled. Deferred income tax assets are recognized when it is probable that there will be sufficient taxable income against which to utilize the benefits of the temporary differences.

(p) Foreign currency translation:

Investment transactions and income and expenses in foreign currencies have been translated into Canadian dollars at the rates of exchange prevailing at the time of the transactions. The fair value of mortgages and cash denominated in foreign currencies has been translated into Canadian dollars at the rates of exchange prevailing at year end. Foreign exchange gains and losses on the receipts of payments on mortgage investments are included in interest and fees on the consolidated statements of income and comprehensive income.

2. Significant accounting policies (continued):

(q) Earnings per share:

Basic earnings per share is calculated by dividing the net income attributable to shareholders of the Company by the weighted average number of Shares outstanding during the year.

Diluted earnings per share is calculated using the "if converted method" and is determined by adjusting the net income attributable to shareholders and the weighted average number of Shares outstanding, adjusted for the dilutive effects of all convertible debentures and granted share options.

(r) Adoption of recent accounting pronouncements:

The following standards and amendments to existing standards have been adopted for the period beginning January 1, 2013:

(i) IFRS 7, Financial Instruments - Disclosures - Offsetting Financial Instruments, as amended requires entities to disclose information about the effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after January 1, 2013. The adoption of this amendment did not result in any changes to the consolidated financial statements.

(ii) IFRS 10, Consolidated Financial Statements ("IFRS 10"), establishes a single control model that applies to all entities (including ‘special purpose entities,' or ‘structured entities'). IFRS 10 requires consolidation of an investee only if the investor possesses the power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. The adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.

2. Significant accounting policies (continued):

(iii) IFRS 11, Joint Arrangements ("IFRS 11"), supersedes International Accounting Standard ("IAS") 31, Interests in Joint Ventures ("IAS 31"), and addresses two forms of joint arrangements (joint operations and joint ventures) where there is joint control. IFRS 11 requires joint arrangements to be classified either as joint operations or joint ventures depending on the contractual rights and obligations of each investor that jointly controls the arrangement. For joint operations, a company recognizes its share of assets, liabilities, revenues and expenses of the joint operation. An investment in a joint venture is accounted for using the equity method as set out in IAS 28, Investments in Associates and Joint Ventures (amended in 2011). Accounting for joint operations will follow accounting similar to that for jointly controlled assets and jointly controlled operations under IAS 31. The Company has classified its joint arrangements as joint operations and concluded that the adoption of IFRS 11 did not result in any changes in the accounting for its joint arrangements.

(iv) IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12"), combines the disclosure requirements for the Company's subsidiaries, joint arrangements, associates and unconsolidated structured entities. The requirements of IFRS 12 include reporting on the nature of risks associated with the Company's interests in other entities, and the effects of those interests on the Company's consolidated financial statements. The Company has adopted IFRS 12 and has provided additional disclosure where appropriate in the consolidated financial statements.

(v) IFRS 13, Fair Value Measurement ("IFRS 13"), provides a single framework for measuring fair value and requires enhanced disclosures when fair value is used for measurement. The standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants, at the measurement date. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

2. Significant accounting policies (continued):

(s) New standards not yet adopted:

The following new standard issued by the IFRS Board may be relevant to the Company in preparing its consolidated financial statements in future periods.

(i) IFRS 9, Financial Instruments ("IFRS 9"), was issued to replace IAS 39, Financial Instruments: Recognition and Measurement. This is a three-phase project with the objective of improving and simplifying the reporting for financial instruments. The current issuance of IFRS 9 includes the first and third phases of the project, which provides guidance on the classification and measurement of financial assets and financial liabilities and hedge accounting. The mandatory effective date of the standard has not been determined due to the incomplete status of the second phase of the project, impairment. The effective date of the entire standard will be determined closer to the completion of the remaining phase. The extent of impact of adoption of IRFS 9 has not been determined.

(ii) IFRIC 21, Levies ("IFRIC 21"), addresses accounting for a liability to pay a levy within the scope of IAS 37, Provisions, Contingent liabilities and Contingent Assets. A levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation, other than income taxes within the scope of IAS 12, Income Taxes, and fines or other penalties imposed for breaches of the legislation. This interpretation becomes effective for annual periods beginning on or after January 1, 2014, and is to be applied retrospectively. The Company is currently assessing the impact of the new interpretation on its consolidated financial statements.

(iii) Amendments to IAS 32, Financial Instruments: Presentation ("IAS 32") was issued in 2011 to clarify that an entity currently has a legally enforceable right to offset if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. The amendments to IAS 32 also clarify when a settlement mechanism provides for net settlement or gross settlement that is equivalent to net settlement. The amendments to IAS 32 are effective for fiscal periods beginning on or after January 1, 2014. These amendments are to be applied retrospectively. The extent of the impact of adoption of the amendments to IAS 32 has not yet been determined.

(In Canadian dollars)

3. Amounts receivable and prepaid expenses:

The following table presents details of the amounts receivable and prepaid expenses as at December 31, 2013 and 2012.

	2013	2012
Interest receivable	$ 1,498,359	$ 1,182,179
Other receivables	61,116	1,200,802
Prepaid expenses and deposits	101,877	13,199
Amounts receivable and prepaid expenses	$ 1,661,352	$ 2,396,180

Included in interest receivable are non-current balances of $74,969.

The remaining interest and other receivables are current and due in the current fiscal year in accordance with contract terms.

4. Loan and mortgage investments:

As at December 31, 2013 and 2012, the Company had principal balance of loan and mortgage investments of $55,278,303 and $31,996,731, respectively. The loan and mortgage investments carry a weighted average effective interest rate of 18.6% (2012 - 19.9%) and a weighted average term to maturity of 1.21 years (2012 - 0.65 years).

In November 2013, a borrower of a residential housing development elected to repay the loan ahead of its maturity date with prepayment penalty of $67,263 on the loan. As a result, the Company recognized a gain of $91,861 and included in interest income in the consolidated statements of income and comprehensive income.

In August 2012, a borrower of a residential housing development elected to repay the loan ahead of its maturity date with a reduced repayment fee on the loan. As a result, the Company wrote-down the carrying amount of the loan by $347,914, recognized a loss which was included in interest income in the consolidated statements of income and comprehensive income.

(In Canadian dollars)

4. Loan and mortgage investments (continued):

The following table presents details of the loan and mortgage investments as at December 31, 2013 and 2012:

	2013		2012	
	Amount	% of investments	Amount	% of investments
Residential housing developments	$ 40,121,019	72.6	$ 30,200,563	94.4
Residential income properties	1,794,084	3.2	1,796,168	5.6
Commercial retail development	600,000	1.1	–	–
Student housing	12,763,200	23.1	–	–
Loan and mortgage investments	$ 55,278,303	100	$ 31,996,731	100

The Company's loan and mortgage investment activities include:

- land loans are either in first or second priority position; and
- mezzanine loans on development projects and income properties are subordinated to first mortgages.

The loans are on most major real estate property types, but predominantly within the residential and commercial asset groups. In some cases land loans will subsequently be subordinated to construction financing as the project progresses through its development period. The loan and mortgage investments are secured by mortgages registered on title and/or other forms of security including, but not limited to floating charge debentures, general security agreements, postponement of specific claims and joint and several guarantees.

(In Canadian dollars)

4. Loan and mortgage investments (continued):

(a) Residential housing developments:

These loans pertain to eight projects at various stages of development, 13 in Toronto, Ontario and one in Kitchener, Ontario. In the aggregate, 14 of the projects are slated for 1,738 high rise condominium units and 469 low rise condominium units. Seven of the loans have been syndicated to private investors (note 9).

(b) Commercial retail development:

The loan represents, first mortgage secured by a five unit retail development located in Kitchener, Ontario.

(c) Residential income properties:

The loans represent, second mortgages secured by a 251 unit apartment building located in Toronto, Ontario and a 50 unit apartment building located in Ottawa, Ontario.

(d) Student housing:

The equity loan secured by a limited partnership interest in an entity that has interest in a portfolio of student housing buildings located in the USA, with 5,352 beds.

The following table presents details of the Company's loan categories as at December 31, 2013 and 2012:

	2013	2012
Non-conventional mortgages	$ 44,078,303	$ 18,032,335
Unsecured loans investments	11,200,000	13,964,396
	$ 55,278,303	$ 31,996,731

Non-conventional mortgages are loans that may or may not exceed 75% of loan to value and earn profit participation. Unsecured investments are loans that are not secured by mortgage charge security.

(In Canadian dollars)

4. Loan and mortgage investments (continued):

Principal repayments and loan and mortgage investments maturing in the next five years are as follows:

	Scheduled principal payments	Investments maturing during the year	Total loans and mortgage investments
2014	$ 2,364	$ 16,841,438	$ 16,843,802
2015	1,750	38,432,751	38,434,501
	$ 4,114	$ 55,274,189	$ 55,278,303

Certain of the loans and mortgage investments have early repayment rights and, if exercised, would result in repayments in advance of their contractual maturity dates.

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing loan and mortgage investments at December 31, 2013 was $1,529,552 including $866,202 of capitalization of future interest relating to the existing loan and mortgage investments (2012 - $3,032,425, including $693,900 of capitalization of future interest relating to the existing loan and mortgage investments).

The loan and mortgage investments at December 31, 2013 includes $2,296,952 of interest and fees earned for the year ended December 31, 2013 and are capitalized to loan and mortgage investments.

5. Joint arrangements:

(a) Interests in joint operations:

The Company's interests in the following properties are subject to joint control and, accordingly, the Company has recorded its proportionate share of the related assets, liabilities, revenue and expenses of the properties following the proportionate consolidation method.

(i) Montreal Street JV:

In July 2009, the Company entered into a co-tenancy agreement (the "Montreal Street JV") with a development partner to develop a store for a national pharmacy chain in Ottawa, Ontario. The land on which the store was developed is subject to a 20 year land lease, with five renewal options of five years each. The Montreal Street JV carries a loan of $2,146,449 as at December 31, 2013, bearing interest at 4.2% per annum, is amortized over 25 years and matures June 1, 2016. The Company's ownership interest in the Montreal Street JV is 52.5%.

(ii) Salem Road JV:

The Company entered into a co-owners' agreement (the "Salem Road JV") with a development partner and financial partner, to acquire and develop a single family residential housing project in Ajax, Ontario. Upon completion of the project and the transfer of all the units to purchasers in December 2012, the Company received its investment of $465,500 and its share of fees of $400,000, in cash.

(iii) Queen Street West JV:

In April 2012, the Company entered into a co-owners' agreement (the "Queen Street West JV") and acquired a land parcel with a development partner to develop a mid-rise residential condominium building in Toronto, Ontario, having a development potential of approximately 100,000 square feet of gross floor area. Under the terms of the co-owners agreement, the Company has agreed to contribute 75% of the capital required during the course of the development, for a 50% ownership interest.

(In Canadian dollars)

5. Joint arrangements (continued):

The financial information in respect of the Company's proportionate share of investments in joint operations is as follows:

	2013	2012
Assets		
Cash and cash equivalents	$ 5,465	$ 31,588
Amounts receivable and prepaid expenses	101,669	41,642
Investment properties	7,671,452	7,834,576
	7,778,586	7,907,806
Liabilities		
Accounts payable and accrued liabilities	24,134	217,343
Loans and mortgages payable	4,680,547	4,368,854
	4,704,681	4,586,197
Net assets	$ 3,073,905	$ 3,321,609

The table below details the results of operations for the years ended December 31, 2013 and 2012, attributable to the Company from its joint operations activities:

	2013	2012
Rental revenue	$ 451,335	$ 343,958
Interest income	58,310	–
Gain on sale of investment property	–	375,000
	509,645	718,958
Property operating costs	287,078	129,186
General and administrative expenses	2,732	210
Interest expense	400,835	169,554
Fair value adjustment - investment properties	78,287	–
	768,932	298,950
Net income (loss)	$ (259,287)	$ 420,008

(In Canadian dollars)

5. Joint arrangements (continued):

(b) Investment properties:

The Company has interests in investment properties that are subject to joint control and accordingly, the Company has recorded its proportionate share of the related assets, liabilities, revenue and expenses of the properties.

The following table summarizes the changes in the Company's proportionate share of the investment properties for the years ended December 31, 2013 and 2012:

	2013	2012
Balance, beginning of year	$ 7,834,576	$ 3,234,658
Acquisition of properties	–	4,994,892
Reduction in amount receivable from joint operations partners	(203,924)	–
Additions - capital expenditures	119,087	4,391,533
Sale of investment properties	–	(4,786,507)
Fair value adjustment	(78,287)	–
Balance, end of year	$ 7,671,452	$ 7,834,576

The Company determined the fair value of investment property in the Montreal Street JV using the direct capitalization method. Under the direct capitalization method, fair values were determined by capitalizing the estimated future net operating income at the market capitalization rates. The capitalization rate used in the valuation property was 7.0%.

As at December 31, 2013, a 25-basis-point decrease in the overall capitalization rate would increase the Company's proportionate share of value of investment property by $71,159. A 25-basis-point increase in the overall capitalization rate would decrease the Company's proportionate share of the value of investment property by $66,251.

The Company determined the fair value of investment property in the Queen Street West JV using the direct comparison method. The direct comparison method involves comparing or contrasting the recent sale, listing or optioned prices of properties comparable to the subject property and adjusting for any significant differences between them.

(In Canadian dollars)

5. Joint arrangements (continued):

The proportionate share of investment property in the Queen Street West JV with an aggregate fair value of $5,755,492 at December 31, 2013 was estimated by an external appraiser. The proportionate share of investment property in the Montreal Street JV with an aggregate value of $1,915,960 was valued by the Company's management.

As at December 31, 2013, a $5.0 increase or decrease in the rate per square floor would increase or decrease the Company's proportionate share of the value of investment property by $256,048, respectively.

6. Portfolio investment:

The Company has invested through the Hill a partnership interest in a 94 unit mid-rise condominium development project located in Toronto, Ontario. The Company does not have significant influence in the partnership and is accounting for this investment as a financial asset at fair value through profit and loss. The carrying value of the investment is $954,073 (2012 - $950,000) and the investment of the other partner in the Hill of $200,000 is included in non-controlling interest. At December 31, 2013 and 2012, the fair values were determined using direct comparison method. The carrying value of investment approximates its fair value.

7. Accounts payable and accrued liabilities:

The following table presents details of the accounts payable and accrued liabilities as at December 31, 2013 and 2012:

	2013	2012
Interest payable	$ 772,735	$ 453,346
Interest reserve	353,705	–
Accounts payable, accrued liabilities and provisions	240,268	739,270
Accounts payable and accrued liabilities	$ 1,366,708	$ 1,192,616

Accounts payable and accrued liabilities are current and payable in the current fiscal year.

(In Canadian dollars)

8. Discontinued operations:

The Company's discontinued operations consist of the assets, liabilities and operations of a sold property located at 870 Red River Road, Thunder Bay, Ontario. The Company has agreed to indemnify rents with respect to a tenant's lease of a unit in the property from the date of sale until its lease expiry of July 2016, to the extent that the tenant fails to make rent payments (the "indemnified tenancy"). The tenant entered into a court appointed receivership process and the receiver was unable to sell the underlying business and as a result, the receiver disclaimed the lease subject to the indemnified tenancy.

An additional provision of $232,313, net of income tax recovery of $82,687, was recorded relating to this obligation during the year ended December 31, 2012. The balance of the provision as at December 31, 2013 and 2012 were $321,490 and $445,957, respectively. The current portion of the provision is $124,412.

Following table summarizes the changes in the provision for discontinued operations for the years ended December 31, 2013 and 2012:

	2013	2012
Balance, beginning of year	$ 445,957	$ 251,864
Lease payments made during the year	(124,467)	(120,907)
Additional provision for remainder of the term	–	315,000
Balance, end of year	$ 321,490	$ 445,957

(In Canadian dollars)

9. Loans and mortgages payable:

The Company sources its loans and mortgages payable through the syndication of certain of its loan and mortgage investments to private investors or to financial institutions, each participating in a prescribed manner per agreement on an investment by investment basis and conventional construction or permanent financing secured by the project or investment property.

The principal balance of loans and mortgage payable at December 31, 2013 and 2012 were $46,569,921 and $21,406,070, respectively. The loans and mortgages carry a weighted average effective interest rate of 12.0% (2012 - 13.9%) and a weighted average term to maturity of 1.31 years (2012 - 0.84 years).

The details of loans and mortgages payable at December 21, 2013 and December 31, 2012 are as follows:

	2013		2012	
	Amount	% of investments	Amount	% of investments
Residential housing developments	$ 28,279,132	60.7	$ 15,689,132	73.3
Residential income properties	1,347,042	2.9	1,348,084	6.3
Commercial retail development	500,000	1.1	–	–
Student housing	12,763,200	27.4	–	–
Montreal Street JV	1,180,547	2.5	1,205,676	5.6
Queen Street West JV	2,500,000	5.4	3,163,178	14.8
	$ 46,569,921	100	$ 21,406,070	100

Scheduled principal repayments and maturity amounts loans and mortgages payable at December 31, 2013 are as follows:

	Scheduled principal payments	Loans maturing during the year	Total loans and mortgages payable
2014	$ 30,611	$ 10,864,132	$ 10,894,743
2015	31,679	34,523,185	34,554,864
2016	13,224	1,107,090	1,120,314
	$ 75,514	$ 46,494,407	$ 46,569,921

(In Canadian dollars)

10. Convertible debentures:

On September 27, 2011 the Company completed a private placement of 10,150, 7.0% unsecured subordinated debentures (the "Debentures") at a price of $1,000 per debenture for gross proceeds of $10,150,000. The Debentures mature on September 27, 2014. Interest is paid on the last business day of each calendar quarter commencing December 31, 2011. The Debentures are convertible at the option of the holder at any time up to maturity at a conversion price of $0.70 per common share. The Debentures are not redeemable or convertible at the option of the Company prior to maturity.

800 of the Debentures, having a face value of $800,000, were placed with directors and officers of the Company.

Upon initial recognition, the fair value of the liability component of the Debentures was determined to be the fair value of the Debenture as a whole.

Issue costs directly attributable to the issuance of the Debentures are deducted from the liability component of the Debenture resulting in an effective interest rate of 7.35%. The Debentures, net of the equity component and issue costs are accreted using the effective interest rate method (the "EIR") over the term to maturity of the Debentures, such that the carrying amount will equal the total face value of the Debenture at maturity.

The following table summarizes the changes in the Debentures for the years ended December 31, 2013 and 2012:

	2013	2012
Balance, beginning of year	$ 10,093,325	$ 10,061,869
Interest expensed at EIR of 7.35%	742,249	741,956
Interest paid	(710,500)	(710,500)
Balance, end of year	$ 10,125,074	$ 10,093,325

(In Canadian dollars)

11. Commitments and contingencies:

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing loan and mortgage investments at December 31, 2013 was $1,529,552 (2012 - $3,032,425).

The Company is also committed to provide additional capital to joint operations in accordance with contractual agreements.

The Company has a lease commitment on its head office premises located at 5000 Yonge Street, Toronto, Ontario. The minimum rental amount is $30,693 per annum extending to March 31, 2017. Additional maintenance and utility costs and realty taxes are payable as incurred.

The Company, from time to time, may be involved in various claims, legal and tax proceedings and complaints arising in the ordinary course of business. The Company is not aware of any pending or threatened proceedings that would have a material adverse effect on the financial condition or future results of the Company.

12. Shareholders' equity:

(a) Shares issued and outstanding:

The following table summarizes the changes in shares for the years ended December 31, 2013 and 2012:

	Shares	Amount
Outstanding, December 31, 2011	30,495,000	$ 10,687,105
Issuance of shares under share option plan	200,000	40,000
Transferred from contributed surplus upon exercise of options	–	30,300
Outstanding, December 31, 2012	30,695,000	10,757,405
Issuance of shares under share option plan	150,000	30,000
Transferred from contributed surplus upon exercise of options	–	8,385
Outstanding, December 31, 2013	30,845,000	$ 10,795,790

As at December 31, 2012, Counsel Corporation, controlled by the then Chairman of the Board of the Company, beneficially owns 20.2% of the common shares of the Company and therefore is considered a related party (note 15).

(In Canadian dollars)

12. Shareholders' equity (continued):

(b) Share-based compensation:

The Company has adopted a share option plan (the "Plan") to grant eligible directors, officers, senior management and consultants to grant options to purchase Shares. The exercise price of an option each option shall be determined by the Board of Directors and in accordance with the Plan and the policies of the Exchange. Subject to the policies of the Exchange, the board of directors may determine the time during which options shall vest and the method of vesting, or that no vesting restriction shall exist, provided that no Option shall be exercisable after five years from the date on which it is granted.

On April 17, 2013, the Company granted share options to Directors and Officers to purchase 245,334 common shares at $0.30 per share. 25% of the share options vested immediately upon grant, with an additional 25% vesting each 90-day period thereafter.

On April 17, 2012, the Company granted share options to Directors and Officers of the Company and employees of the Manager to purchase 910,000 common shares at $0.50 per share. Except for 20,000 share options granted to the former Chairman of the Company's Audit Committee which vested immediately upon grant, 25% of the remaining share options vested immediately, with an additional 25% vesting each 90-day period thereafter.

The fair value of the share options granted was estimated on each of the dates of grant, using the Black-Scholes option pricing model, with the following assumptions:

	April 17, 2013	April 17, 2012
Average expected life	5 years	5 years
Average risk-free interest rate	1.21%	1.47%
Average expected volatility	104.00%	103.00%
Average dividend yield	–	–

The fair value of options granted during the years ended December 31, 2013 and 2012 were $39,208 and $188,581, respectively.

(In Canadian dollars)

12. Shareholders' equity (continued):

The following is the summary of changes in share options for the year ended December 31, 2013 and 2012:

	2013		2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	2,442,667	$ 0.37	1,917,667	$ 0.28
Granted	245,334	0.30	910,000	0.50
Exercised	(150,000)	0.20	(200,000)	0.20
Cancelled	(605,667)	0.42	(185,000)	0.20
Outstanding, end of year	1,932,334	0.37	2,442,667	0.37
Number of options exercisable	1,897,667	$ 0.38	2,270,167	$ 0.36

The following summarizes the Company's outstanding share options as at December 31, 2013:

Number of options outstanding	Expiry date	Number of options exercisable	Exercise price	Market price at date of grant
150,000	June 22, 2014	150,000	$ 0.20	$ 0.09
895,000	January 24, 2016	895,000	0.30	0.28
138,667	December 19, 2016	138,667	0.50	0.40
610,000	April 16, 2017	610,000	0.50	0.30
138,667	April 17, 2018	104,000	0.30	0.25
1,932,334		1,897,667		

(In Canadian dollars)

13. Contributed surplus:

The following table presents the details of the contributed surplus balances as at December 31, 2013 and 2012:

	2013	2012
Balance, beginning of year	$ 573,139	$ 386,599
Fair value of share-based compensation	39,208	216,840
Transferred to share capital - exercise of options	(8,385)	(30,300)
Balance, end of year	$ 603,962	$ 573,139

14. Earnings per share:

The calculation of earnings per share of the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Numerator for basic and diluted earnings per share		
Income attributable to common shareholders	$ 1,699,827	$ 1,251,980
Interest savings on Debentures, net of taxes	545,553	547,193
Diluted income attributed to common shareholders	$ 2,245,380	$ 1,799,173
Denominator basic and diluted earnings per share		
Weighted average number of shares outstanding	30,737,486	30,585,860
Dilutive effect of share-based payments	42,487	118,084
Assumed conversion of Debentures	14,500,000	14,500,000
Weighted average number of diluted common shares outstanding	45,279,973	45,203,944
Earnings per share:		
Basic	$ 0.06	$ 0.04
Diluted	0.05	0.04

15. Transactions with related parties:

Except as disclosed elsewhere in the consolidated financial statements, the following are the related party transactions.

At December 31, 2013, the Chairman of the Board of the Company, indirectly through a wholly owned subsidiary, owned approximately 20% of the issued and outstanding shares of the Company.

At December 30, 2012, Counsel Corporation, controlled by the then Chairman of the Board of the Company, owned approximately 20.2% of the outstanding Shares of the Company, and therefore is considered a related party. On January 1, 2013, Counsel distributed its entire holding of Shares as a dividend to its shareholders.

(a) Management Agreement:

On December 31, 2012, Counsel Asset Management L.P. (the "Manager"), an entity wholly-owned by Counsel Corporation, terminated the Management Agreement with the Company.

Prior to December 31, 2012, pursuant to the term of the Management Agreement, the Manager provided the administration of the day-to-day operations of the Company including providing other general management services to the Company including accounting, reporting, financial statement preparation assistance, and the provision of office space, equipment and personnel and advising on strategic matters including assisting the Company in structuring, sourcing, evaluating, and negotiating investments; the financing of such investments; and dispositions.

For the year ended December 31, 2012, pursuant to the terms of the Management Agreement, for the services provided by the Manager, the Company paid the Manager an annual management fee, quarterly in arrears, equal to the sum of (i) 1.5% of the first $200 million of the Company's shareholder's equity and debt securities excluding syndication of loan or other investments, (ii) 1.25% of the Company's shareholders' equity and debt securities excluding syndication of loan or other investments in excess of $200 million and up to $300 million, and (iii) 1.00% of the Company's shareholders' equity and debt securities excluding syndication of loan or other investments in excess of $300 million, in each case calculated in accordance with Canadian generally accepted accounting principles. For the years ended December 31, 2012, the management fee of $328,900 were included in general and administrative expenses. Of this amount, $84,000 was included in accounts payable and accrued liabilities.

(In Canadian dollars)

15. Transactions with related parties (continued):

In addition, for the year ended December 31, 2012, pursuant to the Management Agreement, the Company paid the Manager, 50% of all fees attributable to lending activities earned by the Company and certain fees or profit earned by the Company in connection with equity participations in commercial and residential developments and investment property acquisitions. The fees paid to the Manager were deducted from the fees used in the determination of the effective interest rate on each of the Company's loan and mortgage investments. During the year ended December 31, 2012, the Company paid $480,100 in such fees to the Manager. At December 31, 2012, the fees payable to the Manager amounted to $125,000 and was included in accounts payable and accrued liabilities.

The Management Agreement transactions were in the normal course of business and were recorded at their exchange amounts agreed to by the related parties, which closely represent the market value of these types of transactions. The terms of the Management Agreement were approved by the independent members of the Company's Board of Directors.

(b) Key management personnel compensation:

Aggregate compensation for key management personnel was as follows:

	2013	2012
Short-term employee benefits	$ 713,762	$ 842,709
Share-based compensation	39,208	216,840
	$ 752,970	$ 1,059,549

In 2013, the key management personnel of the Company include Chief Executive Officer, Chief Financial Officer, Vice President, Operations and the Board of Directors.

In 2012, the key management personnel, excluding the Board of Directors, provided services to the Company pursuant to the Management Agreement and their compensation included in the above was paid through the annual management fee.

During the years ended and as at December 31, 2013 and 2012, no key management personnel were indebted to the Company.

(In Canadian dollars)

15. Transactions with related parties (continued):

(c) Loans and mortgages payable and Debentures:

Several of the Company's loan and mortgage investments are syndicated with other investors of the Company, which may include officers or directors of the Company. The Company ranks equally with other members of the syndicate as to payment of principal and interest.

At December 31, 2013 and 2012, the loan and mortgage investments and Debentures syndicated by officers and directors were $2,840,280 and $2,276,088, respectively. No loans or investments were issued to borrowers controlled by or related to officers or directors of the Company.

16. Interest expense:

The following table presents the interest incurred for the years ended December, 2013 and 2012:

	2013	2012
Interest on loans and mortgages payable	$ 3,717,266	$ 1,657,495
Interest on Debentures	742,249	741,957
Montreal Street JV	48,830	50,017
Queen Street West JV	233,678	119,537
	$ 4,742,023	$ 2,569,006

17. Income taxes:

The following table specifies the current and deferred tax components of income taxes on continuing operations in the consolidated statements of income and comprehensive income:

	2013	2012
Current income tax provision	$ 592,173	$ 556,978
Deferred income tax provision (recovery)	(9,254)	5,342
Total tax provision	$ 582,919	$ 562,320

(In Canadian dollars)

17. Income taxes (continued):

Income tax expense is different from the amount that would result from applying the combined federal and provincial income tax rates to income before continuing operations before income taxes. These differences result from the following items:

	2013	2012
Income from continuing operations before taxes	$ 2,282,746	$ 2,046,613
Combined federal and provincial statutory income taxes	26.50%	26.25%
Income tax provision based on statutory income tax rates	$ 604,928	$ 537,236
Increase (decrease) in income tax due to:		
Non-taxable items	(26,056)	(26,741)
Non-deductible stock-based compensation	10,390	56,921
Change in deferred tax asset not previously recognized	(5,230)	(5,144)
Tax rate differential on temporary differences	(1,113)	48
Total tax provision	$ 582,919	$ 562,320

The combined federal and provincial statutory income tax rate of 26.50% for 2013 has increase from rate of 26.25% for 2012 due to increasing enacted federal and provincial income tax rates.

The composition of the Company's recognized deferred income tax assets and liabilities for the year ended December 31, 2013 is as follows:

	Opening balance	Recognized in income	Closing balance
Investment property	$ (25,838)	$ 10,372	$ (15,466)
Incorporation costs	753	(53)	700
Debenture and share issue costs	9,483	(1,065)	8,418
	$ (15,602)	$ 9,254	$ (6,348)

(In Canadian dollars)

17. Income taxes (continued):

The composition of the Company's recognized deferred income tax assets and liabilities for the year ended December 31, 2012 is as follows:

	Opening balance	Recognized in income	Closing balance
Investment property	$ (25,350)	$ (488)	$ (25,838)
Incorporation costs	794	(41)	753
Debenture and share issue costs	14,296	(4,813)	9,483
	$ (10,260)	$ (5,342)	$ (15,602)

18. Capital management:

The Company defines its capital as the aggregate of shareholders' equity, Debentures and loans and mortgages payable. The Company's capital management is designed to ensure that the Company has sufficient financial flexibility, short-term and long-term and to grow cash flow and solidify the Company's long-term creditworthiness, as well as a good return for the shareholders.

The following table presents the capital structure of the Company as at December, 2013 and 2012:

	2013	2012
Loans and mortgages payable	$ 46,569,921	$ 21,406,070
Convertible debentures	10,125,074	10,093,325
Shareholders' equity	14,524,981	12,755,946
Total capital	$ 71,219,976	$ 44,255,341

The Company is free to determine the appropriate level of capital in context with the cash flow requirements, overall business risks and potential opportunities. As a result, the Company will make adjustments to its capital structure in response to lending opportunities, the availability of capital and anticipated changes in general economic conditions. The Company's overall strategy with respect to capital remains unchanged during the years ended December 31, 2013 and 2012.

During the years ended December 31, 2013 and 2012, the Company had no externally imposed capital requirements.

19. Fair value measurement:

The Company, as part of its operations, carries a number of financial instruments. The Company's financial instruments consist of cash and cash equivalents, funds held in trust, interest and other receivables, loan and mortgage investments, portfolio investment, accounts payable and accrued liabilities, loans and mortgages payable and Debentures.

The fair value of interest and other receivables and accounts payable and accrued liabilities approximate their carrying values due to their short-term maturities.

The fair value of loan and mortgage investments, loans and mortgages payable and Debentures approximate their carrying value as they are short-term in nature. There is no quoted price in an active market for the loans and mortgage investments, mortgage syndication liabilities or Debentures. The Company makes its determinations of fair value based on its assessment of the current lending market for loan and mortgage investments of same or similar terms. As a result the fair value is based on Level 3 on the fair value hierarchy.

The Company uses various methods in estimating the fair values recognized in the consolidated financial statements. The fair value hierarchy reflects the significance of inputs used in determining the fair values.

- Level 1 - quoted prices in active markets;

- Level 2 - inputs other than quoted prices in active markets or valuation techniques where significant inputs are based on observable market data; and

- Level 3 - valuation technique for which significant inputs are not based on observable market data.

The fair value of the Company's investment properties, portfolio investments and non-controlling interests are determined using Level 3 inputs at December 31, 2013 and 2012 and no amounts were transferred between fair value levels during 2013 or 2012. Notes 5 and 6 outlines the key assumptions used by the Company in determining fair value of its investment properties and portfolio investment.

20. Risk management:

In the normal course of business, the Company is exposed to a number of risks that can affect its operating performance. These risks and the actions taken to manage them are as follows:

(a) Market risk:

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market price whether the changes are caused by factors specific to the investment or factors affecting all securities in the market.

The Company's objective of managing this risk is to minimise the volatility of earnings. The Company mitigates this risk by charging interest rates which are significantly above normal banking rates.

(b) Credit risk:

Credit risk is the risk of financial loss from the failure of a borrower, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from the Company's loan and mortgage investment activities. Fluctuations in real estate values may increase the risk of default and may also reduce the net realizable value of the collateral property to the Company. Credit losses occur when a borrower fails to meet its obligations to the Company and the value realized on the sale of the underlying security deteriorates below the carrying amount of the exposure.

The Company is exposed to credit risk on all financial assets and its exposure is generally limited to the carrying amount on the consolidated statements of financial position.

The Company mitigates the risk of credit losses on its loan and mortgage investments by maintaining strict credit policies and conducting thorough investment due diligence, ensuring loans and mortgages have risk-adjusted loan to value, together with personal guarantees by the borrowers and parties related to the borrowers, review and approval of new loans and mortgages and continued monitoring of change in value of underlying securities.

20. Risk management (continued):

(c) Currency risk:

Currency risk is the risk that the fair value or future cash flows of the Company's foreign currency denominated loan and mortgage investments, loans and mortgages payable and cash and cash equivalents will fluctuate based on changes in foreign currency exchange rates. Approximately $985,907 (2012 - nil) of the Company's cash and cash equivalents and $12,763,200 (2012 - nil) of the loans and mortgage investments and loans and mortgages payable at year end are denominated in United States dollars and secured primarily by charges on real estate located in United States; consequently, the Company is subject to currency fluctuations that may impact its financial position and results. The Company manages its currency risk on loan and mortgage investments by syndicating in the same currency.

A change in exchange rate of the Canadian dollar against the U.S. dollar by 5% would not have a significant impact on the net income and comprehensive income and equity for the year.

(d) Interest rate risk:

Interest rate risk arises due to exposure to the effects of future changes in the prevailing level of interest rates.

The Company is exposed to interest rate risk arising from fluctuations in interest rates primarily on its loan and mortgage investments, debentures payable and loans and mortgages payable.

The Company mitigates its exposure to this risk by entering into contracts having either fixed interest rates or interest rates pegged to prime for its loan and mortgage investments and loans and mortgages payable and asset liability matching. Such risk is further mitigated by the general short term nature of loan and mortgage investments.

The Company has no floating rate financial liabilities. At December 31, 2013, if interest rates had been 100 basis points lower or higher, with all other variables held constant, net income and comprehensive income and equity for the year would be affected as follows:

	Lower 100 bps	Higher 100 bps
Interest and fees	$ (552,783)	$ 552,783

(In Canadian dollars)

20. Risk management (continued):

(e) Liquidity risk:

Liquidity risk is the risk the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity risk is to ensure, to the extent possible, that it always has sufficient liquidity to meet its liabilities when they come due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's credit worthiness.

The Company manages liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities.

If the Company is unable to continue to have access to its loans and mortgages payable and convertible debentures, the size of the Company's loan and mortgage investments will decrease and the income historically generated through holding larger investments by utilizing leverage will not be earned.

Contractual obligations as at December 31, 2013, are due as follows:

	Less than 1 year	2 years	3 years	Total
Accounts payable and accrued liabilities	$ 1,366,708	$ –	$ –	$ 1,366,708
Provision for discontinued operations	124,412	124,756	72,322	321,490
Income taxes payable	82,375	–	–	82,375
Loans and mortgages payable	10,894,743	34,554,864	1,120,314	46,569,921
Convertible debentures	10,125,074	–	–	10,125,074
Total liabilities and contractual obligations	$ 22,593,312	$ 34,679,620	$ 1,192,636	$ 58,465,568