



Consolidated Financial Statements
(In Canadian dollars)

TERRA FIRMA CAPITAL CORPORATION

Years ended December 31, 2015 and 2014



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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, 2015 and 2014, the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years 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 audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on 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 in our audits 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, 2015 and 2014, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Professional Accountants, Licensed Public Accountants

March 23, 2016
Toronto, Canada

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Financial Position
(In Canadian dollars)

December 31, 2015 and 2014

	2015	2014
Assets		
Cash and cash equivalents	\$ 11,723,550	\$ 1,083,745
Funds held in trust	2,061,207	834,065
Deposits (note 4)	11,747,370	–
Amounts receivable and prepaid expenses (note 5)	2,279,977	2,058,846
Loan and mortgage investments (note 6)	95,135,201	78,635,796
Investment properties held in joint operations (note 7(b))	2,143,794	2,062,661
Portfolio investments (note 8)	2,339,555	1,620,828
Investment in associates (note 9)	2,315,414	–
Deferred income tax asset (note 21)	–	48,381
	<u>\$ 129,746,068</u>	<u>\$ 86,344,322</u>

Liabilities and Equity

Liabilities:

Accounts payable and accrued liabilities (note 10)	\$ 5,980,560	\$ 2,227,308
Provision for discontinued operations (note 11)	–	27,500
Unearned income	301,099	639,307
Income taxes payable (note 21)	322,046	341,432
Deferred income tax liability	18,665	–
Short-term unsecured notes payable (note 12)	9,286,000	1,500,000
Revolving operating facility (note 13)	9,865,144	–
Loan and mortgage syndications (note 6)	45,691,948	45,390,821
Mortgages payable (note 7)	1,120,314	1,151,118
Convertible debentures (note 14)	10,628,301	10,514,431
	<u>83,214,077</u>	<u>61,791,917</u>

Equity:

Share capital (note 16(a))	31,257,404	16,654,718
Equity component of convertible debentures (note 14)	284,490	284,490
Contributed surplus (notes 16(b) and 17)	2,360,575	1,049,585
Retained earnings	12,374,881	6,352,957
	<u>46,277,350</u>	<u>24,341,750</u>
Non-controlling interest	254,641	210,655
	<u>46,531,991</u>	<u>24,552,405</u>

Commitments and contingencies (note 15)

	<u>\$ 129,746,068</u>	<u>\$ 86,344,322</u>
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See accompanying notes to consolidated financial statements.

The consolidated financial statements were approved
by the Board on March 23, 2016 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, 2015 and 2014

	2015	2014
Revenue:		
Interest and fees	\$ 17,162,141	\$ 12,127,716
Unrealized foreign exchange gain	2,041,443	–
Realized foreign exchange gain	37,345	–
Rental (note 7(a))	189,434	257,595
	<u>19,430,363</u>	<u>12,385,311</u>
Expenses (income):		
Property operating (note 7(a))	61,059	87,751
General and administrative	3,226,499	1,996,205
Share-based compensation (note 16(b))	1,782,722	809,109
Interest (note 20)	5,928,475	6,054,690
Provision for loan and mortgage investments loss (note 6)	478,066	–
Gain on conversion of interest in joint operation (note 7)	–	(487,000)
Fair value adjustment - investment properties (note 7)	(82,500)	(147,950)
Fair value adjustment - portfolio investments (note 8)	(394,170)	(66,755)
Share of income from investment in associates (note 9)	(91,949)	–
	<u>10,908,202</u>	<u>8,246,050</u>
Income from operations before income taxes	8,522,161	4,139,261
Income taxes (note 21)	2,456,251	1,052,522
Income from continuing operations	6,065,910	3,086,739
Income from discontinued operations (note 11)	–	151,644
Net income and comprehensive income	\$ 6,065,910	\$ 3,238,383
Net income and comprehensive income attributable to:		
Common shareholders	\$ 6,021,924	\$ 3,227,728
Non-controlling interest	43,986	10,655
	<u>\$ 6,065,910</u>	<u>\$ 3,238,383</u>
Earnings per share (note 18):		
Continuing operations:		
Basic	\$ 0.11	\$ 0.10
Diluted	0.10	0.08

See accompanying notes to consolidated financial statements.

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Changes in Equity
(In Canadian dollars)

Years ended December 31, 2015 and 2014

	Share capital		Equity component of convertible debentures (note 14)	Contributed surplus (notes 16(b) and 17)	Retained earnings	Total shareholders' equity	Non- controlling interest	Total equity
	Number of shares (note 16(a))	Amount						
Balance, December 31, 2013	30,845,000	\$ 10,795,790	\$ —	\$ 603,962	\$ 3,125,229	\$ 14,524,981	\$ 200,000	\$ 14,724,981
Issuance of shares pursuant to Oct 2014 Offering, net of share issue costs	9,587,300	5,190,543	—	106,235	—	5,296,778	—	5,296,778
Issuance of shares pursuant to private placement	1,000,000	630,000	—	—	—	630,000	—	630,000
Issuance of shares pursuant to share options plan	150,000	38,385	—	(8,385)	—	30,000	—	30,000
Share-based compensation	—	—	—	347,773	—	347,773	—	347,773
Issuance of convertible debentures, equity component	—	—	284,490	—	—	284,490	—	284,490
Net income and comprehensive income	—	—	—	—	3,227,728	3,227,728	10,655	3,238,383
Balance, December 31, 2014	41,582,300	16,654,718	284,490	1,049,585	6,352,957	24,341,750	210,655	24,552,405
Issuance of shares pursuant to May 2015 Offering, net of share issue costs and taxes	18,117,783	14,143,652	—	347,824	—	14,491,476	—	14,491,476
Issuance of shares pursuant to broker warrants	560,000	459,034	—	(106,235)	—	352,799	—	352,799
Share-based compensation	—	—	—	1,069,401	—	1,069,401	—	1,069,401
Net income and comprehensive income	—	—	—	—	6,021,924	6,021,924	43,986	6,065,910
Balance, December 31, 2015	60,260,083	\$ 31,257,404	\$ 284,490	\$ 2,360,575	\$ 12,374,881	\$ 46,277,350	\$ 254,641	\$ 46,531,991

See accompanying notes to consolidated financial statements.

TERRA FIRMA CAPITAL CORPORATION

Consolidated Statements of Cash Flows
(In Canadian dollars)

Years ended December 31, 2015 and 2014

	2015	2014
Cash provided by (used in):		
Operating activities:		
Income from continuing operations	\$ 6,065,910	\$ 3,086,739
Interest and fees earned	(17,162,141)	(12,127,716)
Unrealized foreign exchange gain	(2,041,443)	-
Interest expense	5,928,475	6,054,690
Non-cash items:		
Share-based compensation (note 16(b))	1,782,722	809,109
Provision for loan and mortgage investments loss	478,066	-
Gain on conversion of interest in joint operation	-	(487,000)
Fair value adjustment - investment properties	(82,500)	(147,950)
Fair value adjustment - portfolio investment	(394,170)	(66,755)
Share of income from investment in associates	(91,949)	-
Income tax provision	2,456,251	1,052,522
Change in non-cash operating items:		
Decrease (increase) in other receivables	191,682	(119,611)
Increase in prepaid expenses and deposits	(65,677)	(136,156)
Increase in accounts payable and accrued liabilities	1,572,662	524,490
Interest and fees received	16,484,168	8,913,755
Interest paid	(8,455,327)	(7,462,690)
Income taxes paid	(2,103,591)	(902,869)
Cash provided by (used in) operating activities - continuing operations	4,563,138	(1,009,442)
Cash used in operating activities - discontinued operations (note 11)	(27,500)	(87,671)
	4,535,638	(1,097,113)
Financing activities:		
Proceeds from loan and mortgage syndications	30,484,556	25,740,188
Repayments of loan and mortgage syndications	(20,251,327)	(23,628,514)
Repayments of mortgages payable	(30,804)	(29,429)
Proceeds from short-term notes payable	9,755,497	5,120,000
Repayment of short-term notes payable	(7,450,000)	(3,620,000)
Proceeds from revolving operating facility	19,500,000	-
Repayments of revolving operating facility	(9,500,000)	-
Proceeds from issuance of convertible debentures, net of issue costs	-	4,545,950
Repayment of convertible debentures	-	(3,925,000)
Proceeds from issuance of shares pursuant to the May 2015 Offering, net of issue costs (note 16(a))	14,186,476	-
Proceeds from issuance of shares pursuant to the Oct 2014 Offering, net of issue costs (note 16(a))	-	5,296,778
Proceeds from issuance of shares pursuant to private placement (note 16(a))	-	630,000
Proceeds from issuance of shares pursuant to share options plan	-	30,000
Proceeds from issuance of shares pursuant to broker warrants (note 16)	352,799	-
	37,047,197	10,159,973
Investing activities:		
Funding of loan and mortgage investments	(85,699,048)	(40,192,633)
Deposits made for loan and mortgage investment	(11,747,370)	-
Repayments of loan and mortgage investments	60,582,239	25,619,567
Capital additions to investment properties (note 7)	-	(76,625)
Increase in funds held in trust	(1,227,142)	(450,539)
Proceeds from sale of interest in portfolio investment	8,845,500	-
Funding of investment in associates	(1,372,652)	-
Funding of portfolio investment	(324,557)	(600,000)
	(30,943,030)	(15,700,230)
Increase (decrease) in cash and cash equivalents	10,639,805	(6,637,370)
Cash and cash equivalents, beginning of year	1,083,745	7,721,115
Cash and cash equivalents, end of year	\$ 11,723,550	\$ 1,083,745

See accompanying notes to consolidated financial statements.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements
(In Canadian dollars)

Years ended December 31, 2015 and 2014

1. Reporting entity:

Terra Firma Capital Corporation (the "Company") was incorporated under the Ontario Business Corporations Act 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 located at 22 St. Clair Avenue East, Suite 200, Toronto, Ontario M4T 2S5. The principal business of the Company is to provide real estate financings secured by investment properties and real estate developments throughout Canada and the United States. These financings are made to real estate developers and owners who require shorter-term loans to bridge a transitional period of one to five years where they require capital at various stages of development or redevelopment property, for such development or redevelopment, property repairs or the purchase of investment property.

2. 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, as well as Interpretations of the International Financial Reporting Interpretations Committee.

(b) Basis of presentation:

The Company holds its interests in certain joint operations and portfolio investments in its wholly owned subsidiaries which are controlled by the Company. For accounting purposes, control is established by an investor when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Company's principal subsidiaries are TFCC International Ltd. (100% owned), Terra Firma MA Ltd. (100% owned), Terra Firma Queen Developments Inc. (100% owned), Terra Firma Capital (Hill) Corporation (the "Hill") (79.05% owned), and TFCC LanQueen Ltd. (100% 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.

Non-controlling interest represents equity interest in the Hill owned by an outside party. The share of net assets of the Hill attributable to non-controlling interest is presented as a component of equity.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

2. Basis of presentation (continued):

(c) Basis of measurement:

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

(d) Functional and presentation currency:

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

(e) Critical judgments 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.

In making estimates, the Company relies on external information and observable conditions where possible, supplemented by internal analysis as required. Those estimates and judgments have been applied in a manner consistent with the prior year and there are no known trends, commitments, events or uncertainties that the Company believes will materially affect the methodology or assumptions utilized in making those estimates and judgments in these consolidated financial statements. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed separately in notes 3(c), 6, 7, 8, 9 and 16.

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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. 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, unless otherwise stated.

(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 comprise cash balances that are deposited and held in trust within a wholly owned subsidiary of the Company that administers loan and mortgage 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 are 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 cost using the effective interest rate method (the "EIM"). The loan and mortgage investments are derecognized 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 at both a specific asset and collective level. All individually significant loan and mortgage investments are assessed for specific impairment and are considered to be impaired if one or more loss events that have occurred after its initial recognition have a negative effect on the estimated future cash flows of the financial asset and the loss can be reliably measured.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

Loan and mortgage investments that have been assessed individually and found not to be impaired and all individually insignificant loan and mortgage investments are then assessed collectively, in group of loan and mortgage investments with similar risk characteristics, to determine whether a collective allowance should be recorded due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes into account (i) data from the loan and mortgage investments (such as composition of the loan and mortgage investments, borrower's ability to repay, loan defaults and arrears, the estimated value of the underlying collateral (loan to value ratios), average term to maturity, etc.), (ii) general economic and real estate market conditions (including current real estate prices for various real estate types, any near-term real estate development fundamentals), and (iii) actual historical loan losses and other relevant factors.

An impairment loss in respect of loan and mortgage investments is calculated as the difference between its carrying amount, including accrued interest and the present value of the estimated future cash flows discounted at the loan and mortgage investment's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against the loan and mortgage investments. When a subsequent event causes the amount of an impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(d) Investment in associates:

Associates are those entities over which the Company is able to exert significant influence but which are neither subsidiaries nor interests in a joint venture. The Company's investments in associates are accounted for using the equity method of accounting. Investments in associates are those entities in which the Company has significant influence, but no control or joint control, over the financial and operating policies. Investments in associates are recognized initially at cost. The cost of the investment includes transaction costs.

The consolidated financial statements include the Company's share of the income or loss and other comprehensive income from the date that significant influence commences until the date that significant influence ceases. Accounting policies of the Company's associates are consistent with the policies adopted by the Company.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

The Company assess at each reporting period whether there is any objective evidence that the interest in the associates are impaired. If impaired, the carrying value of the Company's share of the underlying assets in the associates are written down to its estimated recoverable amount.

(e) 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 joint arrangement require the unanimous consent of the parties sharing control. Joint arrangements are of 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.

(f) 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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(g) Financial instruments:

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the 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 transfers the significant risks and rewards, along with the unconditional ability to sell or pledge the asset to another party. Financial liabilities are derecognized when obligations under the contract are discharged, cancelled or expired.

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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

The following table summarizes the accounting treatment of each of financial assets and financial liabilities:

	Classification	Measurement
Loan and mortgage investments	Loans and receivables	Amortized cost
Funds held in trust	Loans and receivables	Amortized cost
Amounts receivable and prepaid expenses	Loans and receivables	Amortized cost
Deposits	Loans and receivables	Amortized cost
Cash and cash equivalents	Loans and receivables	Amortized cost
Portfolio investments	Fair value through profit or loss	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Provision for discontinued operations	Other financial liabilities	Amortized cost
Income taxes payable	Other financial liabilities	Amortized cost
Short-term unsecured notes payable	Other financial liabilities	Amortized cost
Revolving operating facility	Other financial liabilities	Amortized cost
Loan and mortgage syndications	Other financial liabilities	Amortized cost
Mortgages payable	Other financial liabilities	Amortized cost
Convertible debentures	Other financial liabilities	Amortized cost

The Company had neither available-for-sale, nor held-to-maturity instruments as at December 31, 2015 and 2014.

(h) 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 remeasured subsequent to initial recognition. Interest, losses and gains relating to the financial liability are recognized in the consolidated statements of income and comprehensive income.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(i) 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 have occurred that have a negative impact on the future cash flows of the financial asset after initial recognition of the financial asset and the loss can be reliably measured. These assumptions are limited by the availability of reliable comparable market data, economic uncertainty and the uncertainty of future events. Accordingly, by their nature, estimates of impairment are subjective and may not necessarily be comparable to the actual outcome. Should the underlying assumptions change, the estimated future cash flows could vary.

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 year, 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 concessions favorable to the borrower and observable data that there is a measurable decrease in the estimated future cash flows.

(j) Derecognition of financial instruments:

A financial asset is derecognized if substantially all risks and rewards of ownership and, in certain circumstances, control of the financial asset are transferred. A financial liability is derecognized 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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(k) Unearned income:

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

(l) 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.

(m) 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 leases.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(n) 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 the 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 in proportion to 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.

(o) Deferred share unit plan:

The Company has a cash-settled Deferred Share Unit Plan (the "DSU Plan") for employees and directors, whereby the Company's Board of Directors may award Deferred Share Units (the "DSUs") as compensation for services rendered.

The fair value of DSUs granted is measured at the grant date based on the five-day volume weighted average trading price of the Company's Shares, and compensation expense is recognized in proportion to the vesting features over the vesting period with the recognition of a corresponding liability that is included in accounts payable and accrued liabilities. The liability is remeasured at each reporting date at fair value with changes in fair value recognized on the consolidated statements of income and comprehensive income.

(p) 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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(q) Income taxes:

Income tax comprises current and deferred taxes. 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.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized

(r) Foreign currency translation:

Transaction amounts denominated in foreign currencies are translated into Canadian dollar equivalents at the rates of exchange prevailing at the time of the transactions. Carrying values of monetary assets and liabilities are translated at exchange rates prevailing at the dates of the consolidated statements of financial position. Foreign exchange gains and losses on the receipts of payments from translations are included in realized gain/loss on foreign exchange in the consolidated statements of income and comprehensive income. All unrealized foreign exchange gains and losses on monetary assets and liabilities are included in unrealized foreign exchange gain/loss on the consolidated statements of income and comprehensive income.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

(s) 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 and broker warrants.

(t) New standards not yet adopted:

Certain new standards, amendments and interpretations have been published that are mandatory for the Company's accounting periods beginning on or after January 1, 2015 that the Company has decided not to early adopt. The following are standards, amendments and interpretations that may be relevant to the Company in preparing its consolidated financial statements in future years:

- (i) IFRS 9, Financial Instruments ("IFRS 9"), was issued to replace International Accounting Standard 39. IFRS 9 has two measurement categories: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. All equity instruments are measured at fair value. A debt instrument is measured at amortized cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. Otherwise, it is measured at fair value through profit or loss. This standard is effective for years beginning on or after January 1, 2018. The extent of impact of adoption of IFRS 9 has not been determined.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

3. Significant accounting policies (continued):

- (ii) IFRS 15, Revenue from Contracts with Customers ("IFRS 15"), provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standard on leases, insurance contracts and financial instruments. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018 and is to be applied retrospectively. Early adoption is permitted. The extent of the impact of adoption of the standard has not been determined.
- (iii) IFRS 16 Leases ("IFRS 16"), will replace existing lease guidance in IFRS and related interpretations, and requires companies to bring most leases on-balance sheet. The financial reporting impact of adopting IFRS 16 is being assessed and is effective for years beginning on or after January 1, 2019. Early adoption will be permitted only if the company has adopted IFRS 15 Revenue from Contracts with Customers. The extent of the impact of adoption of the standard has not been determined.
- (iv) Amendments to IAS 1, Presentation of Financial Statements ("IAS 1") was issued as part of its major initiative to improve presentation and disclosure in financial reports (the "Disclosure Initiative"). The amendments are effective for annual periods beginning on or after January 1, 2016. Early adoption is permitted. The Company is currently assessing the impact of the amendments on its consolidated financial statements.

4. Deposits:

On December 31, 2015, the Company deposited \$11,747,370 into a joint account established by the Company and a subsidiary of a borrower, requiring joint signatures, pending release for mortgage investments purposes. These mortgage investments were to be assigned to the Company and over which the Company was to have full control. Subsequent to the Company's year end, the loan transaction was cancelled, as funding and investment conditions were not met, and the funds were therefore returned to the Company.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

5. Amounts receivable and prepaid expenses:

The following table presents details of the amounts receivable and prepaid expenses as at December 31, 2015 and 2014:

	2015	2014
Interest receivable	\$ 2,107,889	\$ 1,762,120
Other receivables	5,847	196,162
Prepaid expenses	166,241	100,564
Amounts receivable and prepaid expenses	\$ 2,279,977	\$ 2,058,846

Included in interest receivable are non-current balances of \$1,358,935 (2014 - \$562,871). The remaining interest and other receivables are current and due in the current fiscal year in accordance with contract terms.

6. Loan and mortgage investments and loan and mortgage syndications:

As at December 31, 2015 and 2014, the Company had principal balance of loan and mortgage investments of \$95,613,267 and \$78,635,796, respectively. The loan and mortgage investments carry a weighted average effective interest rate of 15.80% (2014 - 19.6%) and a weighted average term to maturity of 1.43 years (2014 - 0.86 years).

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.

(a) Residential housing developments:

These loans pertain to projects at various stages of development in Toronto, Ontario, Kitchener, Ontario, Markham, Ontario and London, Ontario. Twenty of the loans have been syndicated to private investors.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

(b) Residential income properties:

The loans represent second mortgages secured by an apartment building located in Toronto, Ontario and one apartment building located in Ottawa, Ontario.

(c) Commercial retail development:

The loan represents a first mortgage secured by a retail development located in Toronto, Ontario.

(d) Land and lot inventory:

The loans represent a first and second mortgages secured by real estate assets to be developed and are located in Markham, Ontario, Ottawa, Ontario, Tampa Bay, Florida, Orlando, Florida and Charlotte, North Carolina.

The Company syndicates certain of its loan and mortgage investments to private investors or to financial institutions, each participating in a prescribed manner per agreement and on an investment by investment basis. In these investments, the investors assume the same risks associated with the specific investment transaction as the Company. Each syndicated loan and mortgage investment has a designated rate of return that the syndicated investors expect to earn from that loan and mortgage investment.

The principal balance of loan and mortgage syndications at December 31, 2015 and 2014 were \$45,691,948 and \$45,390,821, respectively. The loan and mortgage syndications carry a weighted average effective interest rate of 10.5% (2014 - 11.9%) and a weighted average term to maturity of 1.40 years (2014 - 0.67 years).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

The following tables present details of the loan and mortgage investments and loan and mortgage syndications as at December 31, 2015 and 2014:

	Loan and mortgage investments	Loan and mortgage syndications	Net investments	% of net investments
Residential housing developments	\$ 65,417,141	\$ 37,678,182	\$ 27,738,959	55.6
Land and lot inventory	25,465,047	7,813,766	17,651,281	35.4
Commercial retail development	1,270,000	–	1,270,000	2.5
Residential income properties	3,461,079	200,000	3,261,079	6.5
	95,613,267	45,691,948	49,921,319	100.0
Allowance for loan and mortgage investments loss	(478,066)	–	(478,066)	
	\$ 95,135,201	\$ 45,691,948	\$ 49,443,253	

	Loan and mortgage investments	Loan and mortgage syndications	Net investments	% of net investments
Residential housing developments	\$ 71,355,076	\$ 40,914,961	\$ 30,440,115	91.6
Land and lot inventory	1,319,000	1,030,000	289,000	0.9
Commercial retail development	1,370,000	500,000	870,000	2.6
Residential income properties	4,591,720	2,945,860	1,645,860	4.9
	78,635,796	45,390,821	33,244,975	100.0
Allowance for loan and mortgage investments loss	–	–	–	
	\$ 78,635,796	\$ 45,390,821	\$ 33,244,975	

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

On February 20, 2015, the Company exercised its option to convert its loan and mortgage investment in a 668-unit high-rise condominium development project (the "Lan Project") located in Toronto, Ontario, through a partnership interest (the "Lan Partnership"). The carrying balance of the loan and mortgage investment at the time of conversion was \$14,821,313, of which \$11,675,000 was syndicated. Syndicate investors in the amount of \$5,125,000 elected to convert their share of interest in the loan investment into units of the Lan Partnership and syndicate investors in the amount of \$6,550,000 converted their share of interest in the loan investment in short-term unsecured notes payable. The Company received \$8,845,500 from new and existing investors to invest in units of the Lan Partnership (note 9).

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

In August 2015, a borrower of a residential housing development renegotiated the participation fee on the loan and elected to repay ahead of its due date. As a result, the Company recognized a gain of \$316,408 and included it in interest income in the consolidated statements of income and comprehensive income.

In March 2015, a borrower of a residential income property renegotiated the exit fee on the loan and elected to repay ahead of its due date. As a result, the Company recognized a gain of \$544,212 and included it in interest income in the consolidated statements of income and comprehensive income.

In August 2014, a borrower of a student housing portfolio elected to repay the loan ahead of its maturity date with a prepayment penalty of \$104,876 on the loan. As a result, the Company recognized a gain of \$342,222 and included it in interest income in the consolidated statements of income and comprehensive income.

During the years ended December 31, 2015 and 2014, the Company capitalized interest income of \$2,692,201 and \$2,800,427, respectively, which is included in the loan and mortgage investments.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

The Company's loan and mortgage investments generally take the form of:

- land loans registered in first or second position at the earlier stages of real estate development;
- term mortgages for the purposes of acquiring or refinancing income-producing properties; or
- mezzanine or subordinated debt financings or real estate developments that have either progressed to the construction phase or are in the process of approaching the construction phase.

Mortgages are loans that are secured by real estate assets and may include other forms of securities. Unregistered loans are not secured by real estate asset, but are secured by other forms of securities, such as personal guarantees, or pledge of shares of the borrowing entity.

The following tables present details of the Company's principal balances of loan categories as at December 31, 2015 and 2014:

2015	Loan and mortgage investments	Loan and mortgage syndications	Net investments	% of net investments
Mortgages	\$ 91,691,123	\$ 44,191,948	\$ 47,499,175	95.1
Unregistered loans	3,922,144	1,500,000	2,422,144	4.9
	\$ 95,613,267	\$ 45,691,948	\$ 49,921,319	100.0

2014	Loan and mortgage investments	Loan and mortgage syndications	Net investments	% of net investments
Mortgages	\$ 59,671,635	\$ 32,468,934	\$ 27,202,701	81.8
Unregistered loans	18,964,161	12,921,887	6,042,274	18.2
	\$ 78,635,796	\$ 45,390,821	\$ 33,244,975	100.0

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

The following table presents details of the Company's principal balances of loan and mortgage investments segmented by geography as at December 31, 2015:

	Loan and mortgage investments	Loan and mortgage syndications	Net investments	% of net investments
Canada	\$ 57,551,220	\$ 31,488,302	\$ 26,062,918	52.2
Unites States	38,062,047	14,203,646	23,858,401	47.8
	\$ 95,613,267	\$ 45,691,948	\$ 49,921,319	100.0

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, 2015 were \$18,455,100, including \$11,733,451 of capitalization of future interest relating to the existing loan and mortgage investments (2014 - \$4,010,043, including \$2,298,304 of capitalization of future interest relating to the existing loan and mortgage investments).

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

	Scheduled principal payments	Investments maturing during the year	Total loan and mortgage investments
2016	\$ —	\$ 38,739,876	\$ 38,739,876
2017	—	29,402,825	29,402,825
2018	—	22,470,566	22,470,566
2019	—	—	—
2020	—	5,000,000	5,000,000
	\$ —	\$ 95,613,267	\$ 95,613,267

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

Scheduled principal repayments and maturity amounts loan and mortgage syndications at December 31, 2015 are as follows:

	Scheduled principal payments	Loans maturing during the year	Total loan and mortgage syndications
2016	\$ –	\$ 23,388,302	\$ 23,388,302
2017	–	7,367,200	7,367,200
2018	–	11,136,446	11,136,446
2019	–	–	–
2020	–	3,800,000	3,800,000
	\$ –	\$ 45,691,948	\$ 45,691,948

Allowance for loan and mortgage investments loss:

As at December 31, 2015, the Company has concluded that there is no objective evidence of impairment on any individual loan and mortgage investments.

The Company also assessed collectively for impairment to identify potential future losses, by grouping the loan and mortgage investments with similar risk characteristics, to determine whether a collective allowance should be recorded due to loss events for which there is objective evidence but whose effects are not yet evident. Based on the amounts determined by the analysis, the Company used judgment to determine whether or not the actual future losses are expected to be greater or less than the amounts calculated. As at December 31, 2015, the Company has recognized a collective impairment provision of \$478,066 (2014 - nil).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

6. Loan and mortgage investments and loan and mortgage syndications (continued):

The changes in the allowance for mortgage investments loss during the years ended December 31, 2015 and 2014 was as follows:

	2015	2014
Balance, beginning of year	\$ –	\$ –
Provision for loan and mortgage investments loss	478,066	–
Balance, end of year	\$ 478,066	\$ –

7. Joint arrangements:

(a) Interests in joint operations:

Where the Company's interests in the following properties are subject to joint control, the Company records its proportionate share of the related assets, liabilities, revenue and expenses of the properties using 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 \$2,036,935, 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%.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

7. Joint arrangements (continued):

(ii) 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.

On April 1, 2014, the Company and the co-owner of the joint operation entered into an agreement, whereby the Company converted its interest in the joint operation into a loan receivable of \$2,818,000 (the Company's original investment in the joint operation), secured by the property. The carrying value of the Company's interest in joint operation at the time of conversion was \$2,331,000 (after recognizing operating losses from the joint operation during prior periods), resulting in a gain on conversion of interest in joint operation of \$487,000.

The following table presents the carrying value of assets in joint operations transferred on conversion:

Investment property	\$ 5,771,041
Other receivables	46,890
Prepaid expenses and deposits	137,469
Accounts payable and accrued liabilities	(124,400)
Loan and mortgage investment	(1,000,000)
Mortgage payable	(2,500,000)
Value of assets transferred on conversion	\$ 2,331,000

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

7. Joint arrangements (continued):

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

	2015	2014
Assets		
Cash and cash equivalents	\$ 4,028	\$ 3,416
Amounts receivable and prepaid expenses	11,644	11,643
Investment properties	2,143,794	2,062,661
	<u>2,159,466</u>	<u>2,077,720</u>
Liabilities		
Accounts payable and prepaid expenses	41,828	41,182
Mortgages payable	1,120,314	1,151,118
	<u>1,162,142</u>	<u>1,192,300</u>
Net assets	<u>\$ 997,324</u>	<u>\$ 885,420</u>

The table below details the results of operations for the years ended December 31, 2015 and 2014, attributable to the Company from its joint operations activities:

	2015	2014
Rental revenue	\$ 189,434	\$ 257,595
Property operating costs	61,059	87,751
General and administrative expenses	921	1,466
Interest expense	46,258	118,766
Fair value adjustment - investment properties	(82,500)	(147,950)
	<u>25,738</u>	<u>60,033</u>
Net income	<u>\$ 163,696</u>	<u>\$ 197,562</u>

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

7. 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, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ 2,062,661	\$ 7,671,452
Change in amount receivable from joint operating partners	(1,367)	(62,325)
Additions, capital expenditures	–	76,625
Sale of investment property	–	(5,771,041)
Fair value adjustment	82,500	147,950
Balance, end of year	\$ 2,143,794	\$ 2,062,661

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 proportionate share of investment property in the Montreal Street JV with an aggregate value of \$2,143,794 was valued by the Company's management. The capitalization rate used in the valuation of investment property was 6.25% (2014 - 6.5%).

As at December 31, 2015, a 25-basis-point decrease in the overall capitalization rate would increase the Company's proportionate share of value of investment property in the Montreal Street JV by \$89,600 (2014 - \$82,500) and a 25-basis-point increase in the overall capitalization rate would decrease the Company's proportionate share of the value of investment property in the Montreal Street JV by \$82,500 (2014 - \$76,450).

On April 1, 2014, the Company converted its interest in the investment property in the Queen Street West JV into a loan receivable. On that date, the carrying value of investment property in the Queen Street West JV approximates its fair value.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

7. Joint arrangements (continued):

(c) Mortgages payable:

Scheduled principal repayments and maturity amounts of mortgages payable at December 31, 2015 are as follows:

	Loans scheduled principal payments	Total maturing during the year	Loans and mortgages payable
2016	\$ 13,224	\$ 1,107,090	\$ 1,120,314

8. Portfolio investments:

The Company has invested through the Hill, in 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 or loss. The carrying value of the investment is \$954,630 (2014 - \$954,073). At December 31, 2015, the fair values were determined by the management, using the direct comparison method. The fair value of the investment at December 31, 2015 was \$1,174,212 (2014 - \$1,020,828).

On December 4, 2014, TFCC LanQueen Ltd. entered into a partnership agreement (the "Agreement"), whereby TFCC LanQueen Ltd. is committed to invest up to \$1,326,400 in redevelopment project located in Toronto, Ontario. The Agreement allows TFCC LanQueen Ltd. to receive a 3% fee at the time of commitment and an amount by way of a preferred return equal to 10% per annum calculated and compounded annually on the amount of its investment in the partnership. TFCC LanQueen Ltd. does not have significant influence in the partnership and is accounting for this investment as a financial asset at fair value through profit or loss. As at December 31, 2015, TFCC LanQueen Ltd. contributed \$924,000 (2014 - \$600,000) in the partnership. At December 31, 2015, the fair value of the investment was determined by the management, using the direct comparison method. The fair value of investment at December 31, 2015 was \$1,165,343 (2014 - \$600,000).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

8. Portfolio investments (continued):

The following table summarizes the changes in the portfolio investments for the years ended December 31, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ 1,620,828	\$ 954,073
Investments made	324,557	600,000
Fair value adjustment	394,170	66,755
Balance, end of year	\$ 2,339,555	\$ 1,620,828

9. Investment in associates:

On February 20, 2015, the Company, together with certain existing syndicate investors, exercised their option to convert the loan and mortgage investment into equity investment in Lan Project through equity in the Lan Partnership (note 6).

At December 31, 2015, the Company's share of investment in the Lan Partnership, after taking into account of sale of its interest in Lan Partnership, was \$2,315,414.

At December 31, 2015, the Lan Partnership has invested \$13,333,333 in the Lan Project. The Company acts as a general partner of the Lan Partnership and is entitled to receive a carried interest at 10% at the end of the Lan Partnership's life. The Company does not earn carried interest until the limited partners in the Lan Partnership have achieved cumulative investment returns on invested capital in excess of a 10% hurdle rate. The Company exerts influence in the Lan Partnership and accounts for this investment using the equity method of accounting.

The share of income from Lan Partnership for the year ended December 31, 2015, was \$91,949. At December 31, 2015, the fair value of the investment in the Lan Partnership was determined by the management, using the direct comparison method.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

9. Investment in associates (continued):

The following table summarizes the changes to the carrying value of investment in associate for the years ended December 31, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ —	\$ —
Loan and mortgage investment converted into equity interest in Lan Partnership (note 6)	14,821,313	—
Loan syndications converted to equity interest in Lan Partnership (note 6)	(5,125,000)	—
Sale of interest in Lan Partnership to investors (note 6)	(8,845,500)	—
Contribution to Lan Partnership	1,372,652	—
Share of income from Lan Partnership	91,949	—
Balance, end of year	\$ 2,315,414	\$ —

10. Accounts payable and accrued liabilities:

The following table presents details of the accounts payable and accrued liabilities as at December 31, 2015 and 2014:

	2015	2014
Interest payable	\$ 1,287,698	\$ 728,439
Interest reserve	456,985	310,483
Accounts payable and accrued liabilities	3,061,220	727,050
Share-based compensation payable (note 16(b)(ii))	1,174,657	461,336
	\$ 5,980,560	\$ 2,227,308

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

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

11. Provision for discontinued operations:

The Company's discontinued operations consist of the assets, liabilities and operations of a sold property for which 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.

Effective July 1, 2015, the unit was leased on subsidized basis to a third party tenant for the remainder of the lease term and the Company paid the \$27,500 balance of the lease payments in full. The balance of the provision as at December 31, 2015 is nil (2014 - \$27,500).

The following table summarizes the changes in the provision for discontinued operations for the years ended December 31, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ 27,500	\$ 321,490
Lease payments made	(27,500)	(87,671)
Reversal of rent obligation	–	(206,319)
Balance, end of year	\$ –	\$ 27,500

12. Short-term unsecured notes payable:

During the year, the Company issued short-term unsecured notes payable to syndicate investors totaling \$21,900,250, including those investors of the loan and mortgage investments in the amount of \$12,144,753 who elected to convert their interest into a short-term unsecured note payable. These notes bear annual interest in the range of 7% - 9%, have term of 6 months from issuance, closed for prepayment through the full term, and are convertible, in whole or in part, into loan and mortgage syndications on the terms and conditions to be agreed by the holders and the Company. At any time prior to the maturity date, the Company may elect to extend these notes by three months.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

12. Short-term unsecured notes payable (continued):

During the year, holders of short-term unsecured notes payable totaling \$6,820,000 elected to convert their notes into syndication in the loan and mortgage investment and the Company repaid \$7,450,000 of short-term unsecured notes payable.

In August 2014, the Company entered into formal short-term loan agreements with three lenders to borrow \$5,120,000, of which an agreement for \$1,000,000 is with the Chairman of the Board of the Company (the "Chairman"). The interest rate is 10% annum, payable monthly. These loans are repayable by the Company anytime, without penalty. Proceeds from these loans were used to fund certain loan and mortgage investments.

The following table summarizes the changes in the short-term unsecured notes payable for the years ended December 31, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ 1,500,000	\$ –
Proceeds from issuance of short-term unsecured notes payable	9,755,497	5,120,000
Transferred from loan and mortgage syndications	12,144,753	–
Transferred to loan and mortgage syndications	(6,820,000)	–
Repayments of short-term unsecured notes payable	(7,450,000)	(3,620,000)
Unrealized foreign exchange loss	155,750	–
Balance, end of year	\$ 9,286,000	\$ 1,500,000

For the year ended December 31, 2015, interest expense of \$233,771 was recorded (2014 - \$118,039).

Included in short-term unsecured notes payable are U.S. dollar denominated balance of Canadian \$4,152,000 (U.S. \$3,000,000) (2014 - Cdn. nil, U.S. nil).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

13. Revolving operating facility:

On April 23, 2015, the Company entered into a Revolving Operating Facility Credit Agreement with a lending institution for a \$10 million secured revolving loan facility (the "Facility") with a 24-month term. Interest on advanced funds under the Facility will be 9.5% per annum for the first 23 months and 12.0% thereafter. The Facility is subject to a redetermination of a borrowing base, calculated as a percentage of eligible loan and mortgage investments and subject to certain adjustments. As security for its obligations under the Facility, the Company has entered into certain security documents, including a general security agreement, a specific assignment of the Company's current and future participating loan interests in certain real estate investments located throughout Canada and the United States. The Facility allows the Company to fund and warehouse new investments while raising syndicate on and/or co-investment capital.

During the year ended December 31, 2015, the Company borrowed an aggregate of \$19,500,000 (2014 - nil) and repaid \$9,500,000 against the Facility.

In connection with the Facility, the Company incurred lender and other third-party costs of \$204,717. The costs associated with the Facility have been deferred and are being amortized over the term of the Facility as interest expense using the effective-interest amortization method.

For the years ended December 31, 2015 and 2014, amortization of deferred financing costs reported as interest expense and financing costs totaled \$69,861 and nil, respectively.

The following table presents details of the revolving operating facility as at December 31, 2015 and 2014:

	2015	2014
Face value	\$ 10,000,000	\$ —
Unamortized financing costs	(134,856)	—
Balance, end of year	\$ 9,865,144	\$ —

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

14. Convertible debentures:

On September 29, 2014, the Company refinanced by way of a private placement, the unsecured subordinated convertible debentures in the principal amount of \$10,150,000 with an original maturity date of September 27, 2014 (the "2011 Debentures"), with the issuance of new unsecured subordinated convertible debentures (the "2014 Debentures") in the principal amount of \$10,850,000. Holders of an aggregate \$6,225,000 principal amount of the 2011 Debentures elected to subscribe to 2014 Debentures.

The 2014 Debentures bear interest at an annual rate of 7%, payable quarterly on the last business day of each calendar quarter commencing December 31, 2014, and mature on September 27, 2017. The 2014 Debentures are convertible into Shares of the Company in whole or in part, at the option of the holder at any time up to maturity at a conversion price of \$0.72 per Share. The Company may, at any time prior to the maturity date and upon giving notice, prepay the 2014 Debentures in full or in part, by paying the holders thereof the outstanding principal amount plus all accrued and unpaid interest, provided that the market price per Share on the date on which the redemption notice is provided is at least 125% of the conversion price.

The fair value of the liability component of the 2014 Debentures was calculated by discounting the stream of future principal and interest payments at the rate of 8.0%, which represents the rate of interest prevailing at the date of issue for instruments of similar terms and risks. The debt component was assigned a value of \$10,486,460 (net of transaction costs of \$76,962) and the equity component was assigned a value of \$284,490 (net of transaction costs of \$2,088). The effective interest rate of the 2014 Debentures is 8.53%.

A portion of the 2014 Debentures were issued to related parties (note 19). Certain directors and officers held 2011 Debentures in an aggregate principal amount of \$800,000.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

14. Convertible debentures (continued):

The following table summarizes the changes in the convertible debentures for the years ended December 31, 2015 and 2014:

	2015	2014
Liability component of debentures, beginning of year	\$ 10,514,431	\$ 10,125,074
Interest expensed	873,370	772,660
Interest paid	(759,500)	(719,763)
Issuance of 2014 Debentures	–	10,850,000
Repayments 2011 Debentures	–	(10,150,000)
Transaction costs	–	(79,050)
Amount classified as equity	–	(284,490)
Liability component of debentures, end of year	\$ 10,628,301	\$ 10,514,431

15. Commitments and contingencies:

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing lending agreements at December 31, 2015 were \$18,455,100 (2014 - \$4,010,043). The unfunded capital commitments under the Agreement at December 31, 2015 was \$402,400 (2014 - \$726,400).

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 22 St. Clair Avenue East, Toronto, Ontario and its previous head office premises located at 5000 Yonge Street, Toronto, Ontario. The future minimum lease payments, which includes estimated operating costs of the office spaces as at December 31, 2015, are as follows:

2016	\$ 267,997
2017	208,217
2018	221,785
2019	221,785
2020	221,785
	\$ 1,141,569

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Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

15. Commitments and contingencies (continued):

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.

16. Shareholders' equity:

(a) Shares issued and outstanding:

The following table summarizes the changes in Shares for the years ended December 31, 2015 and 2014:

	Shares	Amount
Outstanding, December 31, 2013	30,845,000	\$ 10,795,790
Issuance of Shares pursuant to the Oct 2014 Offering	9,587,300	5,190,543
Issuance of Shares pursuant to the Private Placement	1,000,000	630,000
Issuance of shares pursuant to share option plan	150,000	30,000
Transferred from contributed surplus upon exercise of options	–	8,385
Outstanding, December 31, 2014	41,582,300	16,654,718
Issuance of Shares pursuant to the May 2015 Offering	16,911,900	13,118,652
Issuance of Shares pursuant to the Private Placement	1,205,883	1,025,000
Issuance of shares pursuant to broker warrants	560,000	352,800
Transferred from contributed surplus upon exercise of broker warrants	–	106,234
Outstanding, December 31, 2015	60,260,083	\$ 31,257,404

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Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

On October 14, 2015, 140,000 broker warrants to purchase the Company's Shares at \$0.63 per share with the expiry date of October 16, 2015 granted to underwriters were exercised. The total consideration received on the exercise of broker warrants was \$88,200 (note 16(c)).

On July 29, 2015, 420,000 broker warrants to purchase the Company's Shares at \$0.63 per share with the expiry date of October 16, 2015 granted to underwriters were exercised. The consideration received on the exercise of broker warrants of \$264,600 was recorded as share capital and the related contributed surplus of \$79,676 was transferred to share capital (note 16(c)).

On May 5, 2015, the Company completed a bought deal prospectus offering (the "May 2015 Offering") consisting of 16,911,900 Shares, including fully exercised over-allotment Shares, at a price of \$0.85 per Share, for gross proceeds of \$14,375,115. As part of the May 2015 Offering, the Company issued 1,014,714 broker warrants as additional compensation. Each broker warrant entitles the holder to purchase one common share at an exercise price of \$0.85 until May 4, 2017. Share issuance costs amounted to \$1,256,463, consisting of cash costs of \$1,213,639 and non-cash costs of \$347,824 relating to the value attributable to broker warrants issued to underwriters, offset by a deferred tax benefit of \$305,000.

Concurrent with the closing of the May 2015 Offering, the Company also completed a non-brokered private placement of 1,205,883 Shares, at the same price as the Shares issued pursuant to the May 2015 Offering, for aggregate gross proceeds of \$1,025,000. Certain officers and directors participated in the private placement and the Company issued 811,765 Shares to those officers and directors for gross proceeds of \$690,000 (note 19).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

On October 15, 2014, the Company completed a bought deal offering (the "Oct 2014 Offering") of 8,000,000 Shares at a price of \$0.63 per Share, for gross proceeds of \$5,040,000. As part of the Oct 2014 Offering, the Company issued 560,000 broker warrants to underwriters as additional compensation. Each broker warrant entitles the holder to purchase one Share of the Company at an exercise price of \$0.63 per Share, until October 15, 2015. Share issuance costs amounted to \$849,456, consisting of cash costs of \$743,221 and non-cash costs of \$106,235 relating to the value attributable to broker warrants issued to underwriters. Concurrently with the Oct 2014 Offering, the Company issued 1,587,300 Shares through private placement at a price of \$0.63 per Share to the Chairman and the Chief Executive Officer of the Company, for gross proceeds of \$999,999 (note 19).

On November 24, 2014, the Company issued 1,000,000 Shares at \$0.63 per Share to the President and Chief Operating Officer of the Company, for gross proceeds of \$630,000 (note 19).

(b) Share-based payments:

The share-based payments that have been recognized in these financial statements are as follows:

	2015	2014
Share option Plan	\$ 1,069,401	\$ 347,773
DSU Plan	713,321	461,336
	<u>\$ 1,782,722</u>	<u>\$ 809,109</u>

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

(i) Share option plan:

The Company has 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 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.

Pursuant to the employment agreement between the Company and the Chief Executive Officer of the Company, the Chief Executive Officer is eligible to receive options equal to 5% of Shares issued outstanding through to December 31, 2015, at the price determined by the Board.

On May 11, 2015, the Company granted share options to officers and employees of the Company to purchase an aggregate of 980,889 Shares at \$0.85 per share. 25% of the share options vested immediately upon grant, with an additional 25% vesting each 90-day period thereafter.

On November 28, 2014, the Company granted share options to certain officers and a consultant of the Company to purchase an aggregate of 1,050,000 Shares at \$0.79 per share and an aggregate of 599,115 Shares at \$0.68 per share. Except for the 1,000,000 options granted to an officer, which shall vest in equal instalments on a quarterly basis over the three-year period, the options vest in four instalments, with the first 25% of the share options vested immediately upon grant, with an additional 25% vesting each 90-day period thereafter.

On May 20, 2014, the Company granted share options to directors, officers and employees of the Company to purchase an aggregate of 565,000 Shares at \$0.50 per share. Except for the 210,000 options granted to employees, which vested immediately, the options vest in four instalments, with the first 25% of the share options vested immediately upon grant, with an additional 25% vesting each 90-day period thereafter.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

On February 24, 2014, the Company granted share options to consultants of the Company to purchase an aggregate of 100,000 Shares at \$0.50 per share. 25% of the share options vested immediately upon grant, 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:

	May 11, 2015	November 28, 2014	May 20, 2014	February 24, 2014
Average expected life	5.00 years	3.06 years	2.62 years	2.68 years
Average risk-free interest rate	0.80%	1.20%	1.05%	0.98%
Average expected volatility	89.45%	90.00%	96.00%	98.29%

The fair value of options granted during the years ended December 31, 2015 and 2014 were \$574,801 and \$1,029,949, respectively.

In 2014, directors and officers exercised 150,000 options that had been formally granted to purchase the Company's Shares at \$0.20 with an expiry date of September 22, 2014. The consideration of \$30,000, received on exercising the options was recorded as share capital and the related contributed surplus of \$8,385 was transferred to share capital.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

The following is the summary of changes in share options for the year ended December 31, 2015 and 2014:

	2015		2014	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	4,071,449	\$ 0.55	1,932,334	\$ 0.37
Granted	980,889	0.85	2,314,115	0.68
Exercised	–	–	(150,000)	0.20
Cancelled	–	–	(25,000)	0.50
Outstanding, end of year	5,052,338	0.61	4,071,449	0.55
Number of options exercisable	4,140,447	\$ 0.56	2,495,863	\$ 0.43

The following summarizes the Company's outstanding share options as at December 31, 2015:

Number of options outstanding	Expiry date	Number of options exercisable	Exercise price	Market price at date of grant
895,000	January 24, 2016	895,000	\$ 0.30	\$ 0.28
138,667	December 19, 2016	138,667	0.50	0.40
585,000	April 16, 2017	585,000	0.50	0.30
138,667	April 17, 2018	138,667	0.30	0.25
100,000	February 23, 2019	100,000	0.50	0.42
565,000	May 20, 2019	565,000	0.50	0.47
599,115	November 28, 2019	599,115	0.68	0.85
1,050,000	November 28, 2019	383,332	0.79	0.85
980,889	May 11, 2020	735,666	0.85	0.85
5,052,338		4,140,447		

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

(ii) Deferred Share Unit Plan:

In May 2014, the Company established and adopted the DSU Plan to promote a greater alignment of interests between directors, officers and employees and the shareholders of the Company by linking a portion of the annual director retainer and annual bonus to officers or employees to the future value of the Company's Shares.

The Board determines the amount, timing and vesting conditions associated with each award of DSUs. Directors may elect to receive, on the last day of each quarter, a minimum of 50% and up to 100% of their annual retainer in DSUs and employees may elect to receive up to 100% of their annual bonus in DSUs. DSUs granted pursuant to such an election are fully vested on the date of grant. In addition, when the directors or employees elect to receive 50% or more of their fees or annual bonus in DSUs, the Company may grant additional DSUs of up to 50% of the value of the DSUs granted to them. Fifty percent of the additional DSUs granted by the Company vest in six months from the date of grant and 50% of the additional DSUs vest in 12 months from the date of grant.

Each DSU has the same value as one Share (based on the five-day volume weighted average trading price). DSUs must be retained until the director leaves the Board of Directors or termination of employment of officers or employees, at which time, the redemption payment equal to the value of the DSUs, calculated as the volume weighted average closing price of the Shares for the last five days preceding the redemption date, net of applicable taxes are paid out.

The following is the summary of changes in DSUs for the years ended December 31, 2015 and 2014:

	2015	2014
DSUs outstanding, beginning of year	747,705	—
Granted	1,009,296	747,705
DSUs outstanding, end of year	1,757,001	747,705
Number of DSUs vested	1,525,530	670,642

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

The total cost recognized with respect to DSUs, including the change in fair value of DSUs during the years ended December 31, 2015 and 2014, were \$713,322 and \$461,336, respectively.

The carrying amount of the liability, included in accounts payable and accrued liabilities, relating to the DSUs at December 31, 2015 and 2014 is \$1,174,657 and \$461,336, respectively.

(c) Broker warrants:

As part of the May 2015 Offering, the Company granted 1,014,713 broker warrants to underwriters as partial consideration for their services associated with the Offering. Each broker warrant entitles the holder to acquire one Share of the Company at an exercise price of \$0.85 per Share, with an expiry date of May 5, 2017.

As part of the Offering completed on October 15, 2014, the Company granted 560,000 broker warrants to underwriters as partial consideration for their services associated with the Offering. Each broker warrant entitles the holder to acquire one Share of the Company at an exercise price of \$0.63 per Share, with an expiry date of October 15, 2015.

The following is the summary of changes in broker warrants for years ended December 31, 2014 and 2015:

	Number of broker warrants outstanding	Fair value	Exercise price
Outstanding, December 31, 2013	—	\$ —	\$ —
Granted	560,000	106,235	0.63
Outstanding, December 31, 2014	560,000	106,235	0.63
Granted	1,014,713	347,824	0.85
Exercised	(560,000)	(106,235)	0.63
Outstanding, December 31, 2015	1,014,713	\$ 347,824	\$ 0.85

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
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Years ended December 31, 2015 and 2014

16. Shareholders' equity (continued):

The fair value of broker warrants was estimated at the grant date using the Black-Scholes option pricing model with the following assumptions:

	May 5, 2015	October 15, 2014
Average expected life	2.00 years	1.00 year
Average risk-free interest rate	0.67%	1.13%
Average expected volatility	73.96%	73.5%
Average dividend yield	—	—

On July 29, 2015, 420,000 broker warrants to purchase the Company's Shares at \$0.63 per share with the expiry date of October 16, 2015 granted to underwriters were exercised. The total consideration received on the exercise of broker warrants was \$264,600 (note 16(a)).

On October 14, 2015, 140,000 broker warrants to purchase the Company's Shares at \$0.63 per share with the expiry date of October 16, 2015 granted to underwriters were exercised. The total consideration received on the exercise of broker warrants was \$88,200 (note 16(a)).

17. Contributed surplus:

The following table presents the details of the contributed surplus balances as at December 31, 2015 and 2014:

	2015	2014
Balance, beginning of year	\$ 1,049,585	\$ 603,962
Fair value of share-based compensation	1,069,401	347,773
Fair value of broker warrants	347,824	106,235
Transferred to share capital - exercise of options	—	(8,385)
Transferred to share capital - exercise of broker warrants	(106,235)	—
Balance, end of year	\$ 2,360,575	\$ 1,049,585

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

18. Earnings per share:

The calculation of earnings per share of the years ended December 31, 2015 and 2014 is as follows:

	2015	2014
Numerator for basic and diluted earnings per share:		
Income attributable to common shareholders	\$ 6,021,924	\$ 3,227,728
Interest savings on debentures, net of taxes	641,927	567,906
Diluted income attributable to common shareholders	\$ 6,663,851	\$ 3,795,634
Denominator basic and diluted earnings per share:		
Weighted average number of Shares outstanding	53,721,933	33,072,348
Dilutive effect of share-based payments	1,196,238	821,546
Dilutive effect of broker warrants	—	8,992
Assumed conversion of debentures	15,069,444	14,646,251
Weighted average number of diluted Shares outstanding	69,987,615	48,549,137
Earnings per share:		
Basic	\$ 0.11	\$ 0.10
Diluted	0.10	0.08

19. Transactions with related parties:

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

Related party transactions are measured at the exchange amount, which is the amount of consideration established and offered by related parties.

At December 31, 2015, the Chairman, indirectly through a wholly owned subsidiary, owned approximately 11% of the issued and outstanding shares of the Company (2014 - approximately 18%).

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

19. Transactions with related parties (continued):

(a) Key management personnel compensation:

Aggregate compensation for key management personnel was as follows:

	2015	2014
Short-term employee benefits	\$ 2,308,277	\$ 1,135,434
Share-based compensation	1,712,423	763,638
	<u>\$ 4,020,700</u>	<u>\$ 1,899,072</u>

The key management personnel of the Company include the Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer, Managing Director and the Board of Directors.

During the years ended December 31, 2015 and 2014, no key management personnel were indebted to the Company.

(b) Loan and mortgages syndications, short-term notes payable and convertible 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.

On June 18, 2015, the Company advanced loan investment of \$3,000,000 to a company controlled by the Chairman of the Company at the interest rate 12% annum and recognized interest and fees revenue of \$89,353 during the year. In September 2015, the loan was repaid in full.

In August 2014, the Company borrowed \$1,000,000 of short-term unsecured loan from the Chairman. The loan was repaid in September 2014 with interest expense of \$6,849.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

19. Transactions with related parties (continued):

In connection with the financing of the 2014 Debentures (note 14), certain directors and officers of the Company subscribed for an aggregate principal amount of \$1,330,000. The terms offered to related parties for the 2014 Debentures are identical to those offered to non-related 2014 Debenture holders.

At December 31, 2015 and 2014, the loan and mortgage investments and debentures syndicated by officers and directors were \$415,000 and \$1,844,848, respectively. No loans or investments were issued to borrowers controlled by or related to officers or directors of the Company.

(c) Shareholders' equity:

On May 5, 2015, concurrent with the closing of the May 2015 Offering, the Company issued 811,765 Shares through private placement at a price of \$0.85 per Share to certain officers and directors of the Company, for gross proceeds of \$690,000 (note 16).

On October 15, 2014, the Company issued 1,587,300 Shares through private placement at a price of \$0.63 per Share to the Chairman and the Chief Executive Officer of the Company, for gross proceeds of \$999,999 (note 16).

On November 24, 2014, the Company issued 1,000,000 Shares at \$0.63 per share to the President and Chief Operating Officer of the Company, for gross proceeds of \$630,000 (note 16).

20. Interest expense:

The following table presents the interest incurred for the years ended December, 2015 and 2014:

	2015	2014
Interest on loans and mortgages syndications	\$ 4,690,861	\$ 5,202,603
Interest on revolving operating facility	317,986	—
Interest on debentures	873,370	772,661
Montreal Street JV	46,258	47,091
Queen Street West JV	—	32,335
	<u>\$ 5,928,475</u>	<u>\$ 6,054,690</u>

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

21. 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:

	2015	2014
Current income tax provision	\$ 2,084,205	\$ 1,107,251
Deferred income tax	372,046	(54,729)
Total tax provision	\$ 2,456,251	\$ 1,052,522
Income taxes paid	\$ 2,103,591	\$ 902,869

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:

	2015	2014
Income from operations before income taxes	\$ 8,522,161	\$ 4,139,261
Combined federal and provincial statutory income taxes	26.50%	26.50%
Income tax provision based on statutory income taxes	\$ 2,258,373	\$ 1,096,904
Increase (decrease) in income tax due to:		
Non-taxable items	–	(108,133)
Non-deductible stock-based compensation	283,391	92,160
Other	(85,513)	(28,409)
Total tax provision	\$ 2,456,251	\$ 1,052,522

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

21. Income taxes (continued):

The composition of the Company's recognized deferred income tax assets and liabilities for the year ended December 31, 2015 is as follows:

	Opening balance	Recognized in income	Closing balance
Investment property	\$ (138,811)	\$ (37,419)	\$ (176,230)
Portfolio investment	(8,845)	(102,552)	(111,397)
Incorporation costs	651	(45)	606
Deferred Share units	122,254	189,030	311,284
Allowance for loan and mortgage investments loss	–	126,689	126,689
Unrealized foreign exchange loss	–	(540,982)	(540,982)
Debentures, Shares and revolving operating facility issue costs	73,132	298,233	371,365
	\$ 48,381	\$ (67,046)	\$ (18,665)

In addition, the Company recorded a deferred tax benefit of \$305,000, relating to share issue costs.

The composition of the Company's recognized deferred income tax assets and liabilities for the year ended December 31, 2014 is as follows:

	Opening balance	Recognized in income	Closing balance
Investment property	\$ (15,466)	\$ (123,345)	\$ (138,811)
Portfolio investment	–	(8,845)	(8,845)
Incorporation costs	700	(49)	651
Debenture and share issue costs	8,418	64,714	73,132
Deferred Share units	–	122,254	122,254
	\$ (6,348)	\$ 54,729	\$ 48,381

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
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Years ended December 31, 2015 and 2014

22. Capital management:

The Company defines its capital as the aggregate of shareholders' equity, non-controlling interest, convertible debentures, loan and mortgage syndications, short-term notes payable 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 of the Company as at December, 2015 and 2014:

	2015	2014
Short-term notes payable	\$ 9,286,000	\$ 1,500,000
Revolving operating facility	9,865,144	—
Loan and mortgage syndications	45,691,948	45,390,821
Mortgage payable	1,120,314	1,151,118
Convertible debentures	10,628,301	10,514,431
Non-controlling interest	254,641	210,655
Shareholders' equity	46,277,350	24,341,750
Total capital	\$ 123,123,698	\$ 83,108,775

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 remained unchanged during the years ended December 31, 2015 and 2014.

During the years ended December 31, 2015 and 2014, the Company had no externally-imposed capital requirements.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

23. 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, deposits, loan and mortgage investments, portfolio investments, accounts payable and accrued liabilities, loan and mortgage syndications, mortgages payable, short-term notes payable, revolving operating facility and convertible debentures.

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

The fair value of loan and mortgage investments, loan and mortgage syndications, mortgages payable, short-term notes payable and convertible 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, mortgages payable, short-term notes payable, revolving operating facility or debentures. The Company makes its determinations of fair value based on its assessment of the current lending market for these instruments 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, investment in associates and non-controlling interests are determined using Level 3 inputs at December 31, 2015 and 2014 and no amounts were transferred between fair value levels during 2015 or 2014. Notes 7(b), 8 and 9 outline the key assumptions used by the Company in determining fair value of its investment properties, portfolio investment and investment in associates.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

24. 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 minimize 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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

24. Risk management (continued):

The Company regularly reviews the loan and mortgage investments and interest receivable listing for balances in arrears and follows up with clients as needed regarding payment. For individual accounts in arrears where discussion with the client has not succeeded, foreclosure proceedings commence. Balances receivable include accrued interest and legal and other costs related to attempts at collection. Where loan investments are collateralized by real property, losses are recognized to the extent that recovery of the balance through sale of the underlying property is not reasonably assured.

As at December 31, 2015 and 2014, nil and \$124,131 of interest receivable are in arrears over 60 days, respectively, and nil and \$3,923,438 of the loan and mortgage investments are in arrears over 30 days, respectively.

(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.

The following table presents the amounts denominated in United States dollars as at December, 2015 and 2014:

	2015	2014
Cash and cash equivalents	U.S. \$ 5,654,478	U.S. \$ 211,115
Amounts receivable and prepaid expenses	750,357	—
Loan and mortgage investments	27,501,479	—
Accounts payable and accrued liabilities	(378,403)	—
Short-term unsecured notes payable	(3,000,000)	—
Loan and mortgage syndications	(10,262,750)	—
	U.S. \$ 20,265,161	U.S. \$ 211,115

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.

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

24. Risk management (continued):

A change in exchange rate of the Canadian dollar against the U.S. dollar by 5% will change the net income and comprehensive income and equity for the year by \$1,402,349.

(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, convertible debentures, short-term notes payable, loan and mortgage syndications 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, 2015, 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- basis-points	Higher 100- basis-points
Interest and fees	\$ (956,133)	\$ 956,133

At December 31, 2014, 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- basis-points	Higher 100- basis-points
Interest and fees	\$ (786,358)	\$ 756,358

TERRA FIRMA CAPITAL CORPORATION

Notes to Consolidated Financial Statements (continued)
(In Canadian dollars)

Years ended December 31, 2015 and 2014

24. 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 creditworthiness.

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, 2015 are due as follows:

	Less than 1 year	2 years	Total
Accounts payable and accrued liabilities	\$ 5,980,560	\$ –	\$ 5,980,560
Income taxes payable	322,046	–	322,046
Short-term unsecured notes payable	9,286,000	–	9,286,000
Revolving operating facility	–	10,000,000	10,000,000
Mortgages payable	1,120,314	–	1,120,314
Convertible debentures	–	10,850,000	10,850,000
Total liabilities and contractual obligations	\$ 16,708,920	\$ 20,850,000	\$ 37,558,920

25. Subsequent event:

Subsequent to year end, one loan investment of \$2,915,845 and interest receivable of \$237,162 are in arrears, due to liquidity issue with one of the Company's borrowers. Based on management's assessment, the Company does not believe these amounts are impaired.