



# **TERRA FIRMA CAPITAL CORPORATION**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF RESULTS OF OPERATIONS  
AND FINANCIAL CONDITION

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014**

**NOVEMBER 26, 2014**

## **MANAGEMENT’S DISCUSSION AND ANALYSIS**

The following Management’s Discussion and Analysis (“MD&A”) of the financial results of Terra Firma Capital Corporation (the “Company”) dated November 26, 2014 for the three and nine months ended September 30, 2014 should be read in conjunction with the Company’s unaudited condensed consolidated interim financial statements and accompanying notes for the same period as well as the audited consolidated financial statements for the year ended December 31, 2013. These documents are available on SEDAR at [WWW.SEDAR.COM](http://WWW.SEDAR.COM)

## **CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements contained in this MD&A constitute forward-looking information within the meaning of Canadian securities laws. Forward-looking statements are provided for the purposes of assisting the reader in understanding the Company’s financial performance, financial position and cash flows as at and for the periods ended on certain dates and to present information about management’s current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. Forward-looking information may relate to the Company’s future results, performance, achievements, events, prospects or opportunities for the Company or the real estate industry and may include statements regarding the financial position, business strategy, financial results, real estate values, interest rates, loan to cost, plans and objectives of or involving the Company. In some cases, forward-looking information can be identified by such terms such as “may”, “might”, “will”, “could”, “should”, “would”, “occur”, “expect”, “plan”, “anticipate”, “believe”, “intend”, “seek”, “aim”, “estimate”, “target”, “project”, “predict”, “forecast”, “potential”, “continue”, “likely”, “schedule”, or the negative thereof or other similar expressions concerning matters that are not historical facts.

Forward-looking statements necessarily involve known and unknown risks and uncertainties that may be general or specific and which give rise to the possibility that expectations, forecasts, predictions, projections or conclusions will not prove to be accurate, that assumptions may not be correct and that objectives, strategic goals and priorities will not be achieved. A variety of factors, many of which are beyond the Company’s control, affect the lending operations, performance and results of the Company and its business, and could cause actual results to differ materially from current expectations of estimated or anticipated events or results. These factors include, but are not limited to; the risks discussed in the Company’s materials filed with Canadian securities regulatory authorities from time to time, including the risks discussed herein at “Risks and Uncertainties”. The reader is cautioned to consider these and other factors, uncertainties and potential events carefully and not to put undue reliance on forward-looking statements as there can be no assurance that actual results will be consistent with such forward-looking statements.

Information contained in forward-looking statements is based upon certain material assumptions that were applied in drawing a conclusion or making a forecast or projection, including management’s perceptions of historical trends, current conditions and expected future developments, as well as other considerations that are believed to be appropriate in the circumstances, including the following: the Canadian economy will remain stable over the next 12 months; inflation will remain relatively low; interest rates will remain stable; conditions within the real estate industry including competition for real estate financing will be consistent with the current climate; and the referenced above, collectively, will not have a material impact on the Company. While management considers these assumptions to be reasonable based on currently available information, they may prove to be incorrect.

The forward-looking statements made in this MD&A relate only to events or information as of the date on which the statements are made in this MD&A. Except as specifically required by applicable Canadian law, the Company undertakes no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, after the date on which the statements are made or to reflect the occurrence of unanticipated events.

## **BASIS OF PRESENTATION**

The Company’s unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2014 have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The Company’s presentation currency is the Canadian dollar.

## BUSINESS OVERVIEW AND STRATEGY

The Company was incorporated under the *Business Corporations Act* (Ontario) on July 26, 2007. The common shares of the Company (“Shares”) trade on the TSX Venture Exchange (the “Exchange”) under the symbol TII. The registered office of the Company is: 5000 Yonge Street, Suite 1502, Toronto, Ontario, M2N 7E9.

The principal business of the Company is 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 of a property. These loans are typically repaid with lower cost, longer-term debt obtained from other Canadian financial institutions once the applicable transitional period is over or the redevelopment is complete, or from proceeds generated from the sale of the real estate assets.

The types of real estate assets for which the Company arranges financings include residential buildings, mixed-use properties, and land for residential and commercial development and construction projects.

These loan and mortgage financings generally take the form of:

- (i) Land loans registered in first position or second position at the earlier stages of real property development and either subsequently postponing to construction financing or being discharged upon the funding of construction financing, as the project progresses through the development cycle,
- (ii) Term mortgages for the purposes of acquiring or re-financing income producing properties, or
- (iii) Mezzanine / subordinated debt financings on real property developments that have either progressed to the construction phase or are in the process of approaching construction phase.

These financings generally represent loan to cost and loan-to-value ratios of 80%, including all prior encumbrances at the time of underwriting of each loan. In some cases the loan-to-value ratio could increase to 90%. The “loan-to-value” ratio means the ratio, expressed as a percentage, determined by  $A/B \times 100$ , where: (A) is the principal amount of the mortgage, together with all other equal and prior ranking mortgages or tranches of mortgages on the real estate; and (B) is the appraised value of the real estate securing the mortgage at the time of funding the mortgage or in a more recent appraisal, if available.

In addition, the Company participates in the development of real estate in Canada and in the United States by providing equity-type financing to developers. These financings provide a minimum return and/or a share of remaining net cash flow from projects, and may be done as a strategic partnership established with established developers to pursue the development of real properties (“Joint Arrangements” or “Joint Operations”) or an equity investment by the Company in an entity that carries on the business of real estate development (“Portfolio Investments”). The Company generally provides these financings in the form of preferred equity in the entity that holds the real estate asset. When making an equity investment, the Company prefers to invest in the form of preferred equity which ranks ahead of the developers’ or owners’ equity in the project.

The objectives of the Company are to originate, create and maintain a diversified real estate loan and mortgage investments (the “Loan Portfolio”), to preserve the Company’s capital while earning attractive risk-adjusted returns and to create shareholder value over the long-term, through capital appreciation, and payment of dividends (from time to time as the Board of Directors considers appropriate).

Management believes that there is currently a significant market opportunity to identify and fund such loans as a result of financing needs not being met by traditional institutional lenders. Through management’s relationships with mortgage lenders, brokers, local sponsors and other market participants, the Company is able to identify real estate opportunities where it can provide financing solutions to borrowers while achieving equity type returns at reduced risk levels as compared to straight equity ownership. The Company differentiates itself by serving these niches with an experienced financing team which generally can provide more flexible terms and creative structure. Management believes its experience with real estate investments and industry contacts will provide the Company with a consistent flow of quality investment opportunities.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

Investment in real estate comprises a variety of “tranches” with highly differentiated risk/return characteristics based on their position in the capital structure and subordination levels. The Company strives to achieve “equity like” returns on its Loan and Mortgage Investments while bearing lower risk than equity investments, by structuring its financings in a “debt like” structure.

### INVESTMENTS

#### LOANS AND MORTGAGE INVESTMENTS

The Company’s Loan Portfolio as at September 30, 2014 consists of (a) loans relating to 20 residential housing developments, comprising 1,933 high rise units in Toronto, Ontario, 725 low rise single family condominium and freehold units in Toronto and Kitchener, Ontario, representing 93.3% of the Loan Portfolio, (b) three residential income properties consisting of 472 rental units in Toronto and Ottawa, Ontario, representing 4.0% of the Loan Portfolio, (c) a commercial retail development consisting of 5 units in Kitchener, Ontario, representing the remaining 0.8% of the Loan Portfolio, and (d) a 14.6 acre parcel of land located in Ottawa, Ontario, representing the remaining 1.9% of the Loan Portfolio.

The Company’s Loan Portfolio as at December 31, 2013 consist of (a) loans relating to 14 residential housing developments, comprising 1,738 high rise units in Toronto, Ontario, 469 low rise single family condominium and freehold units in Toronto and Kitchener, Ontario, representing 72.6% of the Loan Portfolio, (b) a portfolio of ten student housing income properties consisting of 5,352 student beds in several states in USA, representing 23.1% of the Loan Portfolio, (c) two residential income properties consisting of 301 rental units in Toronto and Ottawa, Ontario, representing 3.2% of the Loan Portfolio, and (d) a commercial retail development consisting of 5 units in Kitchener, Ontario, representing the remaining 1.1% of the Loan Portfolio.

The following table presents details of the Loan Portfolio as at September 30, 2014 and December 31, 2013:

	September 30, 2014			December 31, 2013		
	Weighted Average Effective Interest Rate	Amount	% of Investments	Weighted Average Effective Interest Rate	Amount	% of Investments
Residential housing developments	20.1%	66,081,273	93.3%	19.9%	\$ 40,121,019	72.6%
Commercial retail development	17.0%	600,000	0.8%	17.0%	600,000	1.1%
Residential income properties	15.9%	2,842,339	4.0%	17.7%	1,794,084	3.2%
Student housing	0.0%	-	0.0%	14.6%	12,763,200	23.1%
Land	23.5%	1,319,000	1.9%	0.0%	-	0.0%
<b>Loan Portfolio</b>	<b>20.0%</b>	<b>\$ 70,842,612</b>	<b>100.0%</b>	<b>18.6%</b>	<b>\$ 55,278,303</b>	<b>100.0%</b>

As at September 30, 2014 and December 31, 2013, the principal balance of the Loan Portfolio was \$70,842,612 and \$55,278,303, respectively. The Loan Portfolio continued to grow through the funding of the new loan and mortgage investments during the nine months ended September 30, 2014, an increase of \$15,564,309 or 28% from the balance at December 31, 2013. This increase resulted from the net effect of funding 16 loan investments totaling \$33,295,192, capitalized interest of \$2,021,329, the repayment of six loans totaling \$23,895,400, advances against existing loan commitments of \$1,203,333, loan issued on conversion of joint operations of \$2,818,000, exchange gain on U.S dollar denominated loan of \$123,600 and contractual principal repayments of \$1,745.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table summarizes the change in the Loan Portfolio for the nine months ended September 30, 2014:

	Amount
Balance, December 31, 2013	\$ 55,278,303
Loan Portfolio activity during theyear	
Funding of new loan investments	33,295,192
Advances against existing loan	1,203,333
Conversion of interest in joint operation	2,818,000
Repayments of loans	(23,895,400)
Interest capitalized	2,021,329
Exchange gain	123,600
Principal repayment of loans	(1,745)
Balance, September 30, 2014	\$ 70,842,612

The weighted average effective interest rate of the Loan Portfolio at September 30, 2014 and December 31, 2013 was 20.0% and 18.6%, respectively. The weighted average effective interest rates of the loans and mortgage investments of residential housing developments at September 30, 2014 and December 31, 2013 were 20.1% and 19.9%, respectively and the weighted average effective interest rates of the residential income properties at September 30, 2014 and December 31, 2013 were 15.9% and 17.7%, respectively. The weighted average effective interest rates of the loans and mortgage investments of commercial retail development at September 30, 2014 and December 31, 2013 were 17.0%. The weighted average effective interest rates of the loans and mortgage investments of land at September 30, 2014 was 23.5%. The weighted average effective interest rates of the loans and mortgage investments of income producing student housing portfolio at December 31, 2013 was 14.6%.

The weighted average term to maturity at September 30, 2014 and December 31, 2014 was 0.97 years and 1.21 years, respectively. The relatively short term to maturity of the Loan Portfolio allows for reinvestment of the Loan Portfolio in response to changing market conditions.

Principal repayments and the Loan Portfolio maturing in the next five years are as follows:

	Scheduled principal payments	Investments maturing	Total loan and mortgage investments
Remainder of year 2014	619	3,923,438	3,924,057
2015	1,750	49,124,715	49,126,465
2016	-	14,866,162	14,866,162
2017	-	2,925,928	2,925,928
	\$ 2,369	\$ 70,840,243	\$ 70,842,612

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

The Loan Portfolio is secured by mortgages registered on title and/or other forms of security including but not limited general security agreements, postponement of specific claims and joint and several guarantees.

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing Loan Portfolio at September 30, 2014 amounted to \$5,080,885, including \$2,975,200 of capitalization of future interest relating to the existing Loan Portfolio compared to \$1,529,552 of commitments, including \$866,202 of capitalization of future interest relating to the Loan Portfolio at December 31, 2013.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The investments comprising the Loan Portfolio are classified as financial assets and categorized as loans and receivables. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less any provision for impairment. The Loan Portfolio is reviewed on a quarterly basis to determine any such impairment. As at September 30, 2014 and December 31, 2013, all contractual principal and interest payments have been made on a portfolio wide basis and management believes there was no material change in the condition of the underlying properties/projects or general economic conditions that would warrant the recognition of any impairment.

### JOINT ARRANGEMENTS

#### JOINT OPERATIONS

Where the company's interests in the properties are subject to joint control, the company has records its proportionate share of the related assets, liabilities, revenue and expenses of the properties using the proportionate consolidation method.

#### Montreal Street JV:

In July 2009, the Company entered into a co-tenancy agreement (the "Montreal Street JV") with a development partner and subsequently developed a retail property 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 Company's ownership interest in the Montreal Street JV is 52.5%. The Montreal Street JV carries a loan of \$2,106,550 at September 30, 2014, bearing interest at 4.2% per annum, is amortized over 25 years and matures September 1, 2016.

#### Queen Street West JV:

In April 2012, the Company entered into a co-owners' agreement ("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 operation entered into an agreement by which the Company converted its interest in the joint operation into a loan receivable of \$2,818,000 (the Company's original investment in joint operations), secured by the property. The carrying value of the Company's interest in joint operations at the time of conversion was \$2,331,000, after recognizing operating losses from joint operations during prior periods, resulting in a gain on conversion of joint operations of \$487,000.

The financial information in respect of the company's investment in jointly controlled operations is as follows:

	September 30, 2014	December 31, 2013
Cash and cash equivalents	\$ 3,006	\$ 5,465
Amounts receivable and prepaid expenses	11,355	101,669
Investment properties	1,915,336	7,671,452
<b>Total assets</b>	<b>1,929,697</b>	<b>7,778,586</b>
Accounts payable and accrued liabilities	40,958	24,134
Loans and mortgages payable	1,158,602	4,680,547
<b>Total liabilities</b>	<b>1,199,560</b>	<b>4,704,681</b>
<b>Net assets</b>	<b>\$ 730,137</b>	<b>\$ 3,073,905</b>

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The table below details the results of operations for the three and nine months ended September 30, 2014 and 2013, attributable to the Company from its joint operations activities.

	Three months ended		Nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Revenue				
Rental	\$ 47,520	\$ 113,262	\$ 210,276	\$ 335,916
Expenses				
Property operating costs	15,225	182,784	72,526	251,637
General and administrative expenses	61	301	1,419	1,854
Interest expense	11,847	84,931	107,000	316,011
	27,133	268,016	180,945	569,502
Net income (loss)	\$ 20,387	\$ (154,754)	\$ 29,331	\$ (233,586)

Net loss for the nine months period ended September 30, 2013 was primarily due to the interest expense in the Queens Street West JV.

### INTERESTS IN 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 nine months ended September 30, 2013 and 2014:

	Amount
Balance, December 31, 2012	\$ 7,834,576
Additions - capital expenditures	(211,646)
Balance, September 30, 2013	\$ 7,622,930
Change in amount receivable from joint venture partners	(203,924)
Additions - capital expenditures	330,733
Fair value adjustment	(78,287)
Balance, December 31, 2013	\$ 7,671,452
Change in amount receivable from joint operations partners	(61,700)
Capital expenditures	76,625
Sale of investment property	(5,771,041)
Balance, September 30, 2014	\$ 1,915,336

The Company determined the fair value of investment property in the Montreal Street JV using the direct capitalization method. Under the direct capitalization method, fair values were determined by capitalizing the estimated future net operating income at the market capitalization rates. The capitalization rate used in the valuation of the property was 7.0%. At September 30, 2014, the carrying value of this investment approximates its fair value.

As at September 30, 2014, 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 \$71,159. A 25-basis-point increase in the overall capitalization rate would decrease the Company's proportionate share of the value of investment property by \$66,251.

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

## TERRA FIRMA CAPITAL CORPORATION – MD&A

### PORTFOLIO INVESTMENTS

The Company has invested, through its subsidiary Terra Firma Capital (Hill) Corporation (the “Hill”) (78.95% owned), 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 its investment as a financial asset at fair value through profit and loss. The carrying value of the investment is \$954,073 (December 31, 2013 – \$954,073) and the investment of the other partner in the Hill of \$200,000 is included in non-controlling interest. At September 30, 2014 and December 31, 2013, the fair values were determined using direct comparison method. The carrying value of this investment approximates its fair value.

On May 21, 2014, the Company, through its subsidiary TFCC Cornell Ltd., entered into a partnership agreement (the “Agreement”) to invest in a 244 unit stacked townhouse condominium development project located in Markham, Ontario. The Agreement allows the Company to receive 3% fee at the time of funding and an amount by way of a preferred return equal to 14% per annum calculated and compounded annually on the amount of its investment in the partnership. As at September 2014, the Company contributed \$2,914,161 to the partnership and received \$87,425 in fees and accrued \$108,444 of preferred return. The fees and preferred return are recognized as interest and fees in the Condensed Consolidated Interim Statements of Income and Comprehensive Income.

### FINANCIAL PERFORMANCE

The Company’s financial performance for the three and nine months ended September 30, 2014 and 2013 is summarized below:

	Three months ended,			Nine months ended,		
	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)
Revenue						
Interest and fees earned	\$ 3,206,862	\$ 2,063,541	\$ 1,143,321	\$ 8,669,218	\$ 5,489,936	\$ 3,179,282
Rental income	47,520	113,262	\$ (65,742)	210,276	335,916	(125,640)
Total revenue	3,254,382	2,176,803	1,077,579	8,879,494	5,825,852	3,053,642
Expenses						
Property operating costs	15,225	182,784	(167,559)	72,526	251,637	(179,111)
General and administrative expenses	417,792	353,130	64,662	1,301,988	1,093,216	208,772
Share based compensation	116,044	9,512	106,532	552,645	41,857	510,788
Interest expense	1,520,434	1,061,686	458,748	4,450,889	3,156,270	1,294,619
Gain on conversion of interest in joint operation	-	-	-	(487,000)	-	(487,000)
	2,069,495	1,607,112	462,383	5,891,048	4,542,980	1,348,068
Income from operations before income taxes	1,184,887	569,691	615,196	2,988,446	1,282,872	1,705,574
Income taxes	270,243	146,792	123,451	821,454	331,071	490,383
Income from continuing operations	914,644	422,899	491,745	2,166,992	951,801	1,215,191
Income from discontinued operations	-	-	-	151,644	-	151,644
Net income and comprehensive income	914,644	422,899	491,745	2,318,636	951,801	1,366,835

Total revenue for the three months ended September 30, 2014 experienced significant increase compared to the same period last year. The Company’s Loan Portfolio increased from \$45.1 million at September 30, 2013 to \$70.8 million at September 30, 2014.

Income from operations before taxes for the three months ended September 30, 2014 was \$1,184,887, compared to income from operations before income taxes for the same period last year of \$569,691 and the three months ended June 30, 2014 of \$955,702.



## TERRA FIRMA CAPITAL CORPORATION – MD&A

### INTEREST AND FEES EARNED

Interest and fees earned for the three months ended September 30, 2014 was \$3.2 million compared to \$2.1 million for the three months ended September 30, 2013 and \$2.8 million for the three months ended June 30, 2014. The increase in interest and fees earned from the same period last year was primarily due to the growth in the Company's Loan Portfolio with higher weighted average effective interest rate.

### RENTAL INCOME AND PROPERTY OPERATING COSTS

The Company's proportionate share of the rental income from investment properties in operations jointly controlled by the Company for the three months ended September 30, 2014 was \$47,520 compared to \$113,262 for the same period last year. The Company's proportionate share of the property operating costs in investment properties in operations jointly controlled by the Company for the three months ended September 30, 2014 was \$15,225 compared to \$182,784 for the same period last year. The rental income and property operating costs for the three months ended June 30, 2014 were \$47,319 and \$15,225, respectively. Reduction in the rental income and property operating expenses were mainly due to the sale of investment property on the conversion of interest in the Queen Street West JV to the co-owner of the joint operation.

### INTEREST EXPENSE

Interest expense for the three months ended September 30, 2014 and 2013 were as follows:

	Three months ended,			Nine months ended,		
	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)
Interest on loans and mortgages payable	1,323,920	824,838	499,082	3,829,135	2,365,332	1,463,803
Interest on Debentures	184,667	187,156	(2,489)	553,620	554,942	(1,322)
Montreal Street JV	11,847	12,191	(344)	35,799	36,768	(969)
Queen Street West JV	-	37,501	(37,501)	32,335	199,228	(166,893)
	1,520,434	1,061,686	458,748	4,450,889	3,156,270	1,294,619

Interest expense for the three months ended September 30, 2014 was \$1,520,434 compared to \$1,061,686 for the same period last year. Interest expense for the three months ended June 30, 2014 was \$1,451,536. The increase in interest expense for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 and June 30, 2014, is attributable primarily to additional loans and mortgages payable (the "Loan Syndications") syndicated to fund the Loan Portfolio and mortgages on investment properties held in joint operations.

### GENERAL AND ADMINISTRATIVE EXPENSES

During the three months ended September 30, 2014 and 2013, the Company incurred the following general and administrative expenses:

	Three months ended,			Nine months ended,		
	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)
Salary and benefits	\$ 295,643	\$ 278,566	\$ 17,077	\$ 832,892	\$ 813,730	\$ 19,162
Professional fees	57,199	27,158	30,041	162,190	117,415	44,775
Advertising and promotion	2,482	1,568	914	9,562	7,119	2,443
Directors' fees	25,000	-	25,000	75,000	-	75,000
Rent	22,943	17,504	5,439	68,829	52,867	15,962
Other	14,525	28,334	(13,809)	153,514	102,085	51,429
	\$ 417,792	\$ 353,130	\$ 64,662	\$ 1,301,987	\$ 1,093,216	\$ 208,771

## TERRA FIRMA CAPITAL CORPORATION – MD&A

General and administrative expenses consist mainly salaries and benefits, professional fees, directors' fees, office rent and other operating costs associated with the operation of the Company. General and administrative expenses for the three months ended September 30, 2014 were \$417,792, compared to \$353,130 for the three months ended September 30, 2013 and \$529,678 for the three months ended June 30, 2014. General and administrative expenses for the nine months ended September 30, 2014 were \$1,301,987 compared \$1,093,216 for the same period. Increase in general and administrative expenses are mainly due to increased staff level and directors' fees.

### SHARE BASED PAYMENTS

The share based payments that have been recognized in these financial statements were as follows

	Three months ended,			Nine months ended,		
	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)	Sept 30, 2014	Sept 30, 2013	Change Increase/ (decrease)
Share option Plan	\$ 30,266	\$ 9,512	\$ 20,754	\$ 155,166	\$ 41,857	\$ 113,309
DSU Plan	85,778	-	85,778	397,480	-	397,480
	\$ 116,044	\$ 9,512	\$ 106,532	\$ 552,646	\$ 41,857	\$ 510,789

Share-based payments associated with the Company's Share Option Plan (the "Option Plan") for the three months ended September 30, 2014 amounted to \$30,266, compared to \$9,512 for the three months ended September 30, 2013. On February 24, 2014, the Company granted 100,000 options to consultants of the Company at a strike price of \$0.50 per Share and on May 20, 2014, the Company granted 565,000 share options to directors, officers and employees of the Company at a strike price of \$0.50 per Share.

In May 2014, the Company established a Deferred Share Unit Plan (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. Share-based payments associated with the DSU Plan for the three months ended September 30, 2014 amounted to \$85,778, compared to \$nil for the three months ended September 30, 2013. (See "Shareholders Equity - Share Based Compensation").

### LIQUIDITY AND CAPITAL RESOURCES

#### LIQUIDITY

The return on the Loan Portfolio is an important component of the Company's financial results. The Company's investment strategy focuses on the total return of assets needed to support the underlying liabilities, asset-liability management and achieving an appropriate return on capital. The Company's continued focus is to manage risks and returns and to position its Loan Portfolio to take advantage of market opportunities while attempting to mitigate adverse effects. Material changes in market conditions may adversely affect the Company's net cash flow from operating activities and liquidity. A more detailed discussion of these risks is found under the "Risks and Uncertainties" section.

The Company expects to be able to meet all of its obligations as they become due and to provide for the future growth of the business. The Company has a number of financing sources to fulfill its commitments including (i) cash flow from its operating activities, (ii) Loan Syndications, (iii) issuance of Shares and debentures, or any combination thereof.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

### CASH FLOWS

The following table details the changes in cash for the three and nine months ended September 30, 2014 and 2013:

	Three months ended,		Nine months ended,	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Cash provided by (used in) operating activities	\$ 2,077,924	\$ (258,660)	\$ 1,706,704	\$ 15,989
Cash provided by financing activities	3,135,553	9,418,583	4,962,389	20,689,680
Cash used in investing activities	(10,083,631)	(11,538,531)	(13,975,139)	(21,613,027)
Decrease in cash and cash equivalents	\$ (4,870,154)	\$ (2,378,608)	\$ (7,306,046)	\$ (907,358)
Cash and cash equivalents, beginning of period	5,285,223	4,694,541	7,721,115	3,223,291
Cash and cash equivalents, end of period	\$ 415,069	\$ 2,315,933	\$ 415,069	\$ 2,315,933

Cash on hand at September 30, 2014 was \$415,069 compared to \$5,285,223 at June 30, 2014.

Cash provided by operating activities for the during the three and nine months ended September 30, 2014 of \$2,077,924 and \$1,706,704, respectively and the cash (used in) or provided by operating activities for the during for the three and nine months ended September 30, 2013 of (\$258,660) and \$15,989, respectively are related primarily to the net cash provided by in lending operations.

The cash provided by financing activities for the three months ended September 30, 2014 of \$3,135,553 relates primarily to the net proceeds from the Loan Syndications of \$13,658,668, proceeds from short-term loan payable of \$5,120,000 and proceeds from issuance of convertible debentures of \$4,545,950, which aggregate amount was offset by repayments of the Loan Syndications of \$15,264,065, repayment of convertible debentures of \$3,925,000 and repayment of short-term loan of \$1,000,000. The cash provided by financing activities during the three months ended September 30, 2013 of \$9,418,583 relates to the net proceeds from the Loan Syndications of \$575,000, advance deposits received from investors of \$9,790,593, proceeds from issuance of Shares under the Option Plan of \$20,000 which was offset by repayments of loans \$967,010 in the Loan Syndications.

The cash provided by financing activities during the nine months ended September 30, 2014 of \$4,962,389 relates to the net proceeds from the Loan Syndications of \$20,540,189, proceeds from issuance of Convertible Debentures of \$4,545,950, proceeds from short-term loan payable of \$5,120,000 and proceeds from issuance of Shares under the Option Plan of \$30,000, which aggregate amount was offset by repayments of the Loan Syndications of \$20,348,750, repayment of Convertible Debentures of \$3,925,000 and repayment of short-term loan payable of \$1,000,000. The cash provided by financing activities during the nine months ended September 30, 2013 of \$20,689,680 relates to the net proceeds from the Loan Syndications of \$16,425,000, proceeds from issuance of Shares under the Option Plan of \$20,000, advance deposits received from investors of \$9,790,593, offset by repayments of loans \$5,545,913 in the Loan Syndications.

The cash used in investing activities during the three months ended September 30, 2014 of \$10,083,631 primarily reflects the funding of Loan Portfolio of \$21,683,591, funding of portfolio investment of \$720,000 and decrease in funds held in trust of \$567,440, which aggregate amount was offset by repayments received from Loan Portfolio of \$12,887,400. The cash used in investing activities for the three months ended September 30, 2013 of \$11,538,531 primarily reflects the funding of Loan Portfolio of \$10,440,501 and increase in advance deposits from investors of \$10,096,293, which aggregate amounts were offset by repayments received from Loan Portfolio of \$8,772,706 and adjustments to capital additions to investment properties of \$225,557.

The cash used in investing activities during the nine months ended September 30, 2014 of \$13,975,139 primarily reflects the funding of Loan Portfolio of \$34,498,525, funding of portfolio investment of \$2,914,161, capital additions to investment properties of \$76,625 and increase in funds held in trust of \$382,973, which aggregate amount was offset by repayments received from Loan Portfolio of \$23,897,145. The cash used in investing activities for the nine months ended September 30, 2013 of \$21,613,027, primarily reflects the funding of Loan Portfolio of \$26,337,667 and increase

in advance deposits from investors of \$10,396,708, which aggregate amounts were offset by adjustment to capital additions to investment properties of \$211,646 and repayments received from Loan Portfolio of \$14,909,702.

## **CAPITAL STRUCTURE AND DEBT PROFILE**

### **CAPITAL STRUCTURE**

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

As at September 30, 2014 and December 31, 2013, respectively, the total capital of the Company was as follows:

	September 30, 2014	December 31, 2013
Short-term loans payable	\$ 4,120,000	\$ -
Loans and mortgages payable	43,384,960	46,569,921
Convertible debentures	10,486,731	10,125,074
Shareholders' Equity	17,313,273	14,524,981
<b>Total capital</b>	<b>\$ 75,304,964</b>	<b>\$ 71,219,976</b>

### **LOANS AND MORTGAGES PAYABLE**

The Company leverages its Loan Portfolio through the Loan Syndications and the Debentures. These financial liabilities are designed to increase the Company's overall returns through the issuance of specific debt instruments bearing lower effective interest rates than those being realized on the Loan Portfolio itself, while lowering the Company's overall risk profile.

Loans and mortgages payable is sourced through the following initiatives:

- (i) The syndication of certain loan and mortgage investments to private investors each participating in a prescribed manner on an investment by investment basis. In these cases, the investors assume the same risks associated with the specific investment transaction as the Company.
- (ii) Conventional construction or permanent financing secured by the project or investment property. In these cases, the Company is generally in second position to the conventional construction lenders.

The Loan Portfolio that may initially be funded by the Company may then be syndicated to other lenders sourced by the Company on a pari passu basis. The terms of the syndication would mirror the terms of the loan with the exception of the interest rate paid to syndicated investors. In addition the Company would retain any commitment fee and certain other fees earned from the borrower. Management of the mortgage origination, funding, payouts and delinquency (if applicable) are all handled by the Company on behalf of the syndicate investors. The Company will be registered on the title documentation of the property and the syndicated investors will be secured through a loan servicing agreement with 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. This specific rate will vary from mortgage to mortgage depending on the Loan-to-Value, mortgage position, location, term, and exit strategy.

The loans and mortgages payable have no recourse to the Company and there is no obligation of the Company to fund any principal or interest shortfalls.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table presents details of the Loans Portfolio as at September 30, 2014 and December 31, 2013:

	September 30, 2014			December 31, 2013		
	Weighted Average Effective Interest Rate	Amount	% of Loans Payable	Weighted Average Effective Interest Rate	Amount	% of Loans Payable
Residential housing developments	12.0%	\$ 39,250,188	90.4%	12.9%	\$ 28,279,132	60.7%
Residential income properties	10.9%	1,446,170	3.3%	10.9%	1,347,042	2.9%
Commercial retail development	10.5%	500,000	1.2%	10.5%	500,000	1.1%
Student housing	0.0%	-	0.0%	12.1%	12,763,200	27.4%
Land	12.7%	1,030,000	2.4%	0.0%	-	0.0%
Montreal Street JV	4.2%	1,158,602	2.7%	4.2%	1,180,547	2.5%
Queen Street West JV	0.0%	-	0.0%	4.8%	2,500,000	5.4%
	11.8%	\$ 43,384,960	100.0%	12.0%	\$ 46,569,921	100.0%

At September 30, 2014 the weighted average effective interest rate of loans and mortgages payable was 11.8%, consisting of the syndication of loans pertaining to 17 residential housing developments having weighted average effective interest rate of 12.0%, two residential income properties, having weighted average effective interest rate of 10.9%, one commercial retail development, having weighted average effective interest rate of 10.5% and one parcel of land having weighted average interest rate of 12.7% and mortgage on the Montreal Street JV of 4.2%.

At December 31, 2013 the weighted average effective interest rate of Loans Portfolio was 12.0%, consisting of the syndication of loans pertaining to thirteen residential housing developments having weighted average effective interest rate of 12.9%, two residential income properties, having weighted average effective interest rate of 10.9%, one commercial retail development, having weighted average effective interest rate of 10.5% and one equity loan secured by a limited partnership interest in an entity that has ownership interest in a portfolio of 11 student housing buildings with 5,352 student beds in USA, having weighted average effective interest rate of 12.1% and mortgages on Montreal Street JV and Queen Street JV of 4.2% and 4.8%, respectively.

At September 30, 2014 the Company's syndication activities resulted in \$43,384,960 or 61.2% of the Loan Portfolio being syndicated by investors, yielding a net effective return of 32.9%, thereby increasing its overall return by 12.9% from its non-leveraged 18.8% return compared to \$46,569,921 or 84.2% of the Loan Portfolio being syndicated by investors, yielding a net effective return of 53.9%, thereby increasing its overall return by 35.3% from its non-leveraged 18.6% return, at December 31, 2013. Overall return may fluctuate significantly due to changes in the relative dollar amounts and the relative change in the weighted average effective interest rates within the Loan Portfolio and Loan Syndications.

The following table summarizes the changes in the principal balance of loans and mortgages payable for the nine months ended September 30, 2014 and the year ended December 31, 2013:

	September 30, 2014	December 31, 2013
Balance of loans and mortgages payable, beginning of period	\$ 46,569,921	\$ 21,406,070
Loans and Mortgages Payable activity during the period		
Proceeds to participate in new Loan Portfolio	20,165,189	34,368,200
Additional advances to existing Loan Portfolio	375,000	1,125,000
Repayments of loans and mortgages payable	(21,325,932)	(10,249,517)
Repayments of Queen Street JV	(2,500,000)	-
Principal repayment of loans and mortgages payable	(22,818)	(79,832)
Exchange loss	123,600	-
Balance of loans and mortgages payable, end of period	\$ 43,384,960	\$ 46,569,921

## TERRA FIRMA CAPITAL CORPORATION – MD&A

At September 30, 2014, scheduled principal repayments, and maturity amounts on the loans to be paid over each of the next five fiscal years, are as follows:

	Scheduled principal payments	Loans maturing	Total loans and mortgages payable
Remainder of year 2014	7,794	2,424,999	2,432,793
2015	31,679	33,786,872	33,818,551
2016	13,224	7,120,392	7,133,616
	\$ 52,697	\$ 43,332,263	\$ 43,384,960

### SHORT-TERM LOANS PAYABLE

In August 2014, the Company entered into a formal short-term loan agreement with three lenders to borrow \$5,120,000, of which \$1,000,000 is with the Chairman of the Board of the Company. The interest rate is 10% annum, payable monthly. These loans are repayable by the Company anytime, without penalty. For the three and nine months ended September 30, 2014, an interest expense of \$81,096 was recorded (for the three and nine months ended September 30, 2013 - \$nil). Proceeds from these loans were used to fund certain loan and mortgage investments.

In September 2014, the Company repaid \$1,000,000 of the loan received from the Chairman of the Board of the Company with the interest of \$6,849 (see "Related Party Transactions and Arrangements").

### 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.

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 2011 Debentures bore interest at an annual rate of, 7.0%, paid on the last business day of each calendar quarter and were 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 \$0.70 per Share. The 2011 Debentures were not redeemable or convertible at the option of the Company prior to maturity.

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%.

The fair value of the liability component of the 2011 Debentures was determined to be the fair value of the Debenture as a whole. Issue costs directly attributable to the issuance of the 2011 Debentures were deducted from the liability component of the 2011 Debenture resulting in an effective interest rate of 7.35%.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

A portion of the 2014 Debentures were issued to related parties (“see “Related Party Transactions and Arrangements”). Certain directors and officers held 2011 Debentures in an aggregate principal amount of \$800,000.

The following table summarizes the changes in the Debentures for the nine months ended September 30, 2013 and 2014:

	2011 Debentures	2014 Debentures	Total
Liability component of debentures, December 31, 2012	\$ 10,093,325	\$ -	\$ 10,093,325
Interest expensed at EIR of 7.35%	554,943	-	554,943
Interest paid	(531,415)	-	(531,415)
Liability component of debentures, September 30, 2013	\$ 10,116,853	\$ -	\$ 10,116,853
Interest expensed at EIR of 7.35%	187,306	-	187,306
Interest paid	(179,085)	-	(179,085)
Liability component of debentures, December 31, 2013	\$ 10,125,074	\$ -	\$ 10,125,074
Interest expensed at EIR of 7.35% for 2011 Debentures and 7.79% for 2014 Debentures	549,226	4,394	553,620
Interest paid	(524,300)	(4,123)	528,423
Issuance of debentures	-	10,850,000	10,850,000
Repayment of debentures	(10,150,000)	-	10,150,000
Transaction costs	-	(79,050)	79,050
Amount classified as equity	-	(284,490)	284,490
Liability component of Debentures, September 30, 2014	\$ -	\$ 10,486,731	\$ 10,486,731

### COMMITMENTS AND CONTINGENCIES

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing loan and mortgage investments at September 30, 2014 was \$5,080,885 including \$2,975,200 of capitalization of future interest relating to the existing Loan Portfolio. The unfunded loan commitments under the existing Loan Portfolio at December 31, 2013 were \$1,529,552 including \$866,202 of capitalization of future interest relating to Loan Portfolio.

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

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

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

**SHAREHOLDERS' EQUITY**

**SHARES**

The following table summarizes the changes in Shares for the nine months ended September 30, 2013 and 2014.

	Shares	Amount
Outstanding, December 31, 2012	30,695,000	\$ 10,757,405
Issuance of shares under share Option Plan	100,000	20,000
Transferred from contributed surplus upon exercise of options	-	5,590
Outstanding, September 30, 2013	30,795,000	10,782,995
Issuance of shares under share Option Plan	50,000	10,000
Transferred from contributed surplus upon exercise of options	-	2,795
Outstanding, December 31, 2013	30,845,000	10,795,790
Issuance of shares under share Option Plan	150,000	30,000
Transferred from contributed surplus upon exercise of options	-	8,385
Outstanding, September 30, 2014	30,995,000	\$ 10,834,175

On October 15, 2014, the Company completed a public 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 public offering, the Company issued 560,000 broker warrants to underwriters. Each broker warrant entitles the holder to purchase one Share of the Company at an exercise price of \$0.63, until October 15, 2015. Concurrently with the public offering, the Company issued 1,587,300 Shares through private placement at a price of \$0.63 per Share to certain insiders of the Company, for gross proceeds of \$999,999 (see Subsequent Events).

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 (see Subsequent Events).

As at November 26, 2014, there were 41,582,300 Shares issued and outstanding.

**SHARE BASED COMPENSATION**

(a) Share Option Plan

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

On 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.

On February 24, 2014, the Company granted share options to consultants of the Company to purchase 100,000 common 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.

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



## TERRA FIRMA CAPITAL CORPORATION – MD&A

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:

	Options grant dates		
	May 20, 2014	February 24, 2014	April 17, 2013
Average expected life	5.00 years	5.00 years	5.00 years
Average risk-free interest rate	1.05%	0.98%	1.21%
Average expected volatility	94.61%	98.29%	104.00%
Average dividend yield	0.00%	0.00%	0.00%

The fair value of options granted during the nine months ended September 30, 2014 and 2013 were \$155,166 and \$41,857, respectively.

The following is the summary of changes in the Company's share options for the nine months ended September 30, 2014 and year ended December 31, 2013:

	September 30, 2014		December 31, 2013	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding - beginning of period	1,932,334	\$ 0.37	2,442,667	\$ 0.37
Granted	665,000	0.50	245,334	0.30
Exercised	(150,000)	0.20	(150,000)	0.20
Cancelled	-	-	(605,667)	0.42
Outstanding - end of period	2,447,334	\$ 0.42	1,932,334	\$ 0.37
Number of options exercisable	2,333,584	\$ 0.41	1,897,667	\$ 0.38

The following summarizes the Company's share options as of September 30, 2014:

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
610,000	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	476,250	0.50	0.47
2,447,334		2,333,584		

For the three months ended September 30, 2014 and 2013, the Company recorded share-based compensation expense relating to the Option Plan, with an offsetting increase to contributed surplus of \$30,266 and \$9,512, respectively. For the nine months ended September 30, 2014 and 2013, the Company recorded share-based compensation expense relating to the Option Plan, with an offsetting increase to contributed surplus of \$155,166 and \$41,857, respectively.

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

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table presents the details of the contributed surplus balances as at December 31, 2013 and September 30, 2014:

	Amount
Balance, December 31, 2012	\$ 573,139
Fair value of share-based compensation	41,857
Transferred to share capital - exercise of options	(5,590)
Balance, September 30, 2013	609,406
Fair value of share-based compensation	(2,649)
Transferred to share capital - exercise of options	(2,795)
Balance, December 31, 2013	\$ 603,962
Fair value of share-based compensation	155,166
Transferred to share capital - exercise of options	(8,385)
Balance, September 30, 2014	\$ 750,743

### (b) Deferred Share Unit Plan

In May 2014, the Company established and adopted a 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 will grant additional DSUs of up to 50% of the value of the DSUs granted to employees and directors. 50% of the additional DSUs granted by the Company vest in 6 months from the date of grant and 50% of the additional DSUs vest in twelve months from the date of grant.

Each Deferred Share Unit (the "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 table presents the changes in DSUs for the nine months ended September 30, 2014:

	Number of RSUs
DSUs outstanding, December 31, 2013	-
Granted	679,563
Settled	-
DSUs outstanding, September 30, 2014	679,563
Number of DSUs vested	611,508

The total cost recognized with respect to DSUs, including the change in fair value of DSUs during the three and nine months ended September 30, 2014, were \$85,778 and \$397,480, respectively. The total cost recognized with respect to DSUs, including the change in fair value of DSUs during the three and nine months ended September 30, 2013, were \$nil.

The carrying amount of the liability, included in the accounts payable and accrued liabilities relating to the DSUs at September 30, 2014 is \$397,480 (December 31, 2013 - \$nil).

## RELATED PARTY TRANSACTIONS AND ARRANGEMENTS

At September 30, 2014 and December 31, 2013, the Chairman of the Board of the Company, indirectly through a wholly owned subsidiary, owned approximately 20% of the issued and outstanding Shares of the Company.

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

In connection with the financing of the 2014 Debentures, 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..

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

At September 30, 2014, the loan and mortgage investments and Debentures syndicated by officers and directors were \$2,074,348 (December 31, 2013 - \$2,840,280). No loans or investments were issued to borrowers controlled by or related to officers or directors of the Company.

## SIGNIFICANT ACCOUNTING POLICIES AND CHANGES IN ACCOUNTING POLICIES

A summary of the significant accounting policies are described in Note 2 to the audited consolidated financial statements for the year ended December 31, 2013.

Except for the following, there were no changes in significant accounting policies adopted by the Company in the three months ended September 30, 2014.

### DEFERRED SHARE UNIT PLAN

In May 2014, the Company established and adopted a cash-settled DSU Plan for employees and directors whereby the Company's Board of Directors may award 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 on a proportionate basis consistent with the vesting features over the vesting period with the recognition of a corresponding liability is recorded as accounts payable and accrued liabilities. The liability is re-measured at each reporting date at fair value with changes in fair value recognized in net income.

### ADOPTION OF RECENT ACCOUNTING PRONOUNCEMENTS:

The following standards and amendments to existing standards have been adopted for the period beginning January 1, 2014.

IFRIC 21 - *Levies*, addresses accounting for a liability to pay a levy within the scope of IAS 37, Provisions, Contingent liabilities and Contingent Assets. A levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation, other than income taxes within the scope of IAS 12, Income Taxes, and fines or other penalties imposed for breaches of the legislation. The interpretations are effective for annual periods beginning on or after January 1, 2014. The adoption of this interpretation did not result in any changes to the unaudited condensed consolidated interim financial statements.

*IAS 32, Financial Instruments: Presentation* ("IAS 32") updates the application guidance in IAS 32, to clarify that the right to offset financial assets and financial liabilities must be available on the current date and cannot be contingent on a future event. The amendments to IAS 32 are effective for fiscal periods beginning on or after January 1, 2014. The adoption of these amendments did not result in any changes to the unaudited condensed consolidated interim financial statements.

### **NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED:**

There were no new standards issued during the three months period ended September 30, 2014 that are applicable to the Company in future periods. A Description of standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the consolidated financial statements for the year ended December 31, 2013.

### **USE OF ESTIMATES**

The preparation of the Company's consolidated financial statements in conformity with IFRS 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 date of the consolidated financial statements and the reported amounts of income and expenses during the year. Actual results may differ from these estimates.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant are disclosed separately. Changes to estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. 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 period in which the estimates are revised and in any future periods affected.

### **FINANCIAL INSTRUMENTS**

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

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

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

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

- Level 1 - quoted prices in active markets
- Level 2 - inputs other than quoted prices in active markets or valuation techniques where significant inputs are based on observable market data; and
- Level 3 - valuation technique for which significant inputs are not based on observable market data.

The fair value of the Company's investment properties, portfolio investments and non-controlling interest are determined by using Level 3 inputs at September 30, 2014 and December 31, 2013 and no amounts were transferred between fair value levels during the nine months ended September 30, 2014 and year ended December 31, 2013. The key assumptions used by the Company in determining fair values of its investment properties and portfolio investments were discussed separately.

### **OFF BALANCE SHEET ITEMS**

As of September 30, 2014 and December 31, 2013, the Company did not have any off-balance sheet (statement of financial position) arrangements.

### **RISKS AND UNCERTAINTIES**

There are certain risks inherent in an investment in the securities of the Company and in the activities of the Company, including the following, which current and prospective holders of securities of the Company should carefully consider. If any of the following or other risks occurs, the Company's business, prospects, financial condition, financial performance and cash flows could be materially adversely impacted. In that case, the trading price of the securities of the Company could decline and investors could lose all or part of their investment in such securities. There is no assurance that risk management steps taken will avoid future loss due to the occurrence of the risks described below or other unforeseen risks.

#### **GENERAL BUSINESS RISKS**

The Company is subject to general business risks and to risks inherent in the commercial and residential real estate lending, including both the making of loans secured by real estate and the development and ownership of real property. Income and gains from the Company's investments may be adversely affected by:

- i. changes in national or local economic conditions,
- ii. changes in demand for newly constructed residential units,
- iii. the inability of property owners to secure and retain tenants,
- iv. the financial inability of tenants to meet their lease obligations,
- v. changes in interest rates and in the availability, cost and terms of any mortgage or other financing,
- vi. the impact of present or future environmental legislation and compliance with environmental laws,
- vii. changes in real estate assessed values and taxes payable on such values and other operating expenses, or
- viii. civil unrest, acts of God, including earthquakes and other natural disasters and acts of terrorism or war (which may result in uninsured losses).

Any of the foregoing events could impact the ability of borrowers to timely repay (if at all) loans made by the Company, negatively impact the value or viability of a development project in which the Company has invested or negatively impact the value of portfolio properties of the Company or their ability to generate positive cash flow.

In addition, the Company may be unable to identify and complete investments that fit within its investment criteria. The failure to make a sufficient number of these investments would impair the future growth of the Company.

#### **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.

Cash and cash equivalents are held with financial institutions that management believes are of high credit quality.

### **INTEREST RATE RISK**

Interest rate risk arises due to exposure to the effects of future changes in the prevailing level of interest rates. The Company is exposed to interest rate risk arising from fluctuations in interest rates primarily on its loan and mortgage investments, debentures payable and loans and mortgages payable.

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

### **LIQUIDITY RISK**

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

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

### **OPERATING HISTORY**

The Company has a limited history of earnings or operations, it has not paid any dividends and it is unlikely to pay any dividends in the immediate or foreseeable future. The success of the Company depends largely on the expertise, ability, judgment, discretion, and good faith of its management and board of directors.

### **SUBORDINATED AND UNREGISTERED LOAN FINANCING**

Some of the Company's Loan and Mortgage Investments do not have a first-ranking charge on the underlying property. When a charge on real estate is in a position other than first-ranking, it is possible for a holder of a senior-ranking charge on the real estate, if the borrower is in default under the terms of its obligations to such holder, to take a number of actions against the borrower and ultimately against the real estate to realize on the security given for such loan. Such actions may include a foreclosure action, the exercise of a giving-in-payment clause or an action forcing the real estate to be sold. A foreclosure action or the exercise of a giving-in-payment clause may have the ultimate effect of depriving any person having other than a first-ranking charge on the real estate or the security of the real estate. If an action is taken to sell the real estate and sufficient proceeds are not realized from such sale to pay off creditors who have prior charges on the property, the holder of a subsequent charge may lose its investment or part thereof to the extent of such deficiency unless they can otherwise recover such deficiency from other property, if any, owned by the debtor.

The Company may make an investment in a mortgage where its Loan-to-Value exceeds 85% and invest up to 20% of the principal balance of the Loan Portfolio on the same real estate, and such concentration of investment would increase the risk of loss to the Company. Fluctuations in real estate values may increase the risk of borrower default and may also reduce the net realizable value of the collateral property to the Company.

### DEVELOPMENT STRATEGY

Any development projects in which the Company invests are subject to a number of risks, including, but not limited to:

- (i) construction delays or cost overruns that may increase project costs,
- (ii) financing risks,
- (iii) the failure to meet anticipated occupancy or rent levels,
- (iv) failure to meet anticipated sale levels or prices,
- (v) failure to receive required zoning, land use and other governmental permits and authorizations and/or
- (vi) changes in applicable zoning and land use laws.

### INVESTMENTS IN JOINT OPERATIONS

In any joint operations in which the Company invests, the Company may not be in a position to exercise sole decision-making authority. Investments in joint operations may, under certain circumstances, involve risks not present when a third party is not involved, including the possibility that joint operations partners might become bankrupt or fail to fund their share of required capital contributions. Joint operations partners may have business interests or goals that are inconsistent with the Company's business interests or goals and may be in a position to take actions contrary to the Company's policies or objectives. Any disputes that may arise between the Company and its joint operations partners could result in litigation or arbitration that could increase the Company's expenses and distract its officers and/or directors from focusing their time and effort on the Company's business. In addition, the Company might in certain circumstances be liable for the actions of its joint operations partners.

### SYNDICATION OF LOANS

The Company has, from time to time, entered into strategic relationships to syndicate certain loans as part of its strategy to diversify and manage risks associated with its Loan Portfolio, its liquidity position and to enhance its revenue/yield. This also affords the Company the opportunity to participate in transactions in which it otherwise would not be able to participate. No assurance can be given that such existing strategic relationships will continue or that the terms and conditions of such relationships will not be modified in a way that renders them uneconomic. Furthermore, there can be no assurance that the Company will be able to enter into such relationships in the future. The inability to do so may adversely affect the Company's ability to continue to service existing and prospective clients and manage its liquidity position.

### DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for establishing and maintaining the Company's disclosure controls and procedures. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the CEO and CFO, to allow timely decisions regarding required disclosure. As of the end of the period covered by this MD&A, the Company's CEO and CFO evaluated the Company's disclosure controls and procedures and, based upon that review and evaluation, concluded that those disclosure controls and procedures are effective.

The Company is not required to certify the design and evaluation of its disclosure controls and procedures. Inherent limitations on the ability of the certifying officers to design and implement, on a cost effective basis, disclosure controls and procedures for the Company may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS. Given the small size of the Company, and, consequently, limited staff levels, certain duties within the accounting and finance department cannot be properly segregated. However, none of the segregation deficiencies is likely to result in a misstatement to the consolidated financial statements as the Company relies on certain compensating controls, including the detailed monitoring of operations and transactions by the CEO and CFO. No material changes were made in the Company's internal control over financial reporting during the three months ended September 30, 2014.

The Company is not required to certify the design and evaluation of its internal control over financial reporting and has not completed such an evaluation. Inherent limitations on the ability of the certifying officers to design and maintain, on a cost effective basis, internal control over financial reporting for the Company may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

### **SUBSEQUENT EVENTS**

On October 15, 2014, the Company completed a public 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 public offering, the Company issued 560,000 broker warrants to underwriters. Each broker warrant entitles the holder to purchase one Share of the Company at an exercise price of \$0.63 until October 15, 2015.

Concurrently with the public offering, the Company issued 1,587,300 Shares through private placement at a price of \$0.63 per Share to certain insiders of the Company, for gross proceeds of \$999,999.

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.

On November 24, 2014, the Company granted share options to the President and Chief Operating Officer of the Company to purchase an aggregate of 1,000,000 Shares at \$0.79 per Share. Each of the options shall vest in equal instalments on a quarterly basis over the three-year period and shall expire in five years from the date of grant.

### **FUTURE OUTLOOK**

The following section includes certain forward looking statements, including in regards of the Company's objectives and priorities. Please refer to the section titled "Caution Regarding Forward Looking Statements" on page 1 of this MD&A.

The objective of the Company is to provide attractive returns to shareholders over the long-term, through appreciation in net equity value. Management believes there is currently a significant market opportunities for the Company to expand its presence in the market to identify financing needs not being met by traditional institutional lenders and to create customized solutions to borrowers; however, it continues to be prudent in its approach to selection of new investments and pricing.

The Company remains opportunistic, focusing on those areas of real estate financings that provide for the most favourable risk-adjusted return. Management expects to be able to generate interest rates similar to those reflected in the current portfolio. The Company has a continuous pipeline of opportunities and expects to convert these opportunities into successful transactions. As at November 24, 2014, the Company has issued letters of intent and/or commitments of \$11.2 million to finance various real estate loans that are subject to certain commitments to be fulfilled. These loans are expected to close in the fourth quarter of 2014.

The achievement of the Company's objectives is dependent on management's ability to execute on its business strategy as described while also successfully mitigating business risks as discussed in this MD&A.



## TERRA FIRMA CAPITAL CORPORATION – MD&A

### SELECTED ANNUAL AND QUARTERLY INFORMATION

The following selected financial information should be read in conjunction with the Company's MD&A, audited consolidated financial statements and accompanying notes for the years ended December 31, 2013 and 2012 and the unaudited condensed consolidated interim financial statements and accompanying notes for the three and nine months ended September 30, 2014.

The following table shows information for revenues, profit, total assets, total liabilities, shareholders' equity and earnings per share amounts for the periods noted therein.

	As at September 30, 2014		As at December 31, 2013		As at December 31, 2012	
Total assets	\$	79,518,405	\$	73,669,821	\$ 46,400,778	
Total liabilities	\$	62,005,132	\$	58,944,840	\$ 33,644,832	
Shareholders' equity	\$	17,313,273	\$	14,524,981	\$ 12,755,946	
Loan and mortgage investments	\$	70,842,612	\$	55,278,303	\$ 31,996,731	
Loans and mortgages payable and Debentures	\$	53,871,691	\$	56,694,995	\$ 31,499,395	
Loans and mortgage payable and Debentures to loan and mortgage investments		76.0%		102.6%	98.4%	
	Three months ended,		Years ended,			
		Sept 30, 2014	Sept 30, 2013	December 31, 2013	December 31, 2012	December 31, 2011
Total revenue	\$	3,254,382	\$ 2,176,803	\$ 8,905,498	\$ 5,500,623	\$ 1,526,319
Total expenses	\$	2,069,495	\$ 1,607,112	\$ 6,922,752	\$ 3,454,010	\$ 1,043,945
Income from operations before income taxes	\$	1,184,887	\$ 569,691	\$ 2,282,746	\$ 2,046,613	\$ 677,374
Net income and comprehensive income	\$	914,644	\$ 422,899	\$ 1,699,827	\$ 1,251,980	\$ 287,322
Diluted income and comprehensive income	\$	1,051,345	\$ 560,459	\$ 2,245,380	\$ 1,799,173	\$ 1,799,173
Weighted average number of shares outstanding						
Basic		30,995,000	30,715,430	30,737,486	30,585,860	19,120,808
Diluted		46,758,152	45,288,073	45,279,974	30,517,541	33,620,808
Earnings per share						
Basic	\$	0.03	\$ 0.01	\$ 0.06	\$ 0.04	\$ 0.02
Diluted	\$	0.02	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.02

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table sets out the Company's quarterly results of operations for the eight periods ended September 30, 2014.

	Three months ended							
	Sep 30, 2014	Jun 30, 2014	Mar 31, 2014	Dec 31, 2013	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	Dec 31, 2012
<b>Revenue</b>								
Interest and fees earned	3,206,862	2,841,816	2,620,540	2,964,227	2,063,541	1,840,180	1,586,215	1,897,945
Rental income	47,520	47,319	115,437	115,419	113,262	115,558	107,096	195,113
	3,254,382	2,889,135	2,735,977	3,079,646	2,176,803	1,955,738	1,693,311	2,093,058
<b>Expenses</b>								
Property operating expenses	15,225	15,225	42,076	35,441	182,784	21,238	47,615	76,623
General and administrative expenses	417,792	529,678	354,517	382,940	353,130	372,923	367,163	134,629
Share based compensation	116,044	423,994	12,608	(2,649)	9,512	32,345	-	15,369
Interest expense	1,520,434	1,451,536	1,478,919	1,585,753	1,061,686	1,157,172	937,412	888,303
Gain on conversion of interest in joint operation	-	(487,000)	-	-	-	-	-	-
Fair value adjustment - investment properties	-	-	-	78,287	-	-	-	-
	2,069,495	1,933,433	1,888,120	2,079,772	1,607,112	1,583,678	1,352,190	1,114,924
Income before income taxes	1,184,887	955,702	847,857	999,874	569,691	372,060	341,121	978,134
Income tax provision	270,243	321,563	229,648	251,848	146,792	108,503	75,776	249,445
Income from continuing operations	914,644	634,139	618,209	748,026	422,899	263,557	265,345	728,689
Income (loss) from discontinued operations	-	151,644	-	-	-	-	-	(232,313)
Net income and comprehensive income	914,644	785,783	618,209	748,026	422,899	263,557	265,345	496,376
<b>Diluted net income attributable to common shareholders</b>								
	1,051,345	922,177	752,996	874,726	560,459	399,516	399,709	634,082
<b>Weighted average number of</b>								
<b>Shares outstanding</b>								
- basic	30,995,000	30,864,780	30,845,000	30,842,849	30,715,430	30,695,000	30,695,000	30,585,860
- diluted	46,758,152	45,991,447	45,775,469	45,517,897	45,288,073	45,255,450	45,247,008	45,203,944
<b>Earnings per share</b>								
Basic	\$ 0.03	\$ 0.03	\$ 0.02	\$ 0.03	\$ 0.01	\$ 0.01	\$ 0.01	\$ 0.01
Diluted	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.01	\$ 0.01

Additional information relating to the Company, including the Company's management information circular can be found on the SEDAR at [www.sedar.com](http://www.sedar.com).

Dated: November 26, 2014  
Toronto, Ontario, Canada