



# **TERRA FIRMA CAPITAL CORPORATION**

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

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**APRIL 30, 2013**

## **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 April 30, 2013 should be read in conjunction with the Company’s audited consolidated financial statements and accompanying notes for the years ended December 31, 2012 and 2011. 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 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 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 audited consolidated financial statements for the years ended December 31, 2012 and 2011 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: 1 Toronto Street, Suite 700, P.O. Box 3, Toronto, Ontario, M5C 2V6. The principal business of the Company is the arrangement of and participation in real property financings secured by investment properties and commercial and residential real estate developments, throughout Canada.

These financings generally take the form of:

- (i) Land loans registered in first 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) Mezzanine / equity type financings on real property developments that have either progressed to the construction phase or are near to that juncture, or
- (iii) Mezzanine financings on income property.

These financings generally represent loan to cost ratios of not more than 85% and loan to end value ratios of not more than 80%, including all prior encumbrances at the time of underwriting of each loan. In some cases the loan to value ratio could increase to 85%.

The Company’s primary investment objective is to provide attractive returns to shareholders over the long-term, through appreciation in net book value. 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.

In December 2011, the Company completed a private placement of 11,700,000 Shares at \$0.50 per share for gross proceeds of \$5,850,000, less related costs of \$31,494. 2,700,000 of these Shares were issued to related parties as follows:

- 2,300,000 Shares were issued to Counsel Corporation (“Counsel”). Subsequent to the year end on January 1, 2013, Counsel distributed its entire holding of 6,168,333 Shares as a dividend to its shareholders.
- 200,000 Shares were issued to the Chairman of the Board of Directors of the Company, and
- 200,000 Shares were issued to the Chief Executive Officer.

In September 2011 the Company completed a private placement of 10,150 unsecured subordinated debentures (the “Debentures”) carrying interest at 7.0% per annum, at a price of \$1,000 per Debenture for gross proceeds of \$10,150,000.

In January 2011, the Company issued 895,000 Shares at \$0.30 per share to the Chief Executive Officer, for gross proceeds of \$268,500.

The net proceeds of the private placements were and are being used to enhance the Company’s liquidity position, to fund the Company’s business activity needs and for other general corporate purposes.

Historically, the Company has sought to leverage its relationship with Counsel to access investment opportunities that satisfy the abovementioned objectives and the relationship was governed by a Management Agreement (the “Agreement”) with Counsel Asset Management L.P. (the “Manager”), an entity wholly-owned by Counsel. On December 31, 2012, the Manager terminated the Agreement with the Company.

Following the termination of the Agreement, the Company's overall strategy remains unchanged and management believes that the Company will be better positioned to deliver on its strategy and objectives with a new manager or alternatively, internalizing the management structure. Management is evaluating both options, among others.

## ACCOUNTING ADJUSTMENTS

During the year, the Company reclassified its joint venture interests on a property located on Montreal Street, Ottawa, Ontario and a housing project in Ajax, Ontario from jointly controlled entities to jointly controlled assets. Prior to this reclassification, these joint ventures were accounted for using the equity method, subsequent to the reclassification; the Company has recorded its share of the joint ventures using the proportionate consolidation. This resulted in the reclassification of certain prior year balances to reflect the effects of the proportionate consolidation of these two joint ventures. This error had no effect on net income or equity.

## INVESTMENTS

### LOANS AND MORTGAGE INVESTMENTS

The Company's loan and mortgage investments (the "Investment Portfolio") as at December 31, 2012 consist of (a) loans relating to 12 residential housing developments, comprising 1,110 high rise units in Toronto, Ontario, 1,258 low rise single family condominium and freehold units in Toronto, Vaughan and Ajax, Ontario and a 205-bed student residence in Waterloo, Ontario, representing 94.4% of the Investment Portfolio, and (b) two residential income properties consisting of 300 rental units in Toronto and Ottawa, Ontario, representing the remaining 5.6% of the Loan Portfolio.

The following table presents details of the Investment Portfolio as at December 31, 2012 and 2011:

|                                  | December 31, 2012                        |               |                  | December 31, 2011                        |               |                  |
|----------------------------------|--|---------------|------------------|--|---------------|------------------|
|                                  | Weighted Average Effective Interest Rate | Amount        | % of Investments | Weighted Average Effective Interest Rate | Amount        | % of Investments |
| Residential housing developments | 20.0%                                    | \$ 30,200,563 | 94.4%            | 19.5%                                    | \$ 15,150,768 | 90.6%            |
| Residential income properties    | 17.7%                                    | 1,796,168     | 5.6%             | 20.4%                                    | 498,006       | 3.0%             |
| Commercial retail development    | 0.0%                                     | -             | 0.0%             | 16.0%                                    | 1,076,000     | 6.4%             |
| Loan and mortgage investments    | 19.9%                                    | \$ 31,996,731 | 100.0%           | 19.3%                                    | \$ 16,724,774 | 100.0%           |

As at December 31, 2012 and 2011, the principal balance of the Investment Portfolio was \$31,996,731 and \$16,724,774, respectively. The Investment Portfolio experienced substantial growth during the year ended December 31, 2012, an increase of \$15,271,957 or 91% from the balance at December 31, 2011. This growth resulted from the net effect of funding six loan investments totaling \$17,712,826, capitalized interest of \$774,749, a subsequent contractual advance based on achievement of pre-established conditions on an existing loan of \$800,000, the repayment of two loans totaling \$3,213,780 and contractual principal repayments of \$1,838.

The following table summarizes the change in the Investment Portfolio for the year ended December 31, 2012.

|  | Amount        |
|--|---------------|
| Balance of Investment Portfolio, beginning of year | \$ 16,724,774 |
| Investment Portfolio activity during the year      |               |
| Funding of six new loan investments                | 16,912,826    |
| Advances against existing loan                     | 800,000       |
| Repayments of two loans                            | (3,213,780)   |
| Interest capitalized                               | 774,749       |
| Principal repayment of loans                       | (1,838)       |
| Balance of Investment Portfolio, end of year       | \$ 31,996,731 |

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The weighted average effective interest rate of the Investment Portfolio at December 31, 2012 and 2011 was 19.9% and 19.3%, respectively. The weighted average effective interest rates of the loans and mortgage investments of residential housing developments and residential income properties at December 31, 2012 were 20.0% and 17.7%, respectively and the weighted average effective interest rates of the loans and mortgage investments of residential housing developments, residential income properties and commercial retail development at December 31, 2011 were 19.5%, 16.0% and 20.4%, respectively.

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

|      | Scheduled principal payments | Investments maturing during the year | Total loans and mortgage investments |
|------|------------------------------|--------------------------------------|--------------------------------------|
| 2013 | \$ 2,084                     | \$ 25,751,174                        | \$ 25,753,258                        |
| 2014 | 2,364                        | 5,749,389                            | 5,751,753                            |
| 2015 | 1,750                        | 489,970                              | 491,720                              |
|      | \$ 6,198                     | \$ 31,990,533                        | \$ 31,996,731                        |

The weighted average term to maturity at December 31, 2012 and 2011 was 0.65 years and 1.07 years, respectively. The relatively short term to maturity of the Investment Portfolio allows for reinvestment of the portfolio in response to changing market conditions.

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

The Investment Portfolio is 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.

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, 2012 amounted to \$3,032,425, including \$693,900 of capitalization of future interest relating to the existing loan and mortgage investments. There were no funding commitments at December 31, 2011.

The investments comprising the Investment 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 December 31, 2012 and 2011, 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.

### INTERESTS IN JOINT VENTURES

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

#### Queen Street West JV:

In April 2012, the Company entered into a co-owners' agreement ("Queen 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.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

### Salem Road JV:

In December 2009, the Company entered into a co-owners' agreement (the "Salem Road JV") with a development partner and financial partner, to acquire and develop a single family residential housing project in Ajax, Ontario, comprised of five acres of land on three separate parcels. A portion of the units are complete and subsequent to September 30, 2012, the co-tenancy commenced the transfer of units to purchasers. Upon the completion of the transfer of all units to purchasers in December 2012, the Company received its investment of \$465,500 in cash. The Company's share of fees was \$375,000, net of fees payable to the Manager of \$125,000 and was recorded during the three months ended December 31, 2012.

### 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 development was completed and the tenant commenced paying rent in the first quarter of 2011. The Company provided 80% of the capital required during the development stage, and earned interest at 15% per annum on its capital advance in excess of its 55% ownership interest. In May 2011, the Company's capital contribution was reduced to its ownership interest of 55% when the placement of permanent financing was completed and the construction loan facility discharged. The project's loan of \$2,300,000 bears interest at 4.2% per annum, is amortized over 25 years and matures June 1, 2016.

The completion of the development of a commercial unit in the Montreal Street JV in February of 2011 resulted in recognition of the Company's share of fair value adjustment related to that investment property of \$50,000 and \$195,000 for the three months and year ended December 31, 2011, respectively.

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

|  | December 31,<br>2012 | December 31,<br>2011 |
|--|----------------------|----------------------|
| Cash and cash equivalents                | \$ 31,588            | \$ 109,052           |
| Amounts receivable and prepaid expenses  | 41,642               | 45,645               |
| Investment properties                    | 7,834,576            | 3,234,658            |
| <b>Total assets</b>                      | <b>7,907,806</b>     | <b>3,389,355</b>     |
| Accounts payable and accrued liabilities | 217,343              | 370,396              |
| Loans and mortgages payable              | 4,368,854            | 1,945,640            |
| <b>Total liabilities</b>                 | <b>4,586,197</b>     | <b>2,316,036</b>     |
| <b>Net assets</b>                        | <b>\$ 3,321,609</b>  | <b>\$ 1,073,319</b>  |

The table below details the results of operations for the years ended December 31, 2012 and 2011, attributable to the Company from its joint ventures activities.

|  | Year Ended           |                      |
|--|----------------------|----------------------|
|  | December 31,<br>2012 | December 31,<br>2011 |
| Rental revenue                               | \$ 343,958           | \$ 174,195           |
| Property operating costs                     | 129,186              | 55,901               |
|  | 214,772              | 118,294              |
| General and administrative expenses          | 210                  | -                    |
| Interest expense                             | 169,554              | 44,454               |
| Gain on sale of investment property          | (375,000)            | -                    |
| Fair value adjustment of investment property | -                    | (195,000)            |
| <b>Net earnings</b>                          | <b>\$ 420,008</b>    | <b>\$ 268,840</b>    |

## TERRA FIRMA CAPITAL CORPORATION – MD&A

### 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 rental property for the years ended December 31, 2012 and 2011:

|  | December 31,<br>2012 | December 31,<br>2011 |
|--|----------------------|----------------------|
| Balance, beginning of year                     | \$ 3,234,658         | \$ 2,113,553         |
| Acquisition of properties                      | 4,994,892            | -                    |
| Capital expenditures                           | 4,391,533            | 926,105              |
| Sale of investment properties                  | (4,786,507)          | -                    |
| Fair value adjustment on investment properties | -                    | 195,000              |
| Balance, end of year                           | \$ 7,834,576         | \$ 3,234,658         |

### PORTFOLIO INVESTMENT

The Company has invested \$950,000, for a partnership interest in a 94 unit mid-rise condominium development project located in Toronto, Ontario (the "Portfolio Investment"). The Company does not have significant influence and is accounting for its investment as a financial asset at fair value through profit and loss. At December 31, 2012, the carrying value of this investment approximates its fair value.

### FINANCIAL PERFORMANCE

The Company's financial performance for the three months and years ended December 31, 2012 and 2011, respectively, is summarized below.

|   | Three months ended December 31, |                     |                                  | Years ended December 31, |                     |                                  |
|---|---------------------------------|---------------------|----------------------------------|--------------------------|---------------------|----------------------------------|
|   | 2012                            | 2011 <sup>(1)</sup> | Change<br>Increase<br>(decrease) | 2012                     | 2011 <sup>(1)</sup> | Change<br>Increase<br>(decrease) |
| Revenue   |                                 |                     |                                  |                          |                     |                                  |
| Interest and fees earned  | \$ 1,897,945                    | \$ 749,883          | \$ 1,148,062                     | \$ 5,156,665             | \$ 1,352,124        | \$ 3,804,541                     |
| Rental income   | 195,113                         | 55,305              | 139,808                          | 343,958                  | 174,195             | 169,763                          |
|   | 2,093,058                       | 805,188             | 1,287,870                        | 5,500,623                | 1,526,319           | 3,974,304                        |
| Expenses  |                                 |                     |                                  |                          |                     |                                  |
| Property operating costs  | 76,623                          | 17,834              | 58,789                           | 129,186                  | 55,901              | 73,285                           |
| General and administrative expenses                                 | 134,629                         | 93,829              | 40,800                           | 538,978                  | 245,327             | 293,651                          |
| Share based compensation  | 15,369                          | 32,608              | (17,239)                         | 216,840                  | 284,998             | (68,158)                         |
| Interest expense  | 888,303                         | 294,562             | 593,741                          | 2,569,006                | 457,719             | 2,111,287                        |
|   | 1,114,924                       | 438,833             | 676,091                          | 3,454,010                | 1,043,945           | 2,410,065                        |
| Fair value adjustment of investment properti                        | -                               | 50,000              | (50,000)                         | -                        | 195,000             | (195,000)                        |
| Income from continuing operations                                   |                                 |                     |                                  |                          |                     |                                  |
| before income taxes   | 978,134                         | 416,355             | 561,779                          | 2,046,613                | 677,374             | 1,369,239                        |
| Income tax provision  | 249,445                         | 110,210             | 139,235                          | 562,320                  | 197,210             | 365,110                          |
| Income from continuing operations                                   | 728,689                         | 306,145             | 422,544                          | 1,484,293                | 480,164             | 1,004,129                        |
| Income (loss) from discontinued operations                          | (232,313)                       | 1,928               | (234,241)                        | (232,313)                | (192,842)           | (39,471)                         |
| Net income and comprehensive income                                 | 496,376                         | 308,073             | 188,303                          | 1,251,980                | 287,322             | 964,658                          |
| (1) Certain amounts have been restated. See Accounting Adjustments. |                                 |                     |                                  |                          |                     |                                  |

## TERRA FIRMA CAPITAL CORPORATION – MD&A

Income from continuing operations for the three months and year ended December 31, 2012 experienced significant increases compared to the same periods last year.

Income from continuing operations before income taxes for the year ended December 31, 2012 was \$2,046,613, an increase of \$1,369,239 or 202% compared to income from continuing operations before income taxes for the year ended December 31, 2011. Income from continuing operations before income taxes for the three months ended December 31, 2012 was \$978,134, an increase of \$561,779 or 135% compared to income from continuing operations before income taxes for the three months ended December 31, 2011.

Income from continuing operations for the year ended December 31, 2012 was \$1,484,293, an increase of \$1,004,129 or 209% compared to income from continuing operations before income taxes for the year ended December 31, 2011. Income from continuing operations for the three months ended December 31, 2012 was \$728,689, an increase of \$422,544 or 138% compared to income from continuing operations for the three months ended December 31, 2011.

Increase in income from continuing operations was primarily due to the growth of the Company's loan and mortgage investments together with the related financial leverage created through its syndication activities.

### INTEREST AND FEES EARNED

Interest and fees earned for the year ended December 31, 2012 was \$5,156,665 compared to \$1,352,124 for the year ended December 31, 2011. Interest and fees earned for the three months ended December 31, 2012 was \$1,897,945 compared to \$749,883 for the comparable period last year. The increase in interest and fees earned 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 jointly controlled by the Company for the year ended December 31, 2012 was \$343,958 compared to \$174,195 for the same period last year. The rental income for the three months ended December 31, 2012 was \$195,113 compared to \$55,305 for comparable period last year. The Company's proportionate share of the property operating costs in investment properties jointly controlled by the Company for the year ended December 31, 2012 was \$129,186 compared to \$55,901 for the same period last year. The rental income for the three months ended December 31, 2012 was \$76,623 compared to \$17,834 for comparable period last year. These increases were primarily due to acquisition of investment property in April 2012.

### INTEREST EXPENSE

Interest expense for the three months and years ended December 31, 2012 and 2011 were as follows:

|   | Three months ended December 31, |            |                                  | Years ended December 31, |            |                                  |
|---|---------------------------------|------------|----------------------------------|--------------------------|------------|----------------------------------|
|   | 2012                            | 2011       | Change<br>Increase<br>(decrease) | 2012                     | 2011       | Change<br>Increase<br>(decrease) |
| Interest on loans and mortgages payable | \$ 569,649                      | \$ 90,343  | \$ 479,306                       | \$ 1,657,495             | \$ 219,020 | \$ 1,438,475                     |
| Interest on Debentures                  | 186,720                         | 186,178    | 542                              | 741,957                  | 194,245    | 547,712                          |
| Montreal Street JV                      | 12,397                          | 18,041     | (5,644)                          | 50,017                   | 44,454     | 5,563                            |
| Queen Street West JV                    | 119,537                         | -          | 119,537                          | 119,537                  | -          | 119,537                          |
|   | \$ 888,303                      | \$ 294,562 | \$ 593,741                       | \$ 2,569,006             | \$ 457,719 | \$ 2,111,287                     |

Interest expense for the year ended December 31, 2012 was \$2,569,006 compared to \$457,719 for the year ended December 31, 2011. Interest expense for the three months ended December 31, 2012 was \$888,303 compared to \$294,562 for the comparable period last year. The increase in interest expense is attributable primarily to additional loans and mortgages payable syndicated to fund the loan and mortgage investments, mortgages on investment properties and the issuance of Debentures in September 2011. See – "Capital Structure and Debt Portfolio – Convertible Debentures".



**GENERAL AND ADMINISTRATIVE EXPENSES**

During the three months and year ended December 31, 2012, the Company incurred the following general and administrative expenses:

|                           | Three months ended December 31, |           |                            | Years ended December 31, |            |                            |
|---------------------------|---------------------------------|-----------|----------------------------|--------------------------|------------|----------------------------|
|                           | 2012                            | 2011      | Change Increase (decrease) | 2012                     | 2011       | Change Increase (decrease) |
| Asset management fee      | \$ 84,000                       | \$ 59,822 | \$ 24,178                  | \$ 328,902               | \$ 115,528 | \$ 213,374                 |
| Professional fees         | 21,162                          | 17,594    | 3,568                      | 93,656                   | 53,431     | 40,225                     |
| Advertising and promotion | 5,838                           | 6,737     | (899)                      | 41,690                   | 30,885     | 10,805                     |
| Other                     | 23,629                          | 9,676     | 13,953                     | 74,730                   | 45,483     | 29,247                     |
|                           | \$ 134,629                      | \$ 93,829 | \$ 40,800                  | \$ 538,978               | \$ 245,327 | \$ 293,651                 |

General and administrative expenses for the year ended December 31, 2012 were \$538,978, compared to \$245,327 for the year ended December 31, 2011. General and administrative expenses for the three months ended December 31, 2012 were \$134,629, compared to \$93,829 for the three months ended December 31, 2011. The increase in general and administrative expenses of \$293,651 and \$40,800 for the year and three months ended December 31, 2012, respectively over the same periods last year reflects the growth and increase in lending activities in the Company throughout 2012 and increase in asset management fee.

General and administrative expenses include asset management fees paid to the Manager in respect of the administration of the day-to-day operations of the Company. Prior to September 30, 2011, asset management fee was calculated as a percentage of the Company's shareholders' equity and subsequent to September 30, 2011, the asset management fee calculation included the Debentures issued by the Company. See "Related Party Transactions – Management Agreement with Counsel Asset Management LP".

**SHARE BASED COMPENSATION**

Share-based compensation expenses, which are costs associated with the Company's share option plan (the "Plan") amounted to \$216,840 and \$15,369 for the year and three months ended December 31, 2012, respectively, compared to \$284,998 and \$32,608 for the year and three months ended December 31, 2011, respectively. The increase in Share-based compensation expenses was primarily due to the granting of 910,000 options on April 17, 2012, 202,667 options on December 31, 2011 and 895,000 options on January 25, 2011. (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) issuance of loans and mortgages payable, (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 years ended December 31, 2012 and 2011:

|  | Year Ended           |                      |
|--|----------------------|----------------------|
|  | December 31,<br>2012 | December 31,<br>2011 |
| Cash provided by operating activities        | \$ 792,686           | \$ 415,776           |
| Cash used in investing activities            | (22,284,668)         | (15,151,381)         |
| Cash provided by financing activities        | 15,943,716           | 20,747,401           |
| Increase/(decrease) in cash                  | \$ (5,548,266)       | \$ 6,011,796         |
| Cash and cash equivalents, beginning of year | 8,771,557            | 2,759,761            |
| Cash and cash equivalents, end of year       | \$ 3,223,291         | \$ 8,771,557         |

Cash on hand at December 31, 2012 was \$3,223,291 compared to \$8,881,557 at December 31, 2012.

Cash provided by operating activities for the years ended December 31, 2012 and 2011 of \$792,686 and \$415,776, respectively are related primarily to the net cash provided by in lending activities.

Cash provided by financing activities during the year ended December 31, 2012 of \$15,943,716 relates to the net proceeds from the Loan Portfolio, proceeds from the issuance of Shares of \$40,000, which aggregate amount was offset by repayments of the Loan Portfolio of \$2,161,030.

Cash provided by financing activities for the year ended December 31, 2011 of \$20,747,401 relates primarily to the net proceeds from the Loan Portfolio of \$5,609,367, and proceeds from issuance of the Debentures, net of issue costs, of \$10,054,495 and proceeds from issuance of Shares, net of issue costs, of \$6,088,785, which aggregate amount was offset by repayments of the Loan Portfolio of \$1,005,246.

The cash used in investing activities during the year ended December 31, 2012 of \$22,284,668 primarily reflects the funding of Loan Portfolio of \$17,712,826 and capital additions to investment properties of \$4,391,533, acquisition of investment property of \$2,757,495 and investment in the Portfolio Investment of \$950,000, which aggregate amount was offset by repayments received from Loan Portfolio of \$3,215,618 and proceeds from sale of investment property of \$686,568.

The cash used in investing activities for the year ended December 31, 2011 of \$15,151,381 primarily reflects the funding of the Loan Portfolio of \$14,176,768, which is offset by repayments received from Loan Portfolio of \$251,492 and capital additions to investment properties of \$926,105.

### CAPITAL STRUCTURE AND DEBT PROFILE

#### CAPITAL STRUCTURE

The Company defines its capital as the aggregate of shareholders' equity, Debentures and loans and mortgages payable. The Company's capital management is designed to ensure that the Company has sufficient financial flexibility, 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.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

As at December 31, 2012 and December 31, 2011, respectively, the total capital of the Company was as follows:

|                             | December 31,<br>2012 | December 31,<br>2011 |
|-----------------------------|----------------------|----------------------|
| Loans and mortgages payable | \$ 21,406,070        | \$ 6,777,907         |
| Convertible debentures      | 10,093,325           | 10,061,869           |
| Shareholders' Equity        | 12,755,946           | 11,247,126           |
| <b>Total capital</b>        | <b>\$ 44,255,341</b> | <b>\$ 28,086,902</b> |

### LOANS AND MORTGAGES PAYABLE

The Company leverages its Loan Portfolio through the issuance of the loans and mortgages payable (the "Loan Portfolio") 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 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.

At December 31, 2012 the weighted average effective interest rate of Loans Payable was 15.8%, consisting of the syndication of loans pertaining to six residential housing developments and one residential income property, having weighted average effective interest rates of 16.2% and 10.9%, respectively and mortgages on Montreal Street JV 4.2% and Queen Street JV of 4.2% and 5.4%, respectively, compared to the weighted average effective interest rate of 14.4% in 2011, consisting of the syndication of loans pertaining to four residential housing developments, one residential income property and one commercial retail development, having weighted average effective interest rates of 15.6%, 13.0% and 4.7%, respectively and Montreal Street JV and Salem Road JV of 4.2% and 4.0%, respectively at December 31, 2011.

The following table presents details of the Loans Payable as at December 31, 2012 and 2011:

|                                  | December 31, 2012                                 |               |                       | December 31, 2011                                 |              |                       |
|----------------------------------|---|---------------|-----------------------|---|--------------|-----------------------|
|                                  | Weighted<br>Average<br>Effective<br>Interest Rate | Amount        | % of Loans<br>Payable | Weighted<br>Average<br>Effective<br>Interest Rate | Amount       | % of Loans<br>Payable |
| Residential housing developments | 16.2%   | \$ 15,689,132 | 73.3%                 | 15.6%   | \$ 3,907,264 | 57.6%                 |
| Residential income properties    | 10.9%   | 1,348,084     | 6.3%                  | 13.0%   | 249,003      | 3.7%                  |
| Commercial retail development    | 0.0%  | -             | 0.0%                  | 4.7%  | 676,000      | 10.0%                 |
| Montreal Street JV               | 4.2%  | 1,205,676     | 5.6%                  | 4.2%  | 1,239,787    | 18.3%                 |
| Salem Road JV                    | 0.0%  | -             | 0.0%                  | 4.0%  | 705,853      | 10.4%                 |
| Queen Street West JV             | 5.4%  | 3,163,178     | 14.8%                 |   | -            | 0.0%                  |
|                                  | 13.9%   | \$ 21,406,070 | 100.0%                | 11.2%   | \$ 6,777,907 | 100.0%                |

## TERRA FIRMA CAPITAL CORPORATION – MD&A

At December 31, 2012 the Company's syndication activities resulted in \$14,959,515 or 53.3% of the Loan Portfolio being syndicated by investors, yielding a net effective return of 24.6%, thereby increasing its overall return by 4.7% from its non-leveraged position of 19.9%, representing a 23.6% increase in overall return compared to \$11,892,507 or 28.9% of the Loan Portfolio being syndicated by investors, yielding a net effective return of 21.3%, thereby increasing its overall return by 6.9% from its non-leveraged position of 14.4%, representing a 47.9% increase in overall return. 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 Syndicated and Loan Portfolio.

The following table summarizes the changes in the principal balance of Loans Payable for the year ended December 31, 2012:

|   | Amount               |
|---|----------------------|
| Balance of Loans Payable, beginning of year                   | \$ 6,777,907         |
| Loans Payable activity during the year                        |                      |
| Proceeds from new loans                                       | 10,367,411           |
| Additional advances to existing loans                         | 4,781,868            |
| Assumed on acquisition and sale of investment properties, net | 1,639,914            |
| Repayments of two loans                                       | (2,126,000)          |
| Principal repayment of loans                                  | (35,030)             |
| <b>Balance of Loans Payable, end of year</b>                  | <b>\$ 21,406,070</b> |

At December 31, 2012, scheduled principal repayments, and maturity amounts on the loans to be paid over each of the next five fiscal years, are as follows:

|      | Scheduled<br>principal<br>payments | Loans maturing<br>during the year | Total loans and<br>mortgages<br>payable |
|------|------------------------------------|-----------------------------------|---|
| 2013 | \$ 1,042                           | \$ 17,352,310                     | \$ 17,353,352                           |
| 2014 | 1,182                              | 2,600,000                         | 2,601,182                               |
| 2015 | 875                                | 244,985                           | 245,860                                 |
| 2016 |                                    | 1,205,676                         | 1,205,676                               |
|      | <b>\$ 3,099</b>                    | <b>\$ 21,402,971</b>              | <b>\$ 21,406,070</b>                    |

### CONVERTIBLE DEBENTURES

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

550 of the Debentures, having a face value of \$550,000, were issued to directors and officers of the Company.

As of the date of issuance the fair value of the liability component of the Debentures was determined to be the fair value of the Debenture as a whole.

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

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table summarizes the changes in the Debentures for the years ended December 31, 2012 and 2011:

|  | Amount        |
|--|---------------|
| Debentures issued, September 27, 2011                | \$ 10,150,000 |
| Issue costs  | (95,505)      |
| Interest expensed at EIR of 7.35%                    | 194,245       |
| Interest paid  | (186,871)     |
| Liability component of Debentures, December 31, 2011 | \$ 10,061,869 |
| Interest expensed at EIR of 7.35%                    | 741,956       |
| Interest paid  | (710,500)     |
| Liability component of Debentures, December 31, 2012 | \$ 10,093,325 |

### COMMITMENTS AND CONTINGENCIES

Pursuant to certain lending agreements, the Company is committed to fund additional loan advances. The unfunded loan commitments under the existing loan and mortgage investments at December 31, 2012 was \$3,032,425 including \$693,900 of capitalization of future interest relating to the existing loan and mortgage investments. There were no funding commitments at December 31, 2011.

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 years ended December 31, 2011 and December 31, 2012.

|  | Shares     | Amount        |
|--|------------|---------------|
| Outstanding as at December 31, 2010  | 17,900,000 | \$ 4,571,246  |
| Issuance of shares, January 25, 2011   | 895,000    | 268,500       |
| Issuance of shares, December 20, 2011, net of<br>issue costs of \$31,494 and income tax recovery of \$28,853 | 11,700,000 | 5,847,359     |
| Outstanding as at December 31, 2011  | 30,495,000 | \$ 10,687,105 |
| Issuance of shares under share Option Plan   | 200,000    | 40,000        |
| Transferred from Contributed surplus upon exercise of options  | -          | 30,300        |
| Outstanding as at December 31, 2012  | 30,695,000 | \$ 10,757,405 |

As at April 30, 2013, there were 30,695,000 shares issued and outstanding.

### SHARE BASED COMPENSATION

The Company has adopted the Plan to grant eligible directors, officers, senior management 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 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.

## TERRA FIRMA CAPITAL CORPORATION – MD&A

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

On December 20, 2011, the Company granted share options to Directors of the Company to purchase 202,667 Shares at \$0.50 per Share. 25% of the share options vested immediately, with an additional 25% vesting on March 31, 2012, June 30, 2012 and September 30, 2012.

On January 25, 2011, the Company granted share options to the Chief Executive Officer of the Company to purchase 895,000 Shares at \$0.30 per Share. The share options vested immediately and will expire five years from the date the options were granted.

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 |                      |                     |
|---------------------------------|---------------------|----------------------|---------------------|
|                                 | April 17,<br>2012   | December 20,<br>2011 | January 25,<br>2011 |
| Average expected life           | 5.00 years          | 5.00 years           | 5.00 years          |
| Average risk-free interest rate | 1.47%               | 1.31%                | 1.31%               |
| Average expected volatility     | 103.00%             | 287.00%              | 165.00%             |
| Average dividend yield          | 0.00%               | 0.00%                | 0.00%               |

The following is the summary of changes in the Company's share options for the year ended December 31, 2012:

|                                 | December 31, 2012    |                                    | December 31, 2011    |                                    |
|---------------------------------|----------------------|------------------------------------|----------------------|------------------------------------|
|                                 | Number of<br>options | Weighted average<br>exercise price | Number of<br>options | Weighted average<br>exercise price |
| Outstanding - beginning of year | 1,917,667            | \$ 0.28                            | 820,000              | \$ 0.20                            |
| Granted                         | 910,000              | 0.50                               | 1,097,667            | 0.34                               |
| Exercised                       | (200,000)            | 0.20                               | -                    | -                                  |
| Cancelled                       | (185,000)            | 0.20                               | -                    | -                                  |
| Outstanding - end of year       | 2,442,667            | \$ 0.37                            | 1,917,667            | \$ 0.28                            |
| Number of options exercisable   | 2,270,167            | \$ 0.36                            | 1,765,667            | \$ 0.26                            |

### RELATED PARTY TRANSACTIONS AND ARRANGEMENTS

Counsel is considered a related party due to the significance of the level of ownership interest and its relationship with the Manager.

#### MANAGEMENT AGREEMENT WITH COUNSEL ASSET MANAGEMENT LP

On December 31, 2012, the Manager terminated the Agreement with the Company.

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

Prior to December 31, 2012, pursuant to the terms of the Agreement, for the services provided by the Manager, the Company paid the Manager an annual management fee, quarterly in arrears, equal to the sum of (i) 1.5% of the first \$200 million of the Company's shareholder's equity, (ii) 1.25% of the Company's shareholders' equity in excess of \$200 million and up to \$300 million, and (iii) 1.00% of the Company's shareholders' equity in excess of \$300 million, in each case calculated in accordance with Canadian generally accepted accounting principles. Subsequent to September 30, 2011 and pursuant to an amended Agreement, the management fee calculation included the debt securities issued by the Company, excluding syndication of loan or other investments by the Company. For the years ended December 31, 2012 and 2011, the management fee was \$328,900 and \$115,528, respectively, and is included in general and administrative expenses. Of this amount, \$84,000 (December 31, 2011 - \$60,500) is included in accounts payable and accrued liabilities.

In addition, pursuant to the Agreement, the Company paid the Manager 50% of all fees attributable to lending activities earned by the Company and certain fees or profit earned by the Company in connection with equity participations in commercial and residential developments and investment property acquisitions. These fees paid to the Manager are deducted from the fees used in the determination of the effective interest rate on each of the Company's loan and mortgage investments. During the year ended December 31, 2012, the Company paid \$480,100 (2011 - \$134,240). At December 31, 2012, the fees payable to the Manager amounted to \$125,000 (December 31, 2011 - \$nil) and is included in accounts payable and accrued liabilities.

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

Subsequent to the year end on January 1, 2013, Counsel has paid its entire holding of 6,168,333 Shares in dividends to its shareholders.

#### **LOANS AND MORTGAGES PAYABLE**

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

At December 31, 2012, the loan and mortgage investments and Debentures syndicated by officers and directors were \$2,276,088 (December 31, 2011 - \$1,450,000). No loans or investments were issued to borrowers controlled by or related to officers or directors of the Company. No loans or investments are 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. The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at each financial statement date, and revenues and expenses for the periods indicated. Actual results could differ from those estimates.

#### **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 most significant estimates that the Company is required to make relate to, but are not limited to: revenue recognition using the effective interest rate method; assessment of the recoverability and valuation of loan and mortgage investments; interests in joint ventures, portfolio investment, accrued liabilities; valuation of share options; and accounting for income taxes. 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, interest and other receivables, loan and mortgage investments, portfolio investment, accounts payable and accrued liabilities, loans and mortgages payable and Debentures.

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

The fair value of loans and mortgage investments, portfolio investment loans, loans and mortgage payable and Debentures approximate their carrying value as the underlying interest rates on these instruments approximate the market interest rates.

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.

All of the Company's financial assets and liabilities are valued using Level 3 inputs at December 31, 2012 and 2011 and no amounts were transferred between fair value levels during 2012 or 2011.

### OFF BALANCE SHEET ITEMS

As of December 31, 2012 and 2011, the Company did not have any off-balance sheet (statement of financial position) arrangements.

### FUTURE CHANGES IN CRITICAL ACCOUNTING POLICIES

IASB has issued the following new standards and amendments to existing standards that will be relevant to the Company in preparing its consolidated financial statements in future periods.

#### **IFRS 7 FINANCIAL INSTRUMENTS: DISCLOSURES - OFFSETTING FINANCIAL INSTRUMENTS ("IFRS 7")**

IFRS 7 as amended requires an entity to disclose information about rights to set-off and related arrangements. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will affect disclosure only and the Company intends to adopt in its consolidated financial statements for the annual period beginning on January 1, 2013.



**IFRS 9 FINANCIAL INSTRUMENTS (“IFRS 9”)**

IFRS 9 was issued to replace IAS 39, “Financial Instruments: Recognition and Measurement”. This is a three-phase project with the objective of improving and simplifying the reporting for financial instruments. The issuance of IFRS 9 in November 2009 was the first phase of the project, which provided guidance on the classification and measurement of financial assets and financial liabilities. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. In December 2011, the effective date of adoption of this standard was amended to January 1, 2015 from January 1, 2013. The Company is currently assessing the impact of the new standard on its consolidated financial statements.

**IFRS 10 CONSOLIDATED FINANCIAL STATEMENTS (“IFRS 10”)**

IFRS 10 establishes a single control model that applies to all entities (including ‘special purpose entities,’ or ‘structured entities’ as they are now referred to in the new standards). The changes will require management to exercise significant judgment to determine which entities are controlled, and therefore are required to be consolidated by a parent. Under IFRS 10, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. This principle applies to all investees, including structured entities. IFRS 10 is effective for annual periods commencing on or after January 1, 2013. The Company does not anticipate any changes to its financial results as a result of IFRS 10.

**IFRS 11 JOINT ARRANGEMENTS (“IFRS 11”)**

IFRS 11 addresses two forms of joint arrangements (joint operations and joint ventures) where there is joint control. IFRS 11 defines joint control as the contractually agreed sharing of control of an arrangement which exists only when the decisions about the relevant activities require the unanimous consent of the parties sharing control. Because the new standard uses the principle of control in IFRS 10 to define joint control, the determination of whether joint control exists may change. In addition, IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. For joint operations, an entity recognizes its assets, liabilities, revenues and expenses, and/or its relative share of those items, if any. In addition, when specifying the appropriate accounting, the previous standard focused on the legal form of the entity, whereas IFRS 11 focuses on the nature of the rights and obligations arising from the arrangement. IFRS 11 is effective for annual periods commencing on or after January 1, 2013. The Company currently accounts for its interest in joint ventures using the equity method and therefore does not expect any implications as a result of this new standard.

**IFRS 12 DISCLOSURE OF INTERESTS IN OTHER ENTITIES (“IFRS 12”)**

IFRS 12 includes a number of new disclosures that are required. One of the most significant changes is that an entity is now required to disclose the judgments made to determine whether it controls another entity. IFRS 12 is effective for annual periods commencing on or after January 1, 2013. The Company does not anticipate any changes in disclosure requirements for the consolidated financial statements.

**IFRS 13 FAIR VALUE MEASUREMENT (“IFRS 13”)**

IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. Many of the concepts in this new standard are consistent with current practice; however, the disclosure requirements are substantial and could present additional challenges. IFRS 13 is effective for annual periods commencing on or after January 1, 2013 and will be applied prospectively. The Company is not anticipating any significant changes to its financial results or disclosures as a result of adopting IFRS 13 on January 1, 2013.

## 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 industries, 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 DEBT FINANCING

Subordinated financings that are carried on by the Company would generally be considered riskier than primary financing because the Company will not have a first-ranking charge on the underlying property. When a charge on a property is in a position other than first-ranking, it is possible for the holder of a prior charge on the property to realize on the security given for the loan, in priority to and to the detriment of the Company's security interest in such property or security.

### 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 VENTURES**

In any joint venture in which the Company invests, the Company may not be in a position to exercise sole decision-making authority. Investments in joint ventures may, under certain circumstances, involve risks not present when a third party is not involved, including the possibility that joint venture partners might become bankrupt or fail to fund their share of required capital contributions. Joint venture 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 venture 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 venture partners.

### **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 regulations.

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 year ended December 31, 2012.

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 regulations.

Based on their evaluations as of December 31, 2012, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's internal controls over financial reporting were effective as at December 31, 2012.

## FUTURE OUTLOOK

The objective of the Company is to provide attractive returns to shareholders over the long-term, through appreciation in net book value. 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. Management believes there will be significant opportunities for the Company to expand its presence in the market; however, it continues to be prudent in its approach to selection of new investments and pricing. Management expects to be able to generate interest rates similar to those reflected in the current portfolio in 2012.

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.

## 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, 2012 and 2011 and the unaudited condensed consolidated interim consolidated financial statements and accompanying notes.

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<br>December 31,<br>2012      | As at<br>December 31,<br>2011 <sup>(1)</sup>      |
|--|------------------------------------|---|
| Total assets   | \$ 46,400,778                      | \$ 29,536,401                                     |
| Total liabilities  | \$ 33,644,832                      | \$ 18,289,275                                     |
| Shareholders' equity   | \$ 12,755,946                      | \$ 11,247,126                                     |
| Loan and mortgage investments  | \$ 31,996,731                      | \$ 16,724,774                                     |
| Loans and mortgages payable  | \$ 21,406,070                      | \$ 6,777,907                                      |
| Loans and mortgage loans payable to loan and mortgage investment               | 66.9%                              | 40.5%   |
|  | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2011 <sup>(1)</sup> |
| Total revenue  | \$ 5,500,623                       | \$ 1,526,319                                      |
| Total expenses   | \$ 3,454,010                       | \$ 1,043,945                                      |
| Income from continuing operations before income taxes                          | \$ 2,046,613                       | \$ 677,374  |
| Net income and comprehensive income  | \$ 1,251,980                       | \$ 287,322  |
| Weighted average number of shares outstanding                                  | 30,517,541                         | 19,120,808  |
| Basic and diluted earnings (loss) per share                                    |                                    |   |
| Continuing operations  | \$ 0.05                            | \$ 0.03   |
| Discontinued operations  | \$ (0.01)                          | \$ (0.01)   |
| <sup>(1)</sup> Certain amounts have been restated. See Accounting Adjustments. |                                    |   |

## TERRA FIRMA CAPITAL CORPORATION – MD&A

The following table sets out the Company's quarterly results of operations for the eight periods ended December 31, 2012.

|  | Three months ended   |                       |                  |                   |                                     |                                      |                                 |                                  |
|--|----------------------|-----------------------|------------------|-------------------|-------------------------------------|--------------------------------------|---------------------------------|----------------------------------|
|  | December 31,<br>2012 | September 30,<br>2012 | June 30,<br>2012 | March 31,<br>2012 | December 31,<br>2011 <sup>(1)</sup> | September 30,<br>2011 <sup>(1)</sup> | June 30,<br>2011 <sup>(1)</sup> | March 31,<br>2011 <sup>(1)</sup> |
| <b>Revenue</b>                                       |                      |                       |                  |                   |                                     |                                      |                                 |                                  |
| Interest and fees earned                             | 1,897,945            | 1,234,250             | 1,058,183        | 966,287           | 749,883                             | 247,125                              | 176,915                         | 178,201                          |
| Rental income  | 195,113              | 49,607                | 49,606           | 49,632            | 55,305                              | 47,388                               | 47,373                          | 24,129                           |
|  | 2,093,058            | 1,283,857             | 1,107,789        | 1,015,919         | 805,188                             | 294,513                              | 224,288                         | 202,330                          |
| <b>Expenses</b>                                      |                      |                       |                  |                   |                                     |                                      |                                 |                                  |
| Property operating expenses                          | 76623                | 17512                 | 17513            | 17,538            | 17,834                              | 15,294                               | 66,699                          | 7,495                            |
| General and administrative expenses                  | 134,629              | 143,385               | 133,199          | 127,765           | 93,829                              | 52,870                               | -                               | 47,207                           |
| Share based compensation                             | 15,369               | 41,803                | 129,311          | 30,357            | 32,608                              | -                                    | -                               | 252,390                          |
| Interest expense                                     | 888,303              | 681,942               | 503,070          | 495,691           | 294,562                             | 66,189                               | 52,776                          | 44,192                           |
|  | 1,114,924            | 884,642               | 783,093          | 671,351           | 438,833                             | 134,353                              | 119,475                         | 351,284                          |
| Fair value adjustment of investment properties       | -                    | -                     | -                | -                 | 50,000                              | -                                    | -                               | 145,000                          |
| Income before income taxes                           | 978,134              | 399,215               | 324,696          | 344,568           | 416,355                             | 160,160                              | 104,813                         | (3,954)                          |
| Income tax provision                                 | 249,445              | 109,061               | 112,462          | 91,352            | 110,210                             | 57,000                               | 10,586                          | 19,414                           |
| Income from continuing operations                    | 728,689              | 290,154               | 212,234          | 253,216           | 306,145                             | 103,160                              | 94,227                          | (23,368)                         |
| Loss from discontinued operations                    | (232,313)            | -                     | -                | -                 | 1,928                               | (194,299)                            | (153)                           | (318)                            |
| <b>Net income and comprehensive income</b>           | <b>496,376</b>       | <b>290,154</b>        | <b>212,234</b>   | <b>253,216</b>    | <b>308,073</b>                      | <b>(91,139)</b>                      | <b>94,074</b>                   | <b>(23,686)</b>                  |
| <b>Weighted average number of shares outstanding</b> |                      |                       |                  |                   |                                     |                                      |                                 |                                  |
| basic and diluted                                    | 30,518,087           | 30,495,000            | 30,518,087       | 30,518,087        | 20,321,087                          | 18,795,000                           | 18,795,000                      | 18,556,333                       |
| <b>Basic and diluted earnings (loss) per share</b>   |                      |                       |                  |                   |                                     |                                      |                                 |                                  |
| Continuing operations                                | \$ 0.02              | \$ 0.01               | \$ 0.01          | \$ 0.01           | \$ 0.01                             | \$ 0.01                              | \$ 0.01                         | \$ -                             |
| Discontinued operations                              | (0.01)               | -                     | -                | -                 | -                                   | (0.01)                               | -                               | -                                |

(1) Certain amounts have been restated. See Accounting Adjustments.

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: April 30, 2013  
Toronto, Ontario, Canada