

Armada Mortgage Corp.
Financial Statements
December 31, 2013

Management's Responsibility

To the Shareholders of Armada Mortgage Corp.:

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors is composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Board fulfils these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and external auditors.

MNP LLP is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Committee and management to discuss their audit findings.

March 5, 2014

"Gordon Hone" (signed)
President

Independent Auditors' Report

To the Shareholders of Armada Mortgage Corp.:

We have audited the accompanying financial statements of Armada Mortgage Corp., which comprise the balance sheet as at December 31, 2013, and the statements of loss and retained earnings (deficit) and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Armada Mortgage Corp. as at December 31, 2013, and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Maple Ridge, British Columbia

March 5, 2014

MNP LLP
Chartered Accountants

Armada Mortgage Corp.

Balance Sheet

As at December 31, 2013

	2013	2012
Assets		
Current		
Term deposit	-	250,527
Accounts receivable	-	1,664
Accrued interest receivable (Note 3)	73,467	114,224
Current portion of mortgages receivable (Note 4)	14,074,299	12,324,627
	14,147,766	12,691,042
Mortgages receivable (Note 4)	891,891	2,087,764
	15,039,657	14,778,806
Liabilities		
Current		
Bank indebtedness (Note 5)	67,909	131,434
Accounts payable and accrued liabilities	108,595	38,971
Dividends payable	-	602
Deferred income	56,776	33,085
	233,280	204,092
Redeemable preferred shares (Note 6)	14,829,666	14,431,298
	15,062,946	14,635,390
Shareholders' Equity (Deficit)		
Share capital (Note 7)	101	102
Retained earnings (deficit)	(23,390)	143,314
	(23,289)	143,416
	15,039,657	14,778,806
Approved on behalf of the Board		
<u>"Ed Monteiro" (signed)</u> Director	<u>"Joan Peacock" (signed)</u> Director	

The accompanying notes are an integral part of these financial statements

Armada Mortgage Corp.
Statement of Loss and Retained Earnings (Deficit)
For the year ended December 31, 2013

	2013	2012
Revenue		
Interest income	956,524	1,106,847
Lender fees	70,453	76,107
Other fees	9,275	17,263
Discharge fees	1,350	1,425
	1,037,602	1,201,642
Expenses		
Accounting and audit fees	14,300	18,024
Advertising and promotion	4,360	6,534
Bad debts	6,215	-
Bank charges and interest	16,299	6,307
Consulting fees	3,401	4,594
Dividends	762,221	896,218
Insurance, licenses and dues	1,226	259
Legal fees	4,934	15,908
Management fees	224,492	214,133
Office	5,609	5,636
Repairs and maintenance	414	704
	1,043,471	1,168,317
Earnings (loss) from operations	(5,869)	33,325
Other expense		
Unrealized loss on accrued interest <i>(Note 3)</i>	-	(6,954)
Unrealized loss on mortgages <i>(Note 4)</i>	(160,835)	(68,046)
	(160,835)	(75,000)
Net loss	(166,704)	(41,675)
Retained earnings, beginning of year	143,314	184,989
Retained earnings (deficit), end of year	(23,390)	143,314

The accompanying notes are an integral part of these financial statements

Armada Mortgage Corp.
Statement of Cash Flows
For the year ended December 31, 2013

	2013	2012
Cash provided by (used for) the following activities		
Operating activities		
Net loss	(166,704)	(41,675)
Unrealized loss on mortgages	160,835	68,046
Unrealized loss on accrued interest	-	6,954
	(5,869)	33,325
Changes in working capital accounts		
Accounts receivable	1,664	(1,164)
Accrued interest receivable	40,757	(57,925)
Accounts payable and accrued liabilities	69,624	(2,359)
Dividends payable	(602)	388
Deferred income	23,691	(30,657)
	129,265	(58,392)
Financing activities		
Redemption of common shares	(1)	(15)
Increase in redeemable preferred shares, net	398,368	423,429
Bank indebtedness	(10,000)	40,000
	388,367	463,414
Investing activities		
Purchase of term deposit	-	(250,527)
Advances of mortgages receivable, net	(714,634)	(556,746)
Redemption of term deposit	250,527	-
	(464,107)	(807,273)
Increase (decrease) in cash resources	53,525	(402,251)
Cash resources (deficiency), beginning of year	(91,434)	310,817
Cash deficiency, end of year	(37,909)	(91,434)
Supplementary cash flow information		
Dividends paid	762,221	896,218
Interest paid	14,394	3,188

The accompanying notes are an integral part of these financial statements

1. Incorporation and operations

Armada Mortgage Corporation (the "Company") was incorporated under the laws of the Province of British Columbia on December 29, 1995. The Company is a Mortgage Investment Corporation (MIC) within the meaning assigned by Subsection 130.1(6) of the Income Tax Act (Canada). The Company must continue to comply with the rules under the Income Tax Act to qualify as a MIC. In general terms, the assets of the Company must be invested in Canadian mortgages of which at least 50 percent must be in residential mortgages as defined under the Residential Mortgage Financing Act. Dividends paid during the year or within 90 days after the year-end can be deducted from income for tax purposes.

The primary mandate of the Company is to invest its pooled funds into residential mortgages and to provide its shareholders with an acceptable rate of return on their invested capital. The Company is considered a qualified investment for each of Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Education Savings Plans, Registered Disability Savings Plans, and Tax Free Savings Accounts.

2. Significant accounting policies

The financial statements have been prepared in accordance with Part V of Canadian generally accepted accounting principles as issued by the Accounting Standards Board in Canada using the following significant accounting policies:

Basis of presentation

The Company is an investment company as defined in Canadian generally accepted accounting principles Accounting Guideline 18, *Investment Companies*. As a result, mortgages receivable are recorded at fair value, with any changes in the fair value recorded in the statement of earnings and retained earnings.

Foreclosed assets

Foreclosed assets held for sale are recorded at the lower of cost and estimated net realizable value. Cost is comprised of the balance of the loan at the date on which the Company obtains title to the assets plus subsequent disbursements related to the assets, less any revenues or lease payments received.

Revenue recognition

Interest income from mortgages receivable is recognized over time based on the specific terms of each mortgage.

Lender fees are initially recorded as deferred income on the balance sheet. The amount is recognized as income on a straight-line basis over the term of the mortgage.

Other fees and discharge fees are recorded as income at the time the service is rendered in the normal course of business.

Mortgage Investment Corporation ("MIC") eligibility criteria

To qualify as a MIC for Canadian income tax purposes the Company must comply with the following:

- i) At least 50% of the Company's assets must consist of residentially orientated mortgages and/or cash;
- ii) The Company's only business activity is investing funds of the corporation and not managing or developing any real property;
- iii) The Company must not hold any investments secured by real property situated outside Canada; and
- iv) No shareholder may own more than 10% of the issued shares of any class at any time during the year and there must be at least 20 shareholders.

In the opinion of management, these requirements have been met.

2. **Significant accounting policies** *(Continued from previous page)*

Income taxes

The Company is a mortgage investment corporation ("MIC") for income tax purposes. As such, the Company is able to deduct, in computing its income for a taxation year, dividends paid to its shareholders during the year or within 90 days of the end of the year. The Company intends to maintain its status as a MIC and pay dividends to its shareholders in the year and in future years to ensure that it will not be subject to income taxes. Accordingly, for financial statement reporting purposes, the tax deductibility of the Company's distribution results in the Company being effectively exempt from taxation and no provision for current or future income taxes is required for the Company.

Shareholders who received dividends from the Company, other than capital gains dividends, will be deemed for income tax purposes to have received interest payable on a bond issued by the Company and will be subject to Canadian income or withholding taxes accordingly.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

Market instability can expose the Company to fluctuations in unanticipated weaknesses in asset prices, and constraints on liquidity, credit and access to capital. This can impact the Company's ability to reliably calculate the value of the underlying properties within mortgages receivable. By their nature, these judgments are subject to measurement uncertainty, and the effect on the financial statements of changes in such estimates and assumptions in future periods could be significant.

These estimates and assumptions are reviewed periodically and, as adjustments become necessary they are reported in earnings in the periods in which they become known.

Allowance for loan impairment

Allowance for loan impairment represents specific and general provisions established as a result of reviews of individual loans and groups of loans. Specific allowances are established by reviewing the credit worthiness of individual borrowers and the value of the collateral underlying the loan. General allowances are established by reviewing specific arrears and current economic conditions.

Restructured loans are not considered impaired where reasonable assurance exists that the borrower will meet the terms of the modified debt agreement.

Loans are classified as impaired, and a provision for loss is established, when there is no longer reasonable assurance of the timely collection of the full amount of principal or interest.

In such cases, a specific provision is established to write-down the loan to the estimated future net cash flows from the loan discounted at the rate inherent in the loan when impairment was recognized. In cases where it is impractical to estimate the future cash flows, the carrying amount of the loan is reduced to its estimated realizable value.

Accrual of interest is discontinued and any previously accrued but unpaid interest on the loan is charged to allowance for loan impairment.

2. **Significant accounting policies** *(Continued from previous page)*

Financial Instruments

Fair value through profit and loss

The company has classified the following financial assets at their fair values: cash and term deposits. These instruments are initially recognized at their fair value. Fair value is determined by published price quotations in an active market or approximated by the instrument's initial cost in a transaction between unrelated parties

These instruments are subsequently measured at their fair value. Any gains or losses arising as a result of the difference between the carrying amount and fair value is recognized in net income.

Loans and receivables:

The Company has classified the following financial assets as loans and receivables: accounts receivable, accrued interest receivable, and mortgages receivable. These assets are initially recognized at their fair value. Fair value is determined by reference to recent arm's length market transactions for the same instrument approximated by the instrument's initial cost in a transaction between unrelated parties.

Loans and receivables are subsequently measured at their amortized cost, using the effective interest method. Under this method, estimated future cash receipts are exactly discounted over the asset's expected life, or other appropriate period, to its net carrying value. Amortized cost is the amount at which the financial asset is measured at initial recognition less principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and less any reduction for impairment or uncollectability. Gains and losses arising from changes in fair value are recognized in net income upon derecognition or impairment.

Other financial liabilities:

The Company has classified the following financial liabilities as other financial liabilities: bank indebtedness, accounts payable and accrued liabilities and dividends payable. These liabilities are initially recognized at their fair value. Fair value is determined by recent arm's length market transactions for the same instrument approximated by the instrument's initial cost in a transaction between unrelated parties.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Under this method, estimated future cash payments are exactly discounted over the liability's expected life, or other appropriate period, to their net carrying value. Amortized cost is the amount at which the financial liability is measured at initial recognition less principal repayments, and plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount. Gains and losses arising from changes in fair value are recognized in net income upon derecognition.

2. **Significant accounting policies** (Continued from previous page)

Recent accounting pronouncements

Adoption of International Financial Reporting Standards

The Canadian Accounting Standards Board (AcSB) has confirmed that International Financial Reporting Standards (IFRS) will replace current Canadian GAAP for fiscal years beginning on or after January 1, 2011, for publicly accountable enterprises. In December 2011 the AcSB announced amendments which will provide investment companies with the option to defer adoption of IFRS until fiscal years beginning on or after January 1, 2014. As a result of the amendments, the Company will adopt IFRS at the earliest beginning January 1, 2014, and will issue its first annual financial statements in accordance with IFRS, including comparative IFRS information for the previous fiscal year, for the year ending December 31, 2014.

Management is required to provide progress updates on the entity's IFRS changeover plan at each interim and annual reporting period up until the changeover date.

The Company is evaluating the potential impact of adopting IFRS on its financial statements and is developing a changeover plan to adopt the standards. The key elements of the plan include assessing the impact of adopting IFRS on:

- Accounting policies;
- IT and data systems;
- Internal controls over financial reporting;
- Disclosure controls and procedures; and
- Business activities as well as matters that may be influenced by GAAP measures (such as debt covenants, capital requirements and compensation arrangements).

The changeover plan is still in the early stages of development and, as a result, the impact of adopting IFRS on the Company's financial reporting is not reasonably determinable.

3. **Accrued interest receivable**

	2013	2012
Accrued interest receivable	80,421	121,178
Less: Unrealized loss on accrued interest	(6,954)	(6,954)
	73,467	114,224

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4. Mortgages receivable

Mortgages receivable are secured by various properties of the borrowers with original terms ranging from twelve to sixty months and amortization periods of one to forty years. All performing mortgage repayments are being received monthly, including principal and interest ranging from 6.50% to 12.99% per annum. There are six non-performing mortgages totalling \$2,124,920 (2012 - \$1,437,398). An allowance of \$228,881 (2012 - \$68,046) has been set-up in respect of these non-performing mortgages.

A Victoria area property where The Company had a first mortgage suffered extensive fire damage and the owner was denied the insurance claim. Management took legal action against the insurance company and was successful in obtaining \$200,499 for property damage. A further balance is expected to be received from the sale of the property, however a loss allowance of \$123,881 was required due to the event.

An Abbotsford area business and property owner, where The Company had funded a second mortgage, suffered a complete business failure. Although funded with a loan to value ratio of 63%, a loss allowance of \$105,000 was required on the property due to the depressed real estate market.

	2013	2012
Current portion of mortgages receivable	14,303,180	12,392,673
Less: Unrealized loss on mortgage	(228,881)	(68,046)
	14,074,299	12,324,627
Long-term portion of mortgages receivable	891,891	2,087,764
	14,966,190	14,412,391

The portfolio consists of:

	2013						2012		
Number of mortgages in 1st position	41	91.83%	13,744,033	40	71.43%	10,296,758			
Number of mortgages in 2nd position	12	7.66%	1,145,157	16	28.57%	4,115,633			
Number of mortgages in 3rd position	1	0.51%	77,000						
Average mortgage balance			277,151			257,364			
Weighted-average yield		6.93%			8.34%				

The weighted-average yield on the mortgage balances is based on the pro-rata return to the Company of both the lender fee and interest income over the term of the related mortgages.

The number of mortgages in second and third position contains all inter alia mortgages where a second or third position is held.

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5. Bank indebtedness

	2013	2012
TD Chequing Account	37,909	91,434
TD Revolving Line of Credit	30,000	40,000
	67,909	131,434

The Company has a \$5,000,000 revolving line of credit of which \$30,000 (2012 - \$40,000) was drawn upon as at December 31, 2013. The credit line is secured by a general security agreement representing a first charge on all the assets and undertakings of the Company (book value \$15,039,657 (2012 - \$14,778,806)).

During the year the Company has complied with the following covenants:

- (a) The sum of all mortgages are not to exceed 75% of the sum of all property market values;
- (b) Provide audited financial statements within 90 days of fiscal year-end;
- (c) Provide the Bank notification in writing of any shares sale/RRSP redemption request in excess of \$50,000 detailing the expected source and date of payout(s);
- (d) Be subject to annual audit and review of mortgage files by the Bank of a minimum of 10% of total outstanding mortgages comprising at minimum 20% of the outstanding portfolio amount;
- (e) Provide the Bank a monthly breakdown of the mortgage portfolio in the format specified by the Bank within 30 days of each month-end, complete with a compliance certificate from a senior officer of the Borrower;
- (f) There will be no change to the company's structure or material ending policy without prior consent of the Bank;
- (g) The Company will not incur additional debt against mortgages secured by the Bank's General Security Agreement;
- (h) Agrees to maintain a Debt to Tangible Net Worth ratio of no greater than 0.5:1 and
- (i) Agrees to maintain an Interest Coverage ratio of not less than 300%.

6. Redeemable Preferred Shares

The preferred shares have been classified as financial liabilities of the Company as they are redeemable at the option of the holder. The holders of the preferred shares may redeem their shares for the purchase price. In the event there are insufficient funds from the repayment of mortgages held by the Company to redeem all shares for which a notice has been given, then such shares shall be redeemed in the order and amount for which such funds are and become available. The Company shall not be obligated to redeem any shares if such a redemption would result in the loss of the Company's status as a mortgage investment corporation within the meaning of the Income Tax Act.

Holders of the common shares of the Company are not entitled to dividends. All profits available for the payment of dividends are to be paid to the holders of the Class "A" preferred non-voting shares ratably according to the amounts paid-up thereon. The Company's policy is to make monthly advance payments on an annual dividend that is declared annually and must be paid within three months of the fiscal year-end.

During the current year, there was a total of 558,884 preferred shares issued and 160,516 preferred shares redeemed, each with a par value of \$1.

	2013	2012
Class "A" redeemable, non-voting preferred shares with a par value of \$1	14,829,666	14,431,298

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7. Share capital

	2013	2012
Authorized		
Common shares		
Unlimited - without par value		
Preferred shares		
Unlimited - Class "A" non-voting with a par value of \$1 each		
Issued		
101 Common shares without par value	101	102

Holders of the common shares of the Company are not entitled to dividends. All profits available for the payment of dividends are to be paid to the holders of the Class "A" preferred non-voting shares ratably according to the amounts paid-up thereon. The Company's policy is to make monthly advance payments on an annual dividend that is declared annually and must be paid within three months of the fiscal year-end.

	2013		2012	
	Number	Amount	Number	Amount
Common shares				
Opening balance	102	102	117	117
Common shares issued	-	-	62	62
Common shares redeemed	(1)	(1)	(77)	(77)
Closing balance	101	101	102	102

8. Related party transactions

Included in expenses for the current year are management fees in the amount of \$224,492 (2012 - \$214,133) paid to corporations controlled by certain directors of the Company for the provision of financial and administrative services. These transactions were conducted in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed upon by the related parties.

9. Financial instruments

Fair value

The carrying amount of cash, term deposits, accounts receivable, accrued interest receivable, bank indebtedness, accounts payable and accrued liabilities, deferred income and dividends payable approximates their fair value due to the short-term maturities of these items.

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. As there are no quoted prices in an active market for mortgage investments, management makes its determination of fair value based on its assessment of the current mortgage market investments of same or similar terms. The fair value of mortgage receivable approximates their carrying values due to the fact that the majority of the mortgages are short-term in nature with terms of 12 months or less.

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates and that at the end of a mortgage's term, it will be re-priced to a prevailing interest rate lower than the original one. In seeking to minimize the risks from interest rate fluctuations, the Company manages exposure through its normal operating and financing activities. The Company is exposed to interest rate risk primarily through its mortgages receivable. As a significant portion of the mortgages receivable are short-term in nature and all of the mortgages have a fixed interest rate which is significantly higher than the bank prime rate, the interest rate risk is mitigated.

Credit risk

Credit risk arises from the possibility that mortgagors may experience financial difficulty and be unable to fulfil their mortgage commitments. The Company limits its credit risk by limiting its exposure to any one mortgagor and by requiring collateral which is greater than the mortgage value.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial obligations as they become due. This risk arises in normal operations from fluctuations in cash flow as a result of the timing of mortgage investment fundings and repayments and redemptions of shares. Management routinely forecasts future cash flow sources and requirements to ensure cash is efficiently utilized.

The Company manages liquidity risk by investing in mortgages receivable with short-term maturities and declaring dividends based on cash availability.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or foreign currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. The Company enters into transactions to advance funds on mortgages where an interest rate based upon current mortgage interest rates is charged on the advance date. Should market mortgage interest rates fluctuate in the short-term, the fair value of the mortgages receivable will fluctuate.

The Company manages its other price risk by investing in mortgages receivable with short-term maturities to minimize fluctuations in fair value as a result of market mortgage interest rate changes.

10. Simple Average Rate of Return to Investors

The simple average rate of return to the investors of the Company is calculated as the dividends paid out during the year plus the ending retained earnings less the beginning retained earnings all divided by the average of the Class "A" preferred non-voting shares for the current year.

	2013	2012
Simple average rate of return to investors	4.07%	6.01%

The simple average rate of return to the investors of the Company since inception is 6.92% (2003 to 2012 - 7.21%).

11. Compliance with Mortgage Brokers Act

The Company did not handle or receive trust funds when transacting their mortgage activities and no funds were received that should have been held in trust.

12. Capital management

The Company sets the amount of capital in proportion to risk and manages the capital structure and makes adjustments to it in light of changes to economic conditions and the risk characteristics of the underlying asset mortgage receivables.

The Company is subject to a debt to tangible net worth ratio capital requirement imposed by the Toronto Dominion Bank with regard to maintaining a ratio no greater than 0.5 to 1. In order to maintain this requirement the Company limits the amount of debt the Company holds during the year. During the year ended December 31, 2013, the Company complied with the capital requirement (0.013 to 1).

13. Comparative figures

Certain comparative figures have been reclassified to conform with current year presentation.