

Orchard Calgary Inc. – High Rise Condo Development by Fortress and Lamb Developments

Sector/Industry: Bond Offering / Real Estate

www.fortressrealdevelopments.com

Summary of Proposed Offering

Issuer	Orchard Calgary Inc
Offer Min/Max	\$0.1 million min / \$32.7 million max
Minimum Investment	\$25,000 (25 bonds)
Securities Offered	Bonds
Expected Return	8% p.a. bonds paid quarterly + additional return based on profitability.
Maturity of Bonds	Sept 30, 2018. Management may extend for 2 years and has prepayment option
Sales Fee	10.35% of the gross amount + 4.65% of the gross amount to wholesalers
Auditor	Rice & Company LLP

Based on Offering Memorandum (“OM”) dated September 25, 2014

Investment Highlights

- Orchard Calgary Inc. (“corporation”) is offering 8% p.a. bonds to investors. The funds will be used for the development of the Orchard Calgary Development in Calgary, Alberta.
- The development is a partnership between Fortress Real Developments (“Fortress”) and Lamb Development Corporation (“Lamb”). This will be the 10th joint development between the two companies.
- Fortress specializes in partnering with established developers to finance and assist in developing real estate projects.
- Lamb is a growing Canadian high rise developer who has completed over 1,100 residential units since 2001, and currently has over 3,000 residential units in development.
- Orchard is being developed on a 38,000 sq. meter land parcel in central Calgary.
- Plans are for two 31 storey towers with 432 residential units. The towers will also contain retail space on the ground floors.
- Presales of the units started last month. Management notes that over 30% of the units in the first tower are already sold.
- Management has estimated the total cost to complete the development, including land, to be \$128 million (excluding financing costs).
- The bonds have a term of four years, and investors are expected to receive interest payments quarterly. Fortress may extend the maturity of the bonds by two years. Investors may also receive a one-time additional return based on the profitability of the project.

Risks

- There is no secondary market, and no early redemption options.
- The project will need to secure additional financing for construction.
- Fortress intends to raise capital in stages to meet interest payments to investors when they are due.
- Bond security will be subordinate to other financings (construction financing).
- The development of the property may be subject to delays, and not completed on time, which may negatively impact returns.
- Pre-payment risks exist as management can repay principal prior to maturity.
- The development costs incurred could exceed current estimates.
- A downturn in the real estate market could negatively affect investors’ returns.
- The plans for the development has not been finalized; permits and approvals will be required.
- Returns are sensitive to several factors such as costs, time horizon, sales price etc.

FRC Rating

Expected IRR 8% p.a.

Rating 4+

Risk 5

*see back of report for rating definitions

Background

Orchard Calgary Inc., incorporated in March 2014, is seeking to raise up to \$32.7 million to fund the initial costs of a multi-phase residential condominium project in Calgary, Alberta. The development will be co-managed by Fortress and Lamb.

The project is at the 600 block of 12th avenue south east, which is just minutes from downtown Calgary. The project plan is for two residential towers, which will be constructed in two phases. The first phase is a 215 unit (31 storeys) tower with approximately 18,147 sq. meters of gross floor area (“GFA”). The second tower is a 217 unit (31 storeys) tower with 18,283 sq. meters of GFA. There will be retail space located on the ground floor and an apple orchard is planned to separate the buildings.

Fortress has currently raised \$12.3 million from a syndicate mortgage offering in Ontario. The terms of the Ontario offering are the same as this offering. There is also a \$4.3 million mortgage on the parcel of land. Management currently has enough funds to pre-sell the building and for immediate soft costs. Funds from this offering will be used in conjunction with the Ontario offering to advance the project so that management can seek construction financing.

The construction of the sales center has commenced and pre-sales have started. Management is estimating preliminary development of the property to be completed in 6-18 months. This would include engineering work, zoning and presale completion. Once completed, management will look to secure construction financing for the project. Following that, construction will take place, which is estimated to take 2 - 3.5 years to complete. **Based on this timeline, management estimates a time to completion of 3 - 5 years.**

Management

Fortress and Lamb will be co-developers of this project. The two companies have partnered on 10 previous developments, all within the last 3 years. Fortress has also chosen Scott Construction to construct the development.

Scott is a construction company based in Vancouver, B.C. founded in 1984. Their past projects have included industrial, commercial and residential projects primarily located in the Greater Vancouver area, but they have also expanded into Calgary. Scott is currently constructing Fortress and Lamb’s “6th and Tenth” project in Calgary.

Biographies of the key management for Lamb Developments and Fortress are presented below.

Brad Lamb

Mr. Lamb is the president of Brad J. Lamb Realty Inc. Over the last 20 years, he has led the marketing and sales programs for dozens of condominium projects in Toronto, Ottawa and Montreal. Mr. Lamb is acknowledged in Toronto as one of the city’s foremost condominium

sales experts. His firm has acted as the exclusive broker at namesake developments such as The Candy Factory, Tip Top Lofts, Glas, 550 Wellington West, 75 Portland and others. To date, he has been involved in over 13,000 condo sales for over \$3.5 billion dollars.

Jawad Rathore – CEO of Fortress Real Developments

Mr. Rathore began his career in the financial services industry. Mr. Rathore started his own firm in 2001 and in 2002 was joined by Vince Petrozza and that has evolved into Fortress Real Developments. Fortress has raised over \$400+ million for real estate projects. The company is based out of Toronto, but has expanded to include projects in Ottawa, Regina, Calgary, Winnipeg and British Columbia. Mr. Rathore is a graduate of York University.

Vince Petrozza – COO Fortress Real Developments

Mr. Petrozza leads the mortgage operations and syndicated investment side of Fortress. He is in charge of the due diligence and the adjudication process for evaluating possible Fortress developments. Mr. Petrozza is a sub mortgage broker and has been in the financial services sector for over 10 years.

In 2011, Mr. Rathore and Mr. Petrozza agreed to an OSC settlement, restricting them from participating in the securities markets. The OSC settlement notes that Mr. Rathore and Mr. Petrozza did not disclose compensation they received from recommending certain securities. As a result of the settlement with the OSC, Mr. Rathore and Petrozza agreed to pay \$3 million in the settlement (including administrative costs). **The settlement places no restrictions on their mortgage lending practice. Mr. Rathore has also been subject to disciplinary action by the Mutual Fund Dealers Association in 2005.**

Background

Lamb Development Corporation was founded in 2001 by Brad Lamb. Prior to that, Mr. Lamb had over 13 years of experience consulting, marketing and selling over 100 of Toronto’s residential developments. **Since inception, they have completed 8 residential developments with over 1,100 residential units (see table below).**

*Lamb
Development
Corporation*

Completed projects	Units	Location
East	129	Toronto
Flatiron Lofts	96	Toronto
Glas	163	Toronto
Mcgill Quest	245	Montreal
OneSixNine	46	Toronto
Parc	103	Toronto
The King East	215	Toronto
Work Lofts	153	Toronto

As shown in the table above, all of them, except one, have been developments in Toronto. Lamb has not provided us with any information on the financial performance (including investors' return on investment) of the above projects. However, we have confirmed that all the above developments are completed.

Lamb has 5 development projects currently under construction, and an additional 6 projects in various development phases, listed below. Fortress is their partner on all these projects except the Theatre Park. The following table shows a summary of these projects.

Under Construction	Units	Location	Expected completion	Start Date	Amount raised
6th and Tenth	230	Calgary	Sep-16	December 20, 2011	\$8.8
King Charlotte	232	Toronto	May-15	November 3, 2010	\$8.6
Gotham	250	Ottawa	Jul-15	April 18, 2011	\$6.6
Brand Park	234	Toronto	Nov-15	June 27, 2011	\$8.5
Theatre Park	236	Toronto	N/A	N/A	N/A

In Development	Units	Location	Status	Start Date	Amount raised
The Harlowe	210	Toronto	Pre-sales	September 1, 2013	\$7.9 *
Bronson	209	Ottawa	Pre-development	October 15, 2013	\$8.5
Soba	240	Ottawa	Pre-development	October 20, 2011	\$6.9
Orchard	485	Calgary	Pre-sales	April 16, 2014	\$32.7 *
North	350	Edmonton	Closing on land	July 9, 2014	\$25.0 *
Jasper House	260	Edmonton	Pre-Development	June 30, 2014	\$18.5 *

*Denotes maximum raise

Source: Management (amount in millions)

Fortress Real Developments

Fortress partners with development companies on residential condominiums in major Canadian cities. Fortress assists in raising a portion of the required capital for the developments. The company was formally founded in 2009, but management states they had been operating previous businesses that eventually developed into Fortress.

For the below discussion, all the information was provided by management, unless otherwise specified.

Fortress has raised funds for 61 total projects. The total capital raised to date is \$398

million. The terms of most of these offering are generally between 18 - 48 months, with the majority in the 24 - 36 month range.

The capital raised per project ranged from \$0.35 million to \$32.7 million. **To date, Fortress has exited 4 projects** - Dufferin Medical, Lakeshore Avalon, Munir, and Helen Avenue with annualized rates of return to investors of 9.66%, 16.26%, 8% and 11%, respectively. The time horizon was under 3 years for all three investments. The total value of the capital raised was \$1.2 million for Dufferin, \$1.5 million for Avalon, \$2.9 million for Munir and \$1.8 million for Helen. We have verified distributions to Avalon investors by reviewing trustee documents. For Dufferin, we reviewed letters from the lawyer (third-party) administering the funds. **For Munir and Helen, we have reviewed documentation from Deloitte showing cash flows back to investors.**

The following shows a list of projects Fortress has raised funds for during 2009 – 2013. In order to meet interest payments on the issued bonds, Fortress may raise the maximum capital (as per the OM) upfront and maintain a reserve for interest payments, or raise capital in stages.

History of Fortress projects (red notes exits)

Project	Capital Raised for the Project	Date started*	Term	Maturity
1088 Progress	\$ 13,350,000	September 10, 2012	36	10-Feb-16
6th and Tenth	\$ 8,828,600	December 20, 2011	24	27-Jun-15
Bronson	\$ 8,520,850	October 15, 2013	36	15-Oct-17
Burlington (Modern)	\$ 4,155,000	June 28, 2012	24	25-Jun-14
Brant Park	\$ 7,965,500	June 27, 2011	36	30-Nov-15
Burlington on the water	\$ 5,000,000	July 15, 2013	36	15-Jul-17
Capital Pointe	\$ 7,500,000	October 6, 2011	36	15-Aug-17
Collier	\$ 16,946,950	August 21, 2012	24	01-Feb-15
Countryside Crossing (Gas)	\$ 1,538,000	September 13, 2012	24	10-Apr-15
Crates Landing	\$ 8,600,000	February 3, 2011	36	21-Jul-17
Dufferin Medical	\$ 1,196,900			
Eldin	\$ 2,791,300	September 29, 2009		01-Dec-15
Glens of Halton Hills	\$ 7,543,400	November 15, 2012	36	15-Jun-16
Gotham	\$ 6,595,600	April 18, 2011	36	05-Jul-15
Harris Beech	\$ 2,230,000	March 15, 2013	36	15-Mar-17
Harmony Village Lake Simco	\$ 16,301,173	May 25, 2012	48	26-Oct-16
Harmony Village Sheppard	\$ 16,289,290	February 3, 2012	48	15-May-18
Helen	\$ 1,846,154	October 5, 2011	24	12-Sep-13
King Charlotte	\$ 8,056,017	November 3, 2010	24	01-May-15
King City	\$ 5,210,000	March 19, 2012	36	31-Mar-16
Lakeshore Avalon	\$ 1,495,000			
Langston Hall 1	\$ 3,300,000	February 24, 2010	36	Jan 2020
Langston Hall 2	\$ 4,400,000	January 11, 2011	36	Jan 2020
Live Work Play	\$ 12,030,100	August 31, 2013	48	31-Aug-18
Kipling Court	\$ 10,500,000	November 23, 2013	48	28-Nov-18
Mapleview	\$ 5,410,900	August 10, 2012	36	16-Jan-16
Mayfield	\$ 1,622,500	July 31, 2012	24	20-Apr-15
Mayfield 2	\$ 3,070,000	August 20, 2012	24	April 31, 2017
Mayfield 3	\$ 2,700,000	October 31, 2013	36	01-May-19
Mississauga Meadows 1	\$ 5,209,230	September 13, 2013	24	25-Sep-16
Mississauga Meadows 2	\$ 3,554,200	September 13, 2013	24	26-Sep-16
Munir on Duffins Creek	\$ 2,927,000	September 13, 2011	24	31-Aug-13
Oakville	\$ 2,500,000	April 30, 2012		29-Apr-15
Old Market Lane	\$ 3,789,000	July 19, 2011	36	04-May-17
Port Place	\$ 9,385,545	May 2, 2012	36	20-Jan-18
Residences of Bayview	\$ 19,833,174	May 31, 2013	36	31-May-18
Soba	\$ 6,897,200	October 20, 2011	24	20-Oct-14
Speers Commercial	\$ 4,772,700	October 18, 2013	24	18-Oct-16
Sutton	\$ 992,000	November 7, 2012	36	04-Apr-16
Triple Creek	\$ 12,180,300	October 15, 2012	60	15-May-17
Victoria Park Place	\$ 6,172,520	November 1, 2013	36	01-Nov-12
Wellington Street Lofts	\$ 2,798,600	April 1, 2011	18	15-Sep-12
Wismer 3	\$ 4,000,000	January 15, 2011	36	15-Dec-16
White Cedar Estates	\$ 1,731,000	August 14, 2013	36	14-Aug-17

Project details, status updates and location for each project can be found on Fortress’s website under past projects.

Source: Management

The table below shows Fortress’ recent projects.

Project	Max Capital to be Raised	Date Started	Term (m)
Brookdale	\$10,800,000	Dec-14	48
Cachet	\$21,246,153.85	September 30 th , 2014	60
Capital Pointe 3rd	\$20,000,000.00	April 15 th , 2014	24
Danforth	\$10,000,000	07-Dec-14	48
Harlowe	\$7,900,000	01-Sep-13	36
Jasper	\$18,500,000.00	June 30 th , 2014	48
King Square	\$19,000,000.00	May 19 th , 2014	48
Adelaide	\$7,000,000	Jan-20	48 +12
Peter Street	\$20,000,000.00	January 2nd, 2015	48
Masonry	\$30,000,000.00	August 28 th , 2014	60
Crates Landing 2	\$20,000,000.00	November 21, 2014	21
Nobleton	\$32,700,000.00	May 1, 2014	48
North	\$25,000,000.00	July 9 th , 2014	48
Old Market Lane 3rd	\$14,000,000.00	October 4, 2013	36
Orchard	\$32,700,000.00	April 16 th , 2014	48
Prescott	\$4,000,000.00	July 10 th , 2014	24
Rosewater	\$20,000,000.00	July 5 th , 2014	36
Rutherford	\$15,000,000.00	July 30 th , 2014	36

The maturity dates of the projects listed below have been extended beyond the original term. Management indicated to us that terms of their initial offerings were too short (2 - 3 years), as they did not consider potential delays in project development/construction. Fortress' more recent offerings have longer terms.

Project	
6th and Tenth	Langston Hall 1
Burlington (Modern)	Langston Hall 2
Brant Park	Mayfield
Collier	Mayfield 2
Countryside Crossing (Gas)	Old Market Lane
Gotham	Soba
King Charlotte	Wellington Street Lofts

Management indicated to us that investors on all the above projects (except Langston Hall 1 and 2) have been receiving their interest payments. However, we have not been able to confirm this.

Langston Hall 1 and 2 were involved in legal proceedings early in 2014, as senior lenders of the project were not receiving their interest payments. Fortress' investors held the third position security on the property and were also not receiving interest payments. Fortress was able to subsequently bring on developers, Carlyle Developments and Berkley Homes, to take over the project. According to Fortress, interest payments to investors recommenced after the takeover.

We feel that the delays in development are a major risk to this offering, as shown by the number of delays in previous Fortress projects. However, the benefit of Fortress's

structure compared to a typical investment in a development project is that investors' are likely to receive interest payments during the investment time horizon (even if the projects are delayed). Investors of development projects typically have to wait until a project is completed to recoup their capital and accrued interest. Therefore, we believe the risk of losing 100% of invested capital in Fortress' investments is extremely low even in a worst case scenario.

The financing for Orchard started with Fortress conducting a syndicate mortgage offering in Ontario. As of September 25, 2014, they had raise \$12.3 million. These funds were used to acquire the land and for initial soft costs related to development. The funds from this offering are intended to be used to complete site work for the property and soft costs, including architectural/engineering fees, and attainment of necessary development approvals. Management will need to subordinate these offerings to secure subsequent financings (construction financing) giving investors less security. Although management stated that the terms of the Ontario financing are identical to this offering, management has not provided us the term sheet of the Ontario offering. According to management, this offering, and the Ontario offering, will continue to raise capital as necessary. They do not expect to raise more than \$32.7 million from the two offerings.

To attain construction financing, developers are usually required to maintain approximately 10% - 25% equity on a project based on completed pre-sales. **Management anticipates strong pre-sales on this project, which will enable them to finance up to 90% of the project costs.**

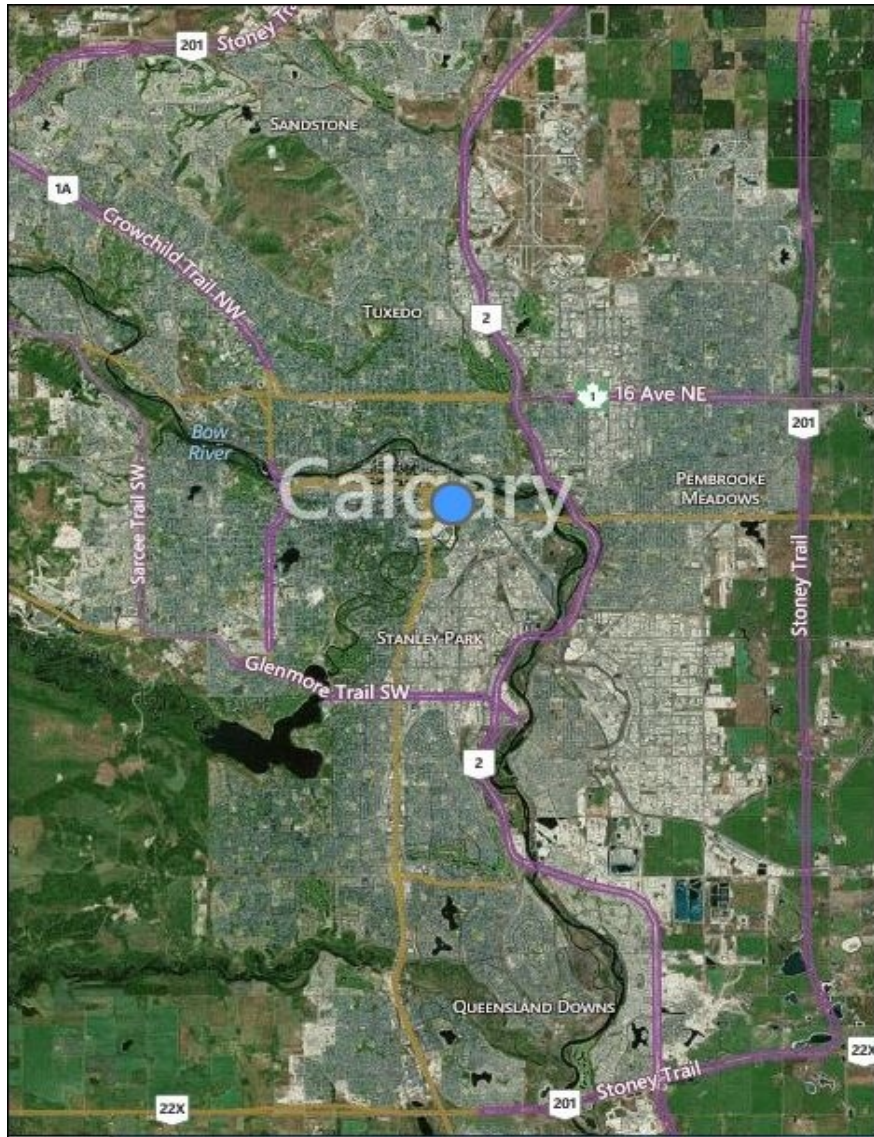
Management has not yet secured construction financing. They note that their relationships with lenders are one of their strengths, with previous projects attaining construction financing at prime plus 1% to 3% p.a.

For development projects, developers typically raise capital from investors in return for an equity interest in the project. Fortress uses a slightly different structure than conventional offerings. Instead of offering equity, Fortress typically offers bonds, with a small profit share component. For this offering, Fortress intends to raise capital in stages to meet interest payments when they are due. This structure allows more of investors' capital to go towards the development of the project. However, this requires the developer to attain additional financing each year to pay investors through the life of the project.

We feel that the bond structure compared to equity, limits the upside to investors, while exposing investors to the same downside. The benefit of this structure is that investors receive interest payments quarterly, which limits their capital at risk.

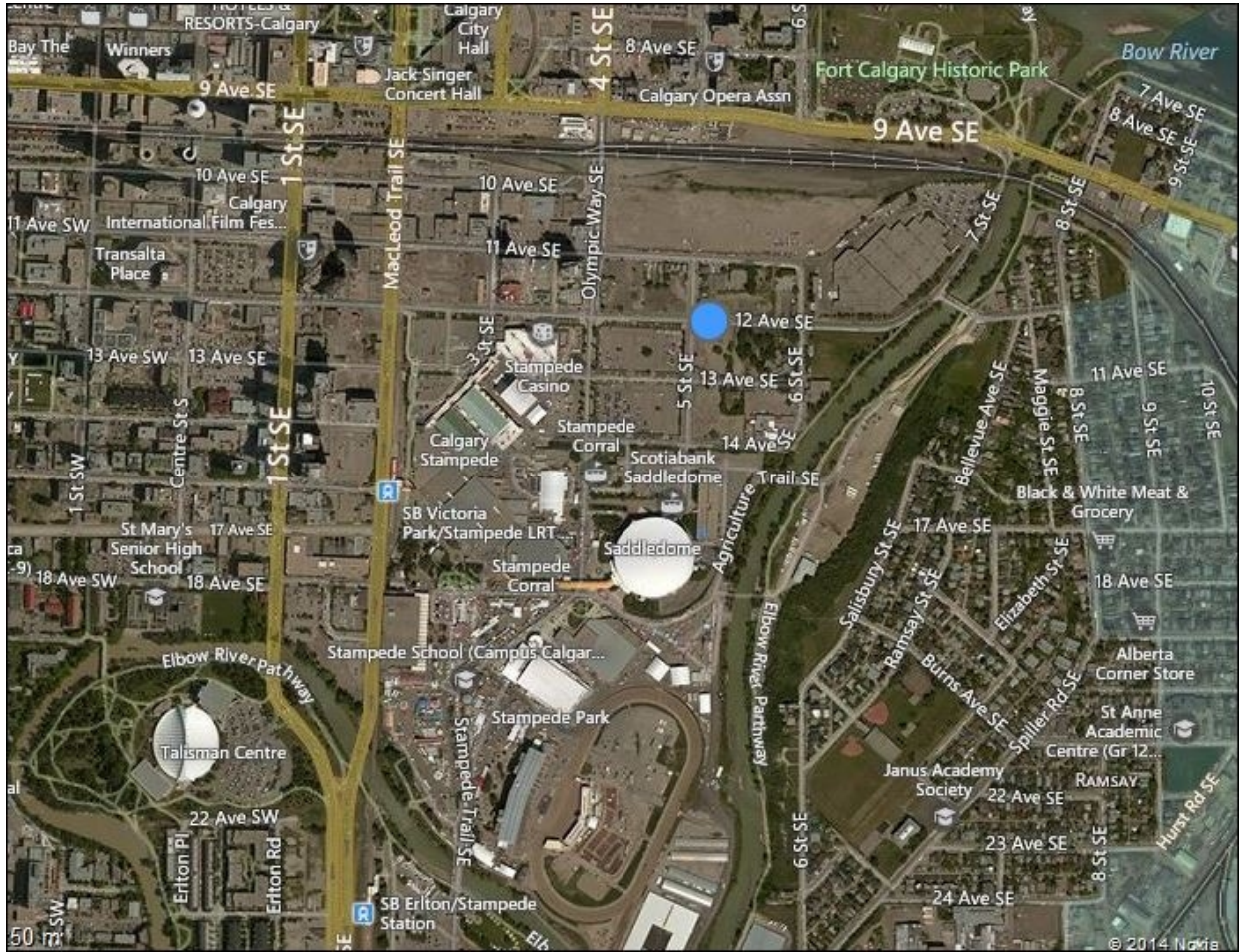
Location

The Orchard property is located at the 600 block of 12th avenue SE in Calgary. The location of the property is shown below.



Source: Bing maps

The property is located south east of the downtown core, which is approximately a 5 minute drive. It is near the Saddledome, a major stadium in Calgary. **The area is up and coming and contains many industrial buildings and undeveloped land.** A closer view of the property location is shown below.



Source: Bing maps

An amenity map is shown below.



Source: The Orchard Development

The first phase (East Tower) will be a 31 storey building (215 units) of approximately 18,147

sq. meters. The second phase (West Tower) will be another 31 storey building (217 units) of approximately 18,283 sq. meters. The two buildings will be separated by an apple orchard (shown below).



Source: Orchard

The sales center for the Orchard was completed in November of 2014, with presales starting in late November. Management notes that phase 1 units have already started selling. So far there has been strong response with over 60 units sold on the opening day. The development has so far sold over 30% of tower 1. We have not been able to confirm this statement.

The land was purchased for \$8.3 million (including related costs). Legacy Global Mercantile Partners assessed the land value at \$26 - \$29 million based on the development being approved. Management indicated to us that the site work and approvals required to develop the project are time consuming and costly, hence the reason for the lower purchase price.

There is a \$4.30 million mortgage (@ 6.75% p.a.) on the property from Harbour Mortgage Corp. It is due in April 2016.

The following chart shows the expected source of funds:

Building Plans / Construction Budget

Financing	Amount needed	Amount raised
Construction Financing	we estimate the project will require approx. \$120.7 million	-
First Mortgage	\$4.3 million	\$4.3 million
Bonds and Syndicate Mortgage (rank equally)	up to \$65.4 million - we estimate the project will require \$31.7 million	\$12.3 million

Management estimates that the project will generate \$180.32 million in revenues from unit sales. Based on our assessment of comparable developments in the area, we feel that the revenue estimate is very reasonable. We feel the units are competitively priced in the market. Our revenue estimate is shown below.

Revenue estimate	sqft/stalls	Price	Total
Residential sqft	300,000 sqft	\$ 545	\$ 163,500,000
Commercial sqft	10,000 sqft	\$ 425	\$ 4,250,000
Parking stalls	425 stalls	\$ 29,900	\$ 12,707,500
			\$ 180,457,500

The following table shows the construction costs estimated by management.

Cost Budget	
Land	\$ 8,297,780
Building costs	\$ 95,152,000
Soft costs	
Consultants	\$ 3,834,454
Development costs	\$ 3,704,891
National home warranty	\$ 348,500
Finance & Interest	\$ 7,180,294
Marketing costs	\$ 2,328,458
Sales commissions	\$ 6,325,138
Development & construction management	\$ 8,280,975
Total cost	\$ 135,452,490

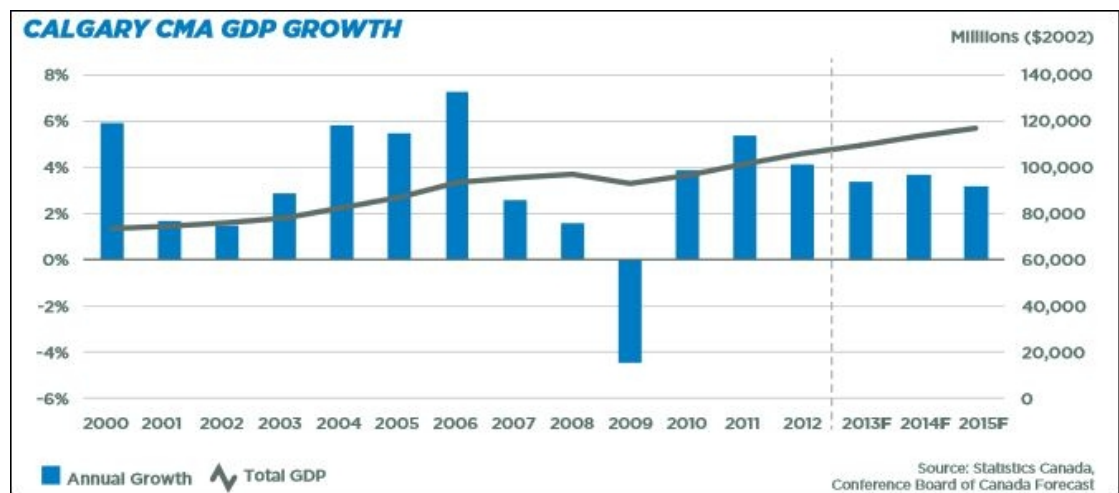
From reviewing industry reports, we feel that the construction costs and development costs are also reasonable. However, we feel that the interest expense reserve is low. Also, Fortress’s development fee (4% of the total cost – discussed later) is not included. Therefore, we estimate that the actual costs may be much higher.

Management estimates an overall profit of \$45 million. Our estimates are discussed in detail later.

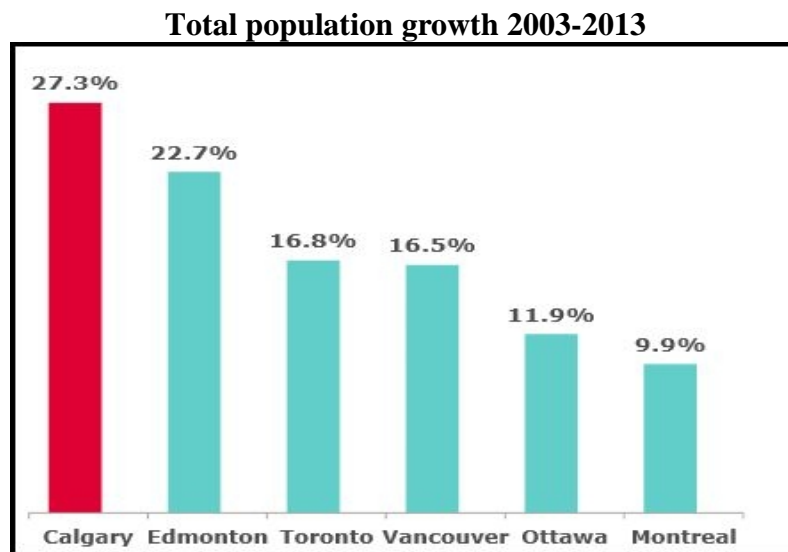
Economic Overview - Calgary

The following looks at the major economic factors that we anticipate will have an effect on the real estate market in Calgary.

- The Gross Domestic Product (“GDP”) of Calgary is forecasted to maintain good growth over the next 2 years, as shown below.

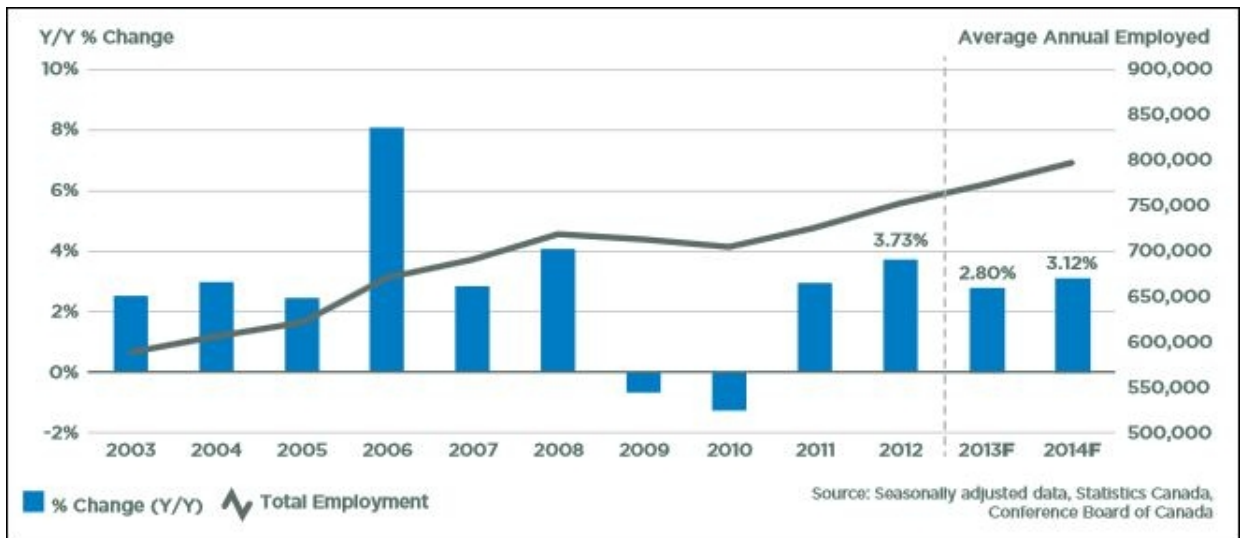


The population growth of Calgary has outperformed other major Canadian metropolitan cities as shown below.



Source: Calgary Economic Development

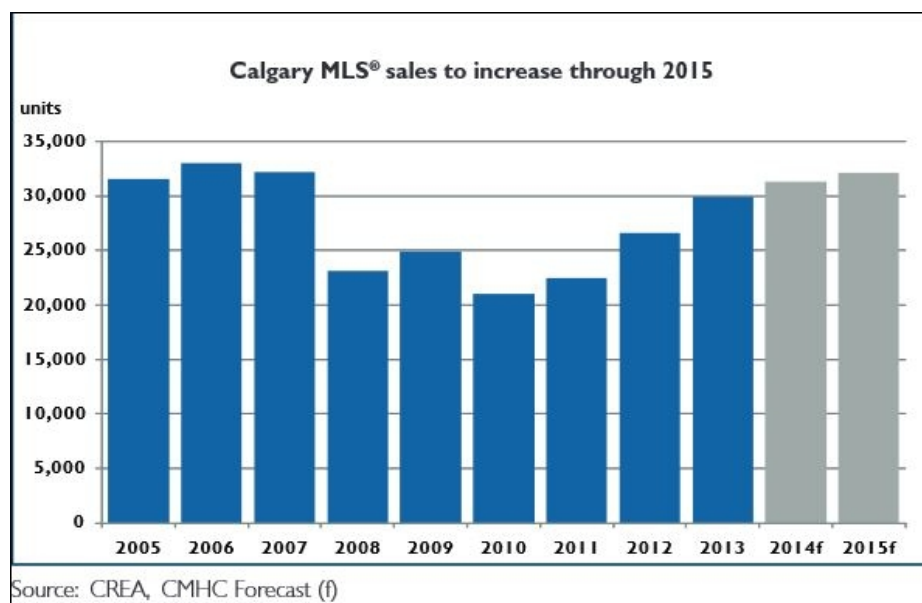
We feel a major reason for this are the strong employment prospects. The chart below shows employment growth in Calgary.



Overall, we feel that the Calgary economy is among the strongest in Canada, and has one of the best growth prospects. We feel the strong economic growth will provide a stable environment for housing.

Housing Outlook - Calgary

Calgary has shown strong growth in residential real estate sales (see chart below).



Prices have also shown appreciation. As shown below, there was a strong increase in apartment prices following 2005, but prices declined during the housing recession. Since then, the price growth has been stable in Calgary.

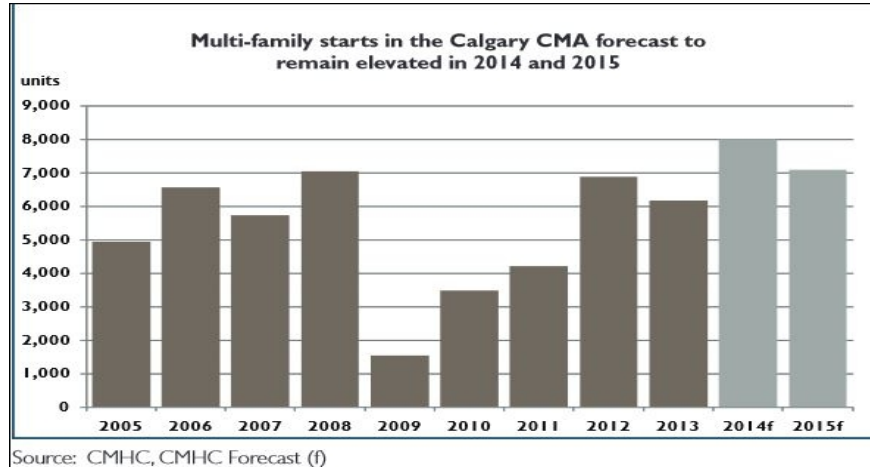


We feel one of the most attractive features of the Calgary market, at this time, is the declining condo inventory (see chart below). We feel this will continue to drive sales volume and prices.

Calgary Months' Inventory



Multi-family starts in 2014, and 2015, are projected to exceed 2013 levels due to current inventory levels being low. We expect a more balanced real estate market as new supply enters the market.



We feel that the Calgary market will continue to show growth in the future. As discussed above, the economic factors are positive, which we feel will benefit the real estate market. Shown below are key real estate metrics for the Calgary market. 2014 YTD has seen a YOY increase in all major categories.

Annual/YTD	2012	2013	% change	2013 YTD	2014 YTD	% change
Total Sales	3,500	4,005	14.43%	3,428	4,152	21.12%
New Listings	5,710	5,594	-2.03%	4,980	6,452	29.56%
Active Listings	553	479	-13.38%	689	1,106	60.52%
Benchmark Price	244,992	266,350	8.72%	N/A	N/A	N/A
Median	251,500	261,000	3.78%	261,120	285,000	9.15%
Average Price	284,666	299,536	5.22%	298,919	325,025	8.73%
Pending Sales	32	15	-53.13%	55	31	-43.64%
Days on Market	53	43	-18.87%	42	36	-14.29%

Source: CREB®

Comparable Properties

We feel the best comparable property for the Orchard is the Guardian Towers located at 12th ave SE and 3rd street SE. Guardian Towers contain two 41 storey residential towers, totaling 308 units. The first tower went on sale in March 2012. Sales have been completed on that tower, and it is currently under construction. The second tower is currently selling with prices ranging from \$551 to \$840 / sq.ft. for the penthouses.

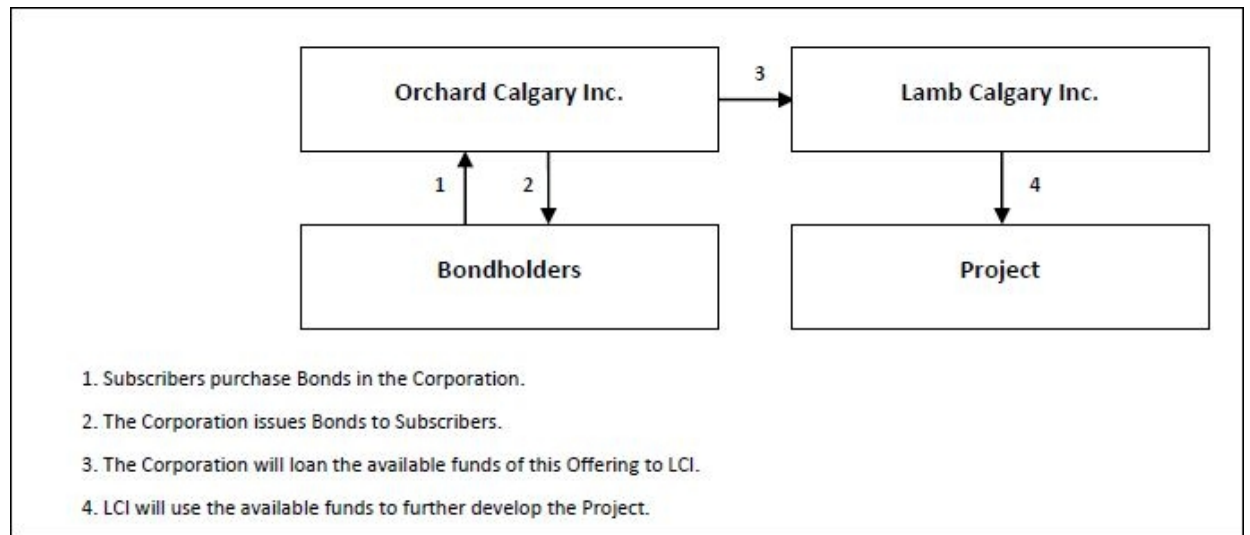
A summary of comparable properties we have reviewed is shown below.

Development	Location	Units	Status	Price
Verve	6 Avenue Southeast & 5 Street Southeast	291	Selling	\$486 average a sqft
Park Point	12 Avenue Southwest & 2 Street Southwest	286	Coming soon	from \$290k
The Park Condos	303 13 Avenue Southwest	156	Selling	\$503-\$678 per sqft
Guardian	12 Avenue Southeast & 3 Street Southeast	308	Selling/Construction	\$551-\$840 per sqft

We have reviewed a price list for the first tower of Orchard and prices start at \$260,000, with units ranging from \$475 to \$741 per sq.ft.

Structure

Investors will receive bonds issued by Orchard Calgary Inc. The corporation will loan the funds received to Lamb Calgary Inc (“LCI”), which will make the funds available to the project. LCI is 50% owned by Lamb, and 50% by Fortress. The structure is summarized below:



There is limited recourse for investors in the event of default. The bonds bear interest at 8% p.a., which is paid quarterly, and mature September 25, 2018. Management has the option to extend the term by 2 years.

Deferred lender fee (“DFL”)

Based on the profitability of the project, investors may also receive an additional return. The overall profit has to exceed \$45 million for investors to receive their deferred lender fee. The deferred lender fee is 16% of the invested amount.

Sales and commission/ marketing fees

Sales and commission fees total 10.35% of the gross amount raised.

There is a 4.65% marketing fee on the total raise that management intends to pay to third party marketing providers.

Management/Development fee

Fortress will receive 4%, and Lamb will receive 4% of the total costs. As per the OM, the total cost is defined as “*means demolition, sitework, building costs, cost of the land, architectural and engineering costs, municipal approval costs and fees, professional fees, financing costs, marketing expenses, Wholesaler fees, Project Development Fees, commissions and other costs*”. **We feel that the management/development fee (8% total) is extremely high relative to comparable offerings. The typical fee is less than 5%.**

Early Redemption

Investors are not able to redeem the bonds. The corporation has the ability to redeem the bonds early at principal plus accrued and unpaid interest.

The bonds are intended to be qualified for registered plans.

We have adjusted the cost budget based on our estimate of when funds will be required for the development. Our estimate of the required capital and source of funds is shown below.

Source of Funds	2014	2015E	2016E	2017E	2018E
Bonds + Syndicate Mortgage Offering (8% p.a.)	\$12,300,000	\$25,176,663	\$27,190,796	\$29,366,060	\$31,715,345
Construction Financing (6% p.a.)			\$40,245,258	\$80,490,515	\$120,735,773
Harbour Mortgage Corp. (6.75% p.a.)	\$4,300,000	\$4,300,000			
Total	\$16,600,000	\$29,476,663	\$67,436,054	\$109,856,575	\$152,451,118

Based on the above, the following table shows our estimate of interest expenses on the various sources of funds. We have used a 6% p.a. interest rate for construction financing.

Interest expense	2014	2015E	2016E	2017E	2018E	Total
Syndicate Mortgage offering		\$984,000	\$2,014,133	\$2,175,264	\$2,349,285	\$7,522,682
Construction financing			\$2,414,715	\$4,829,431	\$7,244,146	\$14,488,293
Mortgage - Harbour	\$290,250	\$290,250	-	-	-	\$580,500
Total Interest Expense	\$290,250	\$1,274,250	\$4,428,849	\$7,004,695	\$9,593,431	\$22,591,474

Management notes that they could attain construction financing with 10% equity in the project. We have used a 15% estimate to be conservative. The following table shows our revenue and cost estimates, assuming an investment time horizon of 4 years (exit by the end of 2018).

Total Revenues	\$	180,457,500
Land	\$	8,297,780
Building costs	\$	95,152,000
Soft costs		
Consultants	\$	3,834,454
Development costs	\$	3,704,891
National home warranty	\$	348,500
Finance & Interest	\$	14,488,293
Marketing costs	\$	2,328,458
Sales commissions (3.5% of revenues)	\$	6,316,013
Syndicate mortgage interest	\$	7,522,682
Harbour mortgage interest	\$	580,500
Sales and Offering costs (OM)	\$	3,776,499
Lamb and Fortress Development fee + Construction Management	\$	14,635,007
Total cost	\$	160,985,076
Profit	\$	19,472,424

We do not anticipate that the project will earn enough profit given our base case to pay the deferred lender fee (DFL) of 16%. We estimate that revenues would have to rise by approximately 14.5%, or costs have to decline by 16%, to generate enough profit to pay the DFL. However, our base-case model indicates that investors are likely to receive their 8% p.a. interest and principal upon exit.

The following table shows a sensitivity analysis based on changes in revenue, and cost estimates.

	-20%	-10%	Base	10%	20%
Revenues	\$144,366,000	\$162,411,750	\$180,457,500	\$198,503,250	\$216,549,000
Cost	\$160,985,076	\$160,985,076	\$160,985,076	\$160,985,076	\$160,985,076
Development profit	(\$16,619,076)	\$1,426,674	\$19,472,424	\$37,518,174	\$55,563,924
Returns to investors					
Annual interest	8%	8%	8%	8%	8%
Deferred lender fee (one time)	N/A	N/A	N/A	N/A	16.0%
IRR	-7.26%	8.00%	8.00%	8.00%	10.59%

	-20%	-10%	Base	10%	20%
Revenues	\$180,457,500	\$180,457,500	\$180,457,500	\$180,457,500	\$180,457,500
Cost	\$128,788,061	\$144,886,569	\$160,985,076	\$177,083,584	\$193,182,092
Development profit	\$51,669,439	\$35,570,931	\$19,472,424	\$3,373,916	(\$12,724,592)
Returns to investors					
Annual interest	8%	8%	8%	8%	8%
Deferred lender fee (one time)	16%	N/A	N/A	N/A	N/A
IRR	10.59%	8.00%	8.00%	8.00%	-2.68%

Risks

We believe the following are this offering’s key risks:

- There is no guarantee that principal or interest will be paid.
- The property in liquidation may not be able to cover all obligations.
- The deferred lender fee is based on the profitability of the project.
- Bonds may be redeemed by management prior to maturity.
- Investors cannot redeem or sell their bonds prior to maturity.
- Management will need to secure additional financing to complete the project.
- Management will need to raise funds annually to meet interest payments.
- Development costs and time horizon may be higher/longer than management’s estimates.
- The real estate market demand for condo units will affect returns.
- The development plans for the project have not yet been finalized. Buildings permits and approvals by the city are still required.
- Construction costs may exceed estimates.

Conclusion

In summary, we believe the Orchard project has good potential. One of the most attractive aspects of this offering is that pre-sales have started, and the response so far has been positive.

As with most development projects, there are many factors that will impact returns to investors. Potential for delays is a significant concern. Given our base case model, we anticipate investors will receive their 8% p.a. (quarterly) and principal upon exit. However, as with most Fortress’ offerings, our main concern is that the structure does not provide the upside potential that investors typically receive for development projects. The risk of losing entire capital is minimal as investors’ receive interest payments quarterly.

We assign an overall rating of 4+, and a risk rating of 5.

FRC Rating	
Expected IRR	8% p.a.
Rating	4+
Risk	5

Fundamental Research Corp. Rating Scale:

- Rating – 1: Excellent Return to Risk Ratio
- Rating – 2: Very Good Return to Risk Ratio
- Rating – 3: Good Return to Risk Ratio
- Rating – 4: Average Return to Risk Ratio
- Rating – 5: Weak Return to Risk Ratio
- Rating – 6: Very Weak Return to Risk Ratio
- Rating – 7: Poor Return to Risk Ratio

A “+” indicates the rating is in the top third of the category, A “-“ indicates the lower third and no “+” or “-“ indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:

- 1 (Low Risk)
- 2 (Below Average Risk)
- 3 (Average Risk)
- 4 (Speculative)
- 5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	24%	Risk - 2	2%
Rating - 3	46%	Risk - 3	31%
Rating - 4	11%	Risk - 4	41%
Rating - 5	5%	Risk - 5	10%
Rating - 6	1%	Suspended	16%
Rating - 7	0%		
Suspended	12%		

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