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COURT	Court of Queen's Bench of Alberta
JUDICIAL CENTRE	CALGARY
APPLICANTS	GAIL CUNNINGHAM and JAMES CARMICHAEL
RESPONDENTS	CROSSROADS-DMD MORTGAGE INVESTMENT CORPORATION
DOCUMENT	**AFFIDAVIT OF BRIAN MENGES**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Gowling WLG (Canada) LLP 1600, 421 – 7th Avenue S.W. Calgary, AB T2P 4K9 Telephone (403) 298-1034 Facsimile (403) 695-3534 File No. A155358 **Attention: Kenneth J. Warren, Q.C.**

AFFIDAVIT OF:	Brian Menges
SWORN ON:	November 17, 2017

I, Brian Menges, of Edmonton, Alberta, SWEAR AND SAY THAT:

1. I have personal knowledge of the matters hereinafter deposed to except where they are stated to be based on information, in which case I believe that information to be true.

2. I am the President and Chief Executive Officer of Caplink Financial Corporation (**"Caplink"**) and hold an MBA degree. I make this Affidavit on behalf of Caplink as the

Investment Fund Manager of Crossroads-DMD Mortgage Investment Corporation ("**Crossroads**").

3. Except as expressly clarified herein, Crossroads relies upon the evidence contained in the Affidavit of Maureen MacDonald filed on November 1, 2016 in this action (the "**MacDonald Affidavit**").

<u>Deloitte Report</u>

4. With respect to paragraph 4 of the MacDonald Affidavit, Deloitte provided a report dated November 16, 2017, containing its opinion as to the fair value of Crossroads' non-voting Class "B" shares as of April 20, 2016, a copy of which is attached to my Affidavit as **Exhibit "A"** (the "**Deloitte Report**"). That value is within the range of $0.49189 and $0.53217 per share, as contrasted with the $0.716 per share offer made by Crossroads in its July 29, 2016 offer to the dissenting shareholders [MacDonald Affidavit, Ex. F]. The process Deloitte followed to provide an opinion as to the fair value of Crossroads' shares and the fair value range it determined is set out in the Deloitte Report.

<u>Dissenting Shareholder Settlements</u>

5. Further to paragraphs 26 and 27 of the MacDonald Affidavit, there are currently forty-one dissenting shareholders representing 1,822,024 shares.

6. Between July 29, 2016 and December 31, 2016, five dissenting shareholders reached settlement agreements with Crossroads. Two of the dissenting shareholders who settled are Gail Cunningham and James Carmichael, the Applicants who filed the Originating Application in this action. In aggregate, 305,505 shares were redeemed at a price of $0.716 per share, for a total payout of $244,734, including 10% dividends for the period of May 1 to June 15, 2016 and interest at 1.15% from June 16, 2016 until the date of redemption. Settlement agreements, conditional on payment being made on or before December 31, 2016, were entered into between Crossroads and two other dissenting shareholders. Those agreements also provided for redemption at a price of $0.716 per share but did not close.

<u>Relationship between Caplink and Crossroads-DMD Mortgage Investment Corporation</u>

7. Caplink was incorporated in January of 1997. For over 20 years Caplink has originated, underwritten and administered mortgage investments on behalf of both syndicated mortgage investors and Mortgage Investment Corporations ("**MICs**") in Alberta, British Columbia and Saskatchewan. In 2003 Caplink acquired management control of the first two of three MICs that it would manage. Those MICs included Cedar Mortgage Corporation and Cedar II Mortgage Corporation (in 2012 Caplink amalgamated these two MICs into one). In 2005 Caplink established its third MIC, Caplink Mortgage Investors Corporation. Effective February 7, 2011 Caplink was registered in the Provinces of Alberta, British Columbia and Saskatchewan as an Exempt Market Dealer ("**EMD**"). Effective November 29, 2011, Caplink was registered as both a Restricted Portfolio Manager ("**RPM**") and Investment Fund Manager ("**IFM**") in the Provinces of Alberta and British Columbia.

8. Currently Caplink is registered as an EMD (Alberta, British Columbia, Saskatchewan and Manitoba), an IFM (Alberta and British Columbia) and RPM (Alberta and British Columbia) and currently acts as EMD, IFM and RPM for and on behalf of Cedar II Mortgage Corporation, Caplink Mortgage Investors Corporation and Crossroads, and as manager for and on behalf of other non-mortgage investment corporation clients. Caplink also holds the necessary mortgage brokerage registrations under applicable real estate licensing legislation in Alberta and British Columbia, and under applicable trust and loan corporation legislation in Saskatchewan.

9. In November of 2013, I published a paper called *Realizable Value - The Real Risk To Mortgage Entity Investors*, with Caplink's CFO Lorrain Smith. The paper provides a detailed explanation on how to calculate the realizable value of a mortgage portfolio. This paper was written at the request of senior management of the Alberta Securities Commission ("**ASC**"). This paper was well received by industry professionals and was, with Caplink's permission, circulated by the accounting firms of BDO and KPMG to their key institutional clients. In addition, this paper, in part, resulted in the ASC asking me to be one of only two mortgage investment corporation mangers in Alberta to sit on the ASC's Exempt Market Dealer Advisor Committee. I accepted this offer and continue to sit on that committee.

10. In or about August 2016, CMS Financial Management Services Ltd. ("**CMS**") entered into terms and conditions with the ASC that required CMS, among other things, to use reasonable efforts to assist Crossroads to find and engage a firm registered as an IFM and RPM to replace CMS as IFM and RPM of Crossroads by November 3, 2016 or such later date approved by the Director, Market Regulation. CMS approached Caplink to become Crossroads' new EMD, RPM and IFM. Formal management discussions commenced in late October or early November of 2016. Given the short time frame available for CMS and Caplink to negotiate management terms the ASC extended CMS's deadline from November 3, 2016 to November 30, 2016. On November 23, 2016, the ASC confirmed it had no objection to Caplink's assumption of management control over Crossroads from CMS. A management agreement between Crossroads and Caplink was finalized on November 30, 2016, at which time Caplink formally became Crossroads' EMD, RPM and IFM.

<u>Change of Counsel for Crossroads</u>

11. On or about December 31, 2016 Caplink retained new legal counsel, Gowling WLG, to represent Crossroads in this action and others due to my view that Crossroads' prior counsel had potential conflicts in jointly representing Crossroads and numerous other defendants in those other actions.

12. Gowling WLG adjourned the fair value hearing originally scheduled for January 16, 2017, to March 3, 2017 and then to June 13, 2017 and finally to December 1, 2017. The adjournments were to provide sufficient time for the review of Crossroads' mortgage portfolio and preparation of a valuation report.

13. In particular, the adjournment from June 13, 2017 to December 1, 2017 was required to address concerns expressed by the Directors of Crossroads. On June 1, 2017, we provided my proposed affidavit, including a report from Deloitte providing an opinion regarding the value of the Class "B" Shares as at April 20, 2016. The Directors provided by letter dated June 26, 2017 a number of comments and criticisms regarding my proposed affidavit and Deloitte's opinion on the fair value of the Class "B" Shares.

14. Caplink and Deloitte considered the Directors' comments and criticisms in arriving at the views set out in this Affidavit and in the Deloitte Report and, in particular, took steps to ensure that the evaluation of the Commercial Loans in Winnipeg is accurate. Details regarding the steps Caplink has taken to evaluate the Commercial Loans in Winnipeg are discussed in detail at paragraph 19(a) below.

15. On August 31, 2017, Caplink caused a Statement of Claim to be filed by Crossroads against CMS, the Directors of Crossroads and others seeking damages in the amount of $12.4M. A copy of the Statement of Claim is attached to my Affidavit as **Exhibit "B"**.

<u>Steps Taken by Caplink as Manager of Crossroads</u>

16. Since assuming the management of Crossroads, Caplink's efforts have included, but are not limited to:

   (a) Making available competent mortgage origination, mortgage administration and corporate accounting management and staff;

   (b) Retaining independent legal counsel to represent the legal interests of Crossroads;

   (c) Acquiring, implementing and making proper use of the Dolphin mortgage database system;

   (d) Taking delivery from CMS of active Crossroads mortgage and corporate operating records;

   (e) Retrieving closed Crossroads' mortgage and operating records from the private storage facility owned by CMS Real Estate Ltd.;

   (f) Commencing work on correcting the accounting records associated with Crossroads' mortgage files and interMIC (i.e. related party) loan balances;

   (g) Commencing work on correcting the financial records associated with Crossroads' operating income and expenses;

   (h) Developing an accurate and functional net asset valuation model for Crossroads;

   (i) Engaging Deloitte consultants to review the Caplink developed net asset valuation model;

(j) Establishing and maintaining shareholder communications, which includes regular written shareholder updates, responding to all shareholder telephone enquiries, responding to all shareholder email enquiries and, in the future, organizing and attending town hall style shareholder public forums, issuing monthly Crossroads financial updates to shareholders, holding annual general meetings, and re-establishing an internet presence for Crossroads;

(k) The timely distribution of 2016 Shareholder T5s;

(l) Actively addressing and attempting to mitigate financial damages associated with current and potential legal actions against Crossroads;

(m) Amending Crossroads' mortgage origination practices;

(n) Amending Crossroads' foreclosure management processes;

(o) Working with BDO Canada LLP on the 2016 Financial Audit and accounting deficiencies identified in the 2015 accounting audit;

(p) Negotiating with Axcess Capital, investment funds manager for six MICs formerly managed by CMS, in an attempt to resolve outstanding mortgage disputes between Crossroads and the other MICs formerly managed by CMS;

(q) Negotiating with Axcess Capital in an attempt to resolve outstanding related party loan disputes between Crossroads and the other MICs formerly managed by CMS;

(r) Negotiating with Myers Norris Penny ("MNP") insolvency practitioners in an attempt to resolve outstanding mortgage disputes and related party loan disputes between Crossroads, Sun Country MIC (which is in bankruptcy) and DMD, DMD II and DMD III MICs (which are in receivership), all of which at one time were managed by CMS;

(s) Maintaining on-going communications with the directors of Crossroads and with CMS;

(t) Reconciling related party loans between Crossroads and other MICs formerly managed by CMS;

(u) Reconciling Winnipeg based mortgages;

(v) Working with existing insurance companies to resolve ongoing insurance issues and claims;

(w) Working with new insurance companies to install more comprehensive insurance coverage for Crossroads;

(x) Attending meetings with Crossroads' legal counsel in person or via phone;

(y) Attending meetings with Crossroads' accounting advisors in person or via phone.

Fair Value of Crossroads Class "B" Non-voting Shares

17. On February 8, 2017, Gowling WLG engaged the services of Deloitte to assess the fair value of Crossroads' Class "B" shares as of April 20, 2016.

18. The steps that Deloitte has taken to assess the fair value of Crossroads' shares are set out in the Deloitte Report.

19. The explanation for the difference between the Deloitte opinion as to fair value in the range of \$0.49189 to \$0.53217 and the Crossroads previous \$0.716/share offer may be summarized as follows. Crossroads' portfolio on April 20, 2016 was made up of 599 loans (\$53,182,840), segments of which include:

(a) **Commercial loans in Winnipeg:**

(i) (12 loans, \$7,273,342). 2015 provision calculations valued these structures as completely renovated and tenanted. CMS had a loss provision on one of these loans at the time (\$619,428). Caplink undertook a site visit and observed that several of the buildings were gutted, vacant, and boarded up. Based on a purchase agreement on one property, and the value of priority loans ahead of Crossroads on title, this property has been written down to the estimated proceeds from the sale (\$1,400,000). Caplink's total loss provision on these loans is approximately \$5.4M.

(ii) In a June 26, 2017 letter from the Directors of Crossroads to Caplink the Directors stated "...The Board has substantial concerns with the loss provisions taken in respect of the Winnipeg loans. First off, it is important to note that the valuation is to be determined as at the April 20, 2016 Valuation Date..." This comment suggested to me that the Directors believed that the loan loss provisions Caplink assigned these properties failed to take into account the fact that as at April 20, 2016 the Winnipeg properties had greater economic value than they did when Caplink assigned its loss provisions in 2017. To address this concern, Caplink retained Winnipeg based Colliers International Realty Advisors Inc. ("**Colliers**") to do retrospective appraisals on nine of the Winnipeg commercial properties. The following table provides the Colliers' April 20, 2016 valuations along with the corresponding April 1, 2016 first mortgage balances. You will note that the April 1, 2016 first mortgage balances were on average two times greater than the "as is" appraised values of each of the nine properties. Thus, at no time in April 2016 was there any reasonable hope that Crossroads would recover the money owed to it on these mortgages.

Winnipeg Street Addresses	Colliers International April 20, 2016 Value	First Mortgage Balance as at April 20, 2016	First Mortgage Multiples of Colliers' Valuation	Equity Available for Crossroads Mortgagee
1032 Logan Ave.	$425,000	$1,507,394	3.55	$0.00
508 Sherbrook St.	$1,280,000	$2,313,000	1.81	$0.00
590 Victor St.	$840,000	$1,773,910	2.11	$0.00
126 Alfred Ave.	$840,000	$2,021,397	2.41	$0.00
702 Consol Ave.	$495,000	$1,313,155	2.65	$0.00
229 Machray Ave.	$960,000	$1,198,205	1.25	$0.00
760 Wellington Ave.	$225,000	$467,415	2.08	$0.00
430 Young St.	$400,000	$904,696	2.26	$0.00
583 Young St.	$180,000	$248,000	1.38	$0.00
		Average	**2.17**	

The first mortgage balance for both 1032 Logan Ave. and 583 Young St. are estimates while all other mortgage balances are as provided by the first mortgagee

(b) **<u>Mortgage Loans to Unrelated Borrowers:</u>**

(i) (527 loans, $29,944,456). 2015 audit procedures by BDO selected a sample of mortgages based on NSF payments, outstanding property taxes, first mortgage arrears and lapsed/cancelled property insurance in the last quarter of 2015. From this set of loans, 23 files were selected for audit. Market value of the properties was assessed by reviewing at least two comparable properties. No allowance was made for distressed property sale (i.e., foreclosure – sold as is, where is, no representations or warranties on the property). The 2015 loss provision on these properties was about $383,800.

(ii) Caplink's approach was more conservative. It applied a distressed property discount where a mortgage had been in default in the previous 12 months. It also applied a loan loss provision to a group of mortgages that paid out after April 20, 2016, if there were indications of default before April 20, 2016. The total additional loan loss provisions total approximately $3,992,271.

(c) **<u>Titled Properties (100% owned by Crossroads)</u>:** (9 loans, $3,411,503). CMS had a provision of $601,287 on four of these files. Caplink increased this provision by $527,544 for a total loss provision of $1,128,831. The loss provision was increased to account for the fact that five of the nine loans did not have a loss provision. The provision applied by Caplink was calculated based on the actual selling price of seven units, and current market evaluations on the remaining two properties. It was reasonable for Caplink to use the selling price of the properties and current market evaluations to determine the loan provision that should have been in place on April 20, 2016, because the properties sold within a year of 2016.

(d) **<u>Mortgages registered on title as security for cash advances to non-arm's length parties (other MICs and non-arm's length parties); Crossroads had shared title with other MICs and with third parties:</u>** (45 loans, $11,605,225). This is an extremely complicated group of loans, some of which involve related parties that are now in receivership or bankruptcy. The loss provisions in place in the aggregate were insufficient and were increased by Caplink by about $1,655,711.

This group of loans represents funds transferred to a group of previously related MICs (Sun Country, DMD, DMD II, DMD III) and funds previously advanced to 1658062 Alberta Ltd. The MICs are now either in bankruptcy (Sun Country) or receivership (DMD, DMD II, DMD III), and secured claims for mortgages registered on title have been disallowed by the Trustee/Receiver, or not registered on title at all. The 1658062 Alberta Ltd. loan has been transferred to another unrelated party, leaving $622,160 of the amount receivable secured by proceeds from the sale of the completed development project.

Of the $11,605,225 receivable, $3,424,337 of principal loans was reclassified to the appropriate inter-company loan receivable account, $1,749,852 was reclassified to represent Crossroads' equity interest in the real estate asset and $1,918,204 of accrued interest was written off. The total adjustment to the mortgage receivable was $7,092,393 on 32 of the 45 loans in this category. This resulted in the provision of $1,790,090 being reduced by $1,313,785.

Provisions on eleven other files were increased by $245,823. These files were not reclassified as the property had been sold and closing of the file was anticipated to take place at the time the work on the portfolio was undertaken.

The $622,160 1658062 Alberta Ltd. loan that was unsecured was fully provided for with an increased loss provision of $622,160.

(e) **<u>Closed titled properties and closed non-arm's length loans:</u>** (6 loans, $948,313). These files were resolved with losses subsequent to April 20, 2016 of $476,228 where provisions were $387,500, resulting in an additional provision of $88,728. Caplink increased the provisions on these six loans on the basis that they had indications that the borrower may default in the 12 months prior to April 20, 2016, which was not accounted for in the initial provision.

(f) **<u>Related Party Loans</u>**: Over the course of 2012 to 2015, CMS caused Crossroads to transfer interest in three properties to Fairview Ventures Inc., for which Crossroads obtained an unsecured interest in Fairview Ventures Inc. in the amount of $662,170. This resulted in an additional write off of $662,170 due to the unsecured nature of Crossroads' interest. Fairview Ventures Inc. is now, to the best of my knowledge, insolvent.

(g) **<u>Loans receivable from other MICs and Statute Barred Claims:</u>** Crossroads regularly made cash advances to other MICs which were documented as loans bearing 15% interest. Some loans were subsequently secured against property owned by the MIC to which the loan was made, while other loans remained unsecured. Some secured loans were originally included in the mortgage portfolio, while others were included in loan accounts for the MIC to which the loan was made. Before adjustments and reclassification of principal amounts from loan accounts were made, the amount receivable was $3,760,494 (made up of principal and accrued interest). The provision on these loans was $2,129,109 for an expected recovery of $1,631,385. Principal amounts from the mortgage portfolio in the amount of $3,424,337 were reclassified to loan accounts corresponding to the MIC to which the loan was made, making the loan account total $7,184,831. The existing provision of $2,129,109 was increased by $2,358,139 to reflect a realistic recovery, after further adjustments were made, of the outstanding principal, in the amount of $2,681,931.

The MICs to whom the loans were made have either declared bankruptcy or are in receivership. Claims were made to the Trustee/Receiver regarding nineteen secured mortgages arising from the loans receivable from the MICs. The claims amount to $6,003,416 and include principal advanced and secured on title with a mortgage plus interest at 15% per the mortgage terms. All of these claims have been rejected by the Trustee/Receiver on the basis that the claims are statute barred. An application was heard on October 10, 2017, by a Master of the Alberta Court of Queen's Bench with respect to these claims. The Master found the Trustee's disallowance on the basis that the claim was statue barred was premature. The Master directed the parties to resolve the issue regarding the Receiver's disallowance, if possible, or have the issue determined by a Justice, as the Master did not have jurisdiction to resolve the issue. The Receiver's disallowance of the claims is the subject of an Application scheduled for December 15, 2017. If the claims are not allowed by the Justice, a further reduction of $2,681,931 (representing the outstanding principal of the loans advanced) to Crossroads' current net asset value ("**NAV**"), will need to be made and will result in a further decrease of the fair value of Crossroads' shares by $0.03922 per share. This further potential reduction in Crossroads' NAV, and corresponding reduction in the fair value of the shares, is not reflected in Deloitte's opinion that the fair value of the shares is between the range of $0.49189 and $0.53217

20. I am informed by BDO, the auditors of Crossroads, that BDO did not provide any opinion on the valuation of the business of Crossroads or the Class "B" shares at any point in time and that auditor testing is not a substitute for a robust analysis on the loan portfolio, which is the responsibility of management. The Deloitte Report is based on a robust analysis of Crossroads' loan portfolio over the past ten months by Caplink.

21. As evidenced by Caplink's and Deloitte's work, Crossroads' assertion that the value per Class "B" share as at April 20, 2016 was $0.716, is grossly overstated. The reasons for this inaccuracy are numerous but some of the more significant reasons include, but are not limited to:

(a) In Crossroads' July 29, 2016 Offer to Dissenting Shareholders [MacDonald Affidavit, Ex. F], Crossroads' NAV was stated to be calculated using Crossroads' December 31, 2015 audited financial statements. Using those statements to calculate Crossroads' April 20, 2016 NAV is inappropriate because an audit is not a business valuation;

(b) Notwithstanding the inappropriateness of using financial statements to calculate NAV:

(i) the financial statements as at March 31, 2016, and not the financial statements as at December 31, 2015, should have been used;

(ii) the loan loss provision included in the December 2015 financial statements solely resulted from calculations that the auditors performed on a sample of loans, which does not constitute a net realizable valuation of the loan portfolio;

(iii) BDO advised Caplink that in performing its 2015 audit, it found that CMS had not booked any loss provisions in the internally prepared financial statements. BDO applied loss provisions to loans it reviewed for the purposes of the 2015 audit; however, loss provisions were not applied to all loans in Crossroads' portfolio because the audit performed by BDO was based on review of approximately 100 of Crossroads' 599 loans. As a result, the loss provisions remained understated;

(iv) the number of shares used in the July 29, 2016 calculation was 69,722,765 shares, which is incorrect. Caplink believes the correct number is 68,387,328; and,

(v) the 2015 financial statements are incorrect to the extent that after doing its preliminary work on Crossroads' 2016 Audit, BDO has advised Caplink that BDO will be restating the 2015 figures presented in the 2016 audited financial statements for comparative purposes.

22. For the foregoing reasons, I am of the view that the fair value of the Class "B" shares as at April 20, 2016 is not $0.716 per share as previously determined by Crossroads.

23. I am of the view, based on the methodology in the Deloitte Report, that as of September 30, 2017 (the last month calculations available before this affidavit was sworn) Crossroads meets the solvency tests in section 191(20) of the *Business Corporations Act* and can pay all of the dissenting shareholders as long as the fair value of the Class "B" shares is within or near the range contained in the Deloitte Report. I will inform Crossroads' counsel of any updated assessment prior to the hearing.

24. Numerous shareholders have made requests to Crossroads that it redeem their shares. The redemption queue currently holds over 650 requests of shareholders to redeem shares (totalling 32,344,000 shares), many of which are over three years old (191 requests, totalling 9,434,323 shares). I am informed by Crossroads' counsel that the amended articles

adopted by Crossroads pursuant to the Special Meeting on April 21, 2016 do not direct any order of priority between payments to dissenting shareholders and redemption of shares. A copy of the original Articles of Incorporation effective until April 20, 2016 are attached to my Affidavit as **Exhibit "C"**. A copy of the Amended Articles of Incorporation effective April 21, 2016 are attached to my Affidavit as **Exhibit "D"**. Caplink proposes to pay the dissenting shareholders before commencing any share redemptions.

25. I make this Affidavit for the purposes of an application to the Court to determine the fair value of the Class "B" shares of Crossroads as at April 20, 2016.

SWORN BEFORE ME at the City of Edmonton, Alberta, this 17th of November, 2017.	)	
(Commissioner for Oaths in and for the Province of Alberta)	)	Brian Menges

CALEY BRI TEGHTMEYER
A Commissioner for Oaths in and for the Province of Alberta
My Commission Expires April 11, 2019