2018 | ANNUAL REPORT

Chief Executive Officer's Report

Brookfield Residential continued our steady performance driven primarily by growth in our U.S. housing and land operations, while the Canadian markets remained challenged. As anticipated, a significant amount of closings occurred in the fourth quarter where a high proportion of the year's income was realized. For the year ended December 31, 2018, our income before income taxes was $222 million, an increase of $4 million when compared to 2017.

Operational and financial highlights for the year:

- Home closings of 3,411 homes, increased 7% when compared to 2017
- Net new home orders of 2,855 in 2018 with our backlog at 1,137 units valued at $612 million
- Single-family lot closings of 2,838 lots, an increase of 21% when compared to 2017
- Sale of a commercial property in our Seton community in Calgary for a pre-tax gain of $6 million
- Net debt to total capitalization remained within our target range at 44%
- Liquidity available includes $70 million of cash and $515 million undrawn on our North American unsecured revolving credit facility

Market Overview

The U.S. macroeconomic environment continues to benefit from good underlying fundamentals, such as low unemployment rates, and as a result, this positively impacted us during the 2018 spring selling season. Activity in 2018 for our U.S. operations saw a 25% increase in home closings and a 31% increase in single-family lot closings. Both our New Haven at Ontario Ranch in Southern California and Eastmark in Arizona were recognized in the top 10 performing master-planned communities in the country. However, with consumer confidence being affected by affordability due to the threat of rising interest rates and increased cost pressures causing house price escalations, our U.S. operations experienced a slowdown of homebuyer traffic in the last half of the year, which was consistent across the industry. Recent declines in mortgage rates has helped stimulate our U.S. markets to start 2019 but the results of the spring selling season will determine whether the recent slowdown is temporary or not.

Our Canadian markets continue to be materially impacted by the changes to the mortgage rules as homebuyers adjust to what they can now afford as a result of the stress test combined with government policies relating to the Ontario real estate market and the Alberta energy sector surrounding pipeline approvals. Despite these challenges, we were able to execute on our Ontario backlog, increased our single-family lot sales and also sell a commercial property in Calgary. Looking ahead to 2019, we anticipate that our Canadian markets will remain challenged where our Ontario market will see lower home closings due to lower sales backlog entering 2019. The upcoming spring selling season will likely yield a majority of closings for 2020 versus 2019 closings. Our Alberta operations will continue to be challenged due to the economic conditions but with a spring Provincial election and a fall Federal election, we are optimistic that the results of these elections will hopefully re-affirm that Canada is "open for business" and positively impact the future economic outlook, public policy and improve consumer confidence.

Company Initiatives

As previously mentioned in past reports, we look to actively grow our mixed-use development business and evaluate other built forms to keep us closely in step with the changing preferences and requirements of the consumer. On January 1, 2019, a management company, Brookfield Properties Development, of our parent company, Brookfield Asset Management Inc., was formed. This management company will serve as an umbrella organization overseeing both the current Brookfield Residential organization as well as overseeing and coordinating the mixed-use and multi-family opportunities that exist in Brookfield's North American real estate portfolio. While there are no changes to the senior leadership of Brookfield Residential and how the Company will operate, we look forward to sharing on how we can leverage the combined strength in areas such as brand recognition, buying power, economic footprint and talent management in the near future.

Alan Norris
Chairman & Chief Executive Officer
February 5, 2019

BROOKFIELD RESIDENTIAL PROPERTIES PORTFOLIO

Our business is focused on land development and single family and multi-family homebuilding in the markets in which we operate. Our assets consist primarily of land and housing inventory and investments in unconsolidated entities. Our total assets as at December 31, 2018 were $4.5 billion.

As of December 31, 2018, we controlled 88,684 single family lots (serviced lots and future lot equivalents) and 191 multi-family, industrial and commercial serviced parcel acres. Controlled lots and acres include those we directly own and our share of those owned by unconsolidated entities. Our controlled lots and acres provide a strong foundation for our future lot and acre sales and homebuilding business, as well as visibility on our future cash flow. The number of building lots and acre parcels we control in each of our primary markets as of December 31, 2018 is as follows:

	Single Family Housing & Land Under and Held for Development[1]								Multi-Family, Industrial & Commercial Parcels Under Development	
	Housing & Land		Unconsolidated Entities		Total Lots		Status of Lots 12/31/2018		Total Acres	
	Owned	Options	Owned	Options	12/31/2018	12/31/2017	Entitled	Unentitled	12/31/2018	12/31/2017
Calgary	18,517	—	2,437	—	20,954	22,311	10,613	10,341	65	79
Edmonton	11,442	—	—	—	11,442	12,344	6,232	5,210	27	31
Ontario	7,141	—	1,100	—	8,241	8,230	1,708	6,533	—	—
Canada	37,100	—	3,537	—	40,637	42,885	18,553	22,084	92	110
Northern California	2,374	4,950	266	—	7,590	8,038	2,640	4,950	—	—
Southern California	6,578	—	1,398	1,001	8,977	9,460	7,347	1,630	—	—
Hawaii	127	—	—	—	127	175	127	—	3	—
Other	100	—	—	—	100	—	100	—	—	—
California	9,179	4,950	1,664	1,001	16,794	17,673	10,214	6,580	3	—
Denver	7,786	—	—	—	7,786	8,274	7,786	—	15	10
Austin	12,211	228	—	—	12,439	12,143	12,439	—	60	—
Phoenix	284	616	3,173	—	4,073	5,450	3,453	620	14	1
Washington, D.C. Area	3,070	1,004	—	—	4,074	4,455	4,037	37	4	18
Other	2,881	—	—	—	2,881	—	2,881	—	3	—
Central and Eastern U.S.	26,232	1,848	3,173	—	31,253	30,322	30,596	657	96	29
Total	72,511	6,798	8,374	1,001	88,684	90,880	59,363	29,321	191	139
Entitled lots	53,643	1,848	3,872	—	59,363					
Unentitled lots	18,868	4,950	4,502	1,001	29,321					
Total December 31, 2018	72,511	6,798	8,374	1,001	88,684					
Total December 31, 2017	73,420	6,133	10,326	1,001		90,880				

[1] Land held for development will include some multi-family, industrial and commercial parcels once entitled.

BROOKFIELD RESIDENTIAL PROPERTIES INC.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report, including the Chief Executive Officer's Report, incorporated herein by reference, contains "forward-looking statements" within the meaning of applicable Canadian securities laws and United States ("U.S.") federal securities laws. Forward-looking statements can be identified by the words "may," "believe," "will," "anticipate," "expect," "plan," "intend," "estimate," "project," "future," and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters. Such statements are neither historical facts nor assurances of future performance. Instead, they reflect management's current beliefs and are based on information currently available to management as of the date on which they are made. The forward-looking statements in this annual report include, among others, statements with respect to:

- the current business environment and outlook, including statements regarding: economic and market conditions in the U.S. and Canadian housing markets; the impact of recent legislation enacted in Ontario to address affordability of housing; the impact of changes to Canadian mortgage rules affecting the ability of prospective homebuyers to qualify for mortgage financing; the impact of potential interest rate increases in the U.S. and Canada and resulting consumer confidence; the economic uncertainty surrounding the energy industry and pipeline approvals and the impact thereof on demand in our markets, particularly in Alberta; consumer confidence and the resulting impact on the housing market; the impact of provincial elections in Alberta and federal elections on the Canadian market; our ability to meet our obligations under our North American unsecured credit facility; our costs to complete related to our letters of credit and performance bonds; expected project completion times; our ability to grow our mixed-use development segment, including identifying other built forms that may meet the demands and requirements of our customers, identifying other mixed-use opportunities, and our ability to execute on our plans for a mixed-use operational platform and expected redevelopment opportunities resulting therefrom; home price growth rates and affordability levels generally; our ability to benefit from growth in our U.S. operations; recovery in the housing market and the pace thereof; reduction in our debt levels and the timing thereof; our expected unit and lot sales and the timing thereof; expectations for 2019 and beyond;
- possible or assumed future results, including our outlook and limited guidance for 2019 and any updates thereto, how we intend to use additional cash flow, the operative cycle of our business and expected timing of income and expected performance and features of our projects, the continued strategic expansion of our business operations, the impact of acquisitions on our operations in certain markets;
- the expected closing of transactions;
- the expected exercise of options contracts;
- the effect on our business of business acquisitions;
- business goals, strategy and growth plans;
- trends in home prices in our various markets and generally;
- the effect of challenging conditions on us;
- factors affecting our competitive position within the homebuilding industry;
- the ability to generate sufficient cash flow from our assets to repay maturing bank indebtedness and project specific financings and take advantage of new opportunities;
- the ability to meet our covenants and re-pay interest payments on our unsecured senior notes and the requirement to make payments under our construction guarantees;
- the visibility of our future cash flow;
- social and environmental conditions, policies and risks;
- governmental policies and risks;
- expected backlog and closings and the timing thereof;
- the sufficiency of our access to and the sources of our capital resources;
- the impact of foreign exchange rates on our financial performance and market opportunities;
- the impact of credit rating agencies' rating on our business;
- the timing of the effect of interest rate changes on our cash flows;
- the impact of changes to U.S. tax legislation;
- the effect of debt and leverage on our business and financial condition; and
- the effect on our business of existing lawsuits

Although management of Brookfield Residential believes that the anticipated future results, performance or achievements expressed or implied by the forward-looking statements and information in this annual report are based upon reasonable assumptions and expectations, readers of this annual report should not place undue reliance on such forward-looking statements and information because they involve assumptions, known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of Brookfield Residential to differ materially from anticipated future results, performance, or achievements expressed or implied by such forward-looking statements and information.

Various factors, in addition to those discussed elsewhere in this annual report, that could affect the future results of Brookfield Residential and could cause actual results, performance, or achievements to differ materially from those expressed in the forward-looking statements and information include, but are not limited to, those factors included under the sections entitled "Cautionary Statements Regarding Forward-Looking Statements" and "Business Environment and Risks" of the Annual Report for the fiscal year ended December 31, 2018.

The forward-looking statements and information contained in this annual report are expressly qualified by this cautionary statement. Brookfield Residential undertakes no obligation to publicly update or revise any forward-looking statements, whether written or oral, or information contained in this annual report, whether as a result of new information, future events or otherwise, except as required by law. However, any further disclosures made on related subjects in subsequent public disclosure should be consulted.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS

ABOUT THIS MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis relates to the year ended December 31, 2018 and has been prepared with an effective date of February 5, 2019. It should be read in conjunction with the annual consolidated financial statements and the related notes thereto included elsewhere in this annual report. All dollar amounts discussed herein are in U.S. dollars, unless otherwise stated. Amounts in Canadian dollars are identified as "C$." The consolidated financial statements referenced herein have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP").

OVERVIEW

Brookfield Residential Properties Inc. (unless the context requires otherwise, references in this annual report to "we," "our," "us," the "Company" and "Brookfield Residential" refer to Brookfield Residential Properties Inc. and the subsidiaries through which it conducts all of its homebuilding and land development operations) is a wholly-owned subsidiary of Brookfield Asset Management Inc. and has been in operation for over 60 years. We are the flagship North American residential property company of Brookfield Asset Management Inc., a leading global alternative asset manager with $330 billion of assets under management.

Brookfield Residential is a leading North American homebuilder and land developer with operations in Canada and the United States. We entitle and develop land to create master-planned communities to create shared value for our stakeholders through a balanced mix of revenue-generating consumer and commercial deliverables. We build and sell lots to third-party builders, conduct our own homebuilding operations and, in select developments, establish commercial areas. We also participate in select strategic real estate opportunities, including infill projects, mixed-use developments, infrastructure projects and joint ventures.

Our disciplined land entitlement process, synergistic operations and capital flexibility allow us to pursue land investment, traditional homebuilding and mixed-use development in typically supply-constrained markets where we have strategically invested. We currently focus on the following three operating segments: Canada, California and Central and Eastern U.S. Our Canadian operations are primarily in the Alberta (Calgary and Edmonton) and Ontario (Toronto) markets. Our California operations include Northern California (San Francisco Bay Area and Sacramento), Southern California (Los Angeles / Southland and San Diego / Riverside) and Hawaii. Our Central and Eastern U.S. operations include Washington, D.C. Area, Colorado (Denver), Texas (Austin), Arizona (Phoenix) and Tennessee (Nashville).

We target these markets as they have strong underlying economic fundamentals and we believe over the longer term they offer robust, diversified housing demand, barriers to entry and close proximity to areas where employment growth is expected.

Principal Business Activities

Through the activities of our operating subsidiaries, we develop land for our own communities and sell lots to other homebuilders and third parties. We may also design, construct and market single family and multi-family homes in our own and others' communities. In each of our markets, we operate through local business units which are involved in all phases of the planning and building of our master-planned communities, infill projects and mixed-use developments. These operations include sourcing and evaluating land acquisitions, site planning, obtaining entitlements, developing the land, product design, constructing, marketing and selling homes and providing homebuyer customer service. These business units may also develop or sell land for the construction of commercial shopping centers in our communities. Through this flexible, integrated operating model, we maintain balanced and diversified operations offering value at the various stages of the land development process while also being responsive to the economic conditions within each market where we do business.

As a result, Brookfield Residential has developed a reputation for delivering innovative, award-winning master-planned communities and residential products. Our reputation stems from our passion to create "The Best Places to Call Home." This goes beyond the physical structures we build. To us, it's also about creating sustainable communities that offer a high quality of life and truly make a difference in people's lives. That's why our business is more than a traditional housing operation. The master-planned communities we develop typically also feature community centres, parks, recreational areas, schools, commercial areas and other amenities. As we grow our mixed-use platform, we are uniquely positioned to apply our distinct expertise to urban redevelopment projects that are residentially anchored.

Home Construction

We construct homes on lots that have been developed by us or that we purchase from others. Having a homebuilding operation allows us the opportunity to extract value from the land and provides us with market knowledge through our direct contact with the homebuyers. In markets where the Company has significant land holdings, homebuilding is carried out on a portion of the land in specific market segments and the balance of lots are sold to and built on by third-party builders.

Land Acquisition

Our traditional land development and homebuilding industry involves converting raw or undeveloped land into residential housing built by us and/or like-minded building partners, as well as commercial areas to add to the community placemaking strategy and provide added value creation. This process begins with the purchase or control of raw land and is followed by the entitlement and development of the land, and the marketing and sale of homes constructed on the land.

As a land developer in all of our markets, we target the acquisition of raw land during the low point of the economic cycle. Due to our local presence and collective capital strength, we are uniquely positioned to acquire underutilized land or brownfield development opportunities as they arise. We make diligent investments in supply-constrained markets with strong underlying economic fundamentals informed by strategic land studies to review growth patterns.

Entitlement Process & Land Development

Our unique approach to land development begins with our disciplined approach to acquiring land in the path of growth in dynamic and resilient markets in North America that have barriers to entry caused by infrastructure or entitlement processes. We create value through the planning and entitlement process, developing and marketing residential lots and commercial sites and working with industry partners who share the same vision and values. We plan to continue to grow this business over time by selectively acquiring land that either enhances our existing inventory or provides attractive projects that are consistent with our overall strategy and management expertise.

These larger tracts held for development afford us a true “master-planned” development opportunity that, following entitlement and assuming market conditions allow, creates a multi-year stream of cash flow. Creating this type of community requires a long-term view of how each piece of land should be developed with a vision of how our customers live in each of our communities. Through strong relationships with the jurisdictions and key stakeholders where we operate, we create shared value and infrastructure that supports great places.

We may also purchase smaller infill or re-use parcels, or in some cases finished lots for housing. As a city grows and intensifies, so do its development opportunities. Inner city revitalization opportunities contribute to the strategic expansion of our business. We develop and construct homes in previously urbanized areas on underutilized land. Urban developments provide quick turnarounds from acquisition to completion, create new revenue streams, and infuse new ideas and energy into the Company.

In addition to building homes and community amenities, as part of the planning process, we also consider the opportunity for mixed-use and commercial space within the community to cultivate the live, work and play experience many customers desire today.

Mixed-use development is a growing focus of the Company. We have been developing commercial properties within our master-planned communities for decades. Seton, in Calgary, Alberta, is a prime example of adding value to a master plan through appropriate mixed-use planning and building on our own land. A shift in consumer behavior has resulted in further demand for infill/brownfield locations. With many municipalities also focused on urban intensification, we believe these trends will create a significant pipeline of redevelopment opportunities.

In addition, our 2018 acquisition of OliverMcMillan Inc. ("OliverMcMillan"), including its premier mixed-use projects under development in Tennessee (Nashville) and Hawaii (Waikiki), allows us to design and build leading-edge mixed-use developments in some of the most vibrant urban centers in the U.S. Through this strategic acquisition we increased our position in this area and set the stage for this additional growth strategy.

Our core land and homebuilding operations remains our focus and priority; however, we see increasing our position in mixed-use development as a significant opportunity and reflects our view of some potential shifts in our residential portfolio to continue to meet customer needs and lifestyle preferences. We believe Brookfield Residential, combined with OliverMcMillan, has the necessary entitlement and re-entitlement expertise to implement this strategic focus, including the determination of appropriate future uses for a site, including retail, office, hospitality, for sale residential, and for rent residential.

Consumer Deliverables

We construct homes on lots that have been developed by us or that we purchase from others. Having a homebuilding operation allows us the opportunity to monetize our land and provides us with market knowledge through our direct contact with the homebuyers to understand customer preferences and product choices. In markets where the Company has significant land holdings, homebuilding is carried out on a portion of the land in specific market segments and the balance of lots are sold to and built on by third-party builders. Certain master-planned communities will also include the development of mixed-use space, consisting of retail or commercial assets, which we will build and add value through leasing, before selling to a third-party operator.

RESULTS OF OPERATIONS

Key financial results and operating data for the year ended December 31, 2018 compared to the year ended December 31, 2017 were as follows:

(US$ millions, except percentages, unit activity, average selling price and per share amounts)	Years Ended December 31 2018	2017
Key Financial Results(1)		
Housing revenue	$ 1,794	$ 1,733
Land revenue	368	318
Gross margin ($)	473	473
Gross margin(2) (%)	22%	23%
Income before income taxes	222	218
Income tax expense	(40)	(52)
Net income attributable to Brookfield Residential	174	166
Basic earnings per share	$ 1.34	$ 1.28
Diluted earnings per share	$ 1.34	$ 1.28
Key Operating Data		
Home closings for Brookfield Residential (units)	3,411	3,174
Home closings for unconsolidated entities (units)	4	7
Average home selling price for Brookfield Residential (per unit)	$ 526,000	$ 546,000
Average home selling price for unconsolidated entities (per unit)	$ 1,328,000	$ 1,162,000
Net new home orders for Brookfield Residential (units)	2,855	3,326
Net new home orders for unconsolidated entities (units)	3	7
Backlog for Brookfield Residential (units)	1,137	1,693
Backlog for unconsolidated entities (units)	—	2
Backlog value for Brookfield Residential	$ 612	$ 928
Backlog value for unconsolidated entities	$ —	$ 1
Lot closings for Brookfield Residential (single family units)	2,838	2,349
Lot closings for unconsolidated entities (single family units)	554	467
Acre closings for Brookfield Residential (multi-family, industrial and commercial)	79	84
Acre closings for unconsolidated entities (multi-family, industrial and commercial)	16	46
Acre closings for Brookfield Residential (raw and partially finished parcels)	19	628
Average lot selling price for Brookfield Residential (single family units)	$ 112,000	$ 111,000
Average lot selling price for unconsolidated entities (single family units)	$ 113,000	$ 117,000
Average per acre selling price for Brookfield Residential (multi-family, industrial and commercial)	$ 603,000	$ 591,000
Average per acre selling price for unconsolidated entities (multi-family, industrial and commercial)	$ 350,000	$ 242,000
Average per acre selling price for Brookfield Residential (raw and partially finished parcels)	$ 94,000	$ 11,000

(1) The Company applied ASC Topic 606 Revenue from Contracts with Customers, ("ASC Topic 606") with an initial application date of January 1, 2018. ASC Topic 606 was applied using the modified retrospective approach and therefore, the comparative information has not been adjusted and continues to be reported under ASC Topic 605 Revenue Recognition. For more information, refer to Note 2 "Change in Accounting Policies" of the consolidated financial statements.

(2) Gross margin percentage is a non-GAAP financial measure and has been presented as we find it useful in evaluating our performance and believe that it helps readers of our financial statements compare our operations with those of our competitors. However, gross margin percentage as presented may not be fully comparable to similarly-titled measures reported by our competitors. See the Non-GAAP Financial Measures section on page 31.

Segmented Information

We operate in three operating segments within North America: Canada, California and Central and Eastern U.S. Each of the Company's segments specializes in land entitlement and development for master-planned communities, mixed-use properties and the construction of single family and multi-family homes. The Company evaluates performance and allocates capital based primarily on return on assets together with a number of risk factors. The following table summarizes information relating to revenues, gross margin and assets by operating segment for the years ended December 31, 2018 and 2017.

(US$ millions, except unit activity and average selling price)	Years Ended December 31 2018	2017
Housing revenue		
Canada	$ 458	$ 566
California	876	818
Central and Eastern U.S.	460	349
Total	$ 1,794	$ 1,733
Land revenue		
Canada	$ 159	$ 163
California	114	87
Central and Eastern U.S.	95	68
Total	$ 368	$ 318
Housing gross margin		
Canada	$ 87	$ 120
California	178	169
Central and Eastern U.S.	79	58
Total	$ 344	$ 347
Land gross margin		
Canada	$ 69	$ 78
California	35	36
Central and Eastern U.S.	25	12
Total	$ 129	$ 126
Home closings (units)		
Canada	1,215	1,413
California	1,205	1,007
Central and Eastern U.S.	991	754
	3,411	3,174
Unconsolidated Entities	4	7
Total	3,415	3,181
Average home selling price		
Canada	$ 377,000	$ 401,000
California	727,000	812,000
Central and Eastern U.S.	464,000	463,000
	526,000	546,000
Unconsolidated Entities	1,328,000	1,162,000
Average	$ 527,000	$ 547,000
Active housing communities		
Canada	34	28
California	26	26
Central and Eastern U.S.	28	27
	88	81
Unconsolidated Entities	—	1
Total	88	82

	Years Ended December 31	
	2018	2017
Lot closings (single family units)		
Canada	928	893
California	674	546
Central and Eastern U.S.	1,236	910
	2,838	2,349
Unconsolidated Entities	554	467
Total	3,392	2,816
Acre closings (multi-family, industrial and commercial)		
Canada	42	44
California	24	—
Central and Eastern U.S.	13	40
	79	84
Unconsolidated Entities	16	46
Total	95	130
Acre closings (raw and partially finished parcels)		
Canada	19	604
California	—	16
Central and Eastern U.S.	—	8
Total	19	628
Average lot selling price (single family units)		
Canada	$ 126,000	$ 131,000
California	167,000	141,000
Central and Eastern U.S.	72,000	68,000
	112,000	111,000
Unconsolidated Entities	113,000	117,000
Average	$ 112,000	$ 112,000
Average per acre selling price (multi-family, industrial and commercial)		
Canada	$ 945,000	$ 997,000
California	94,000	—
Central and Eastern U.S.	427,000	142,000
	603,000	591,000
Unconsolidated Entities	350,000	242,000
Average	$ 560,000	$ 467,000
Average per acre selling price (raw and partially finished parcels)		
Canada	$ 94,000	$ 4,000
California	—	254,000
Central and Eastern U.S.	—	95,000
Average	$ 94,000	$ 11,000
Active land communities		
Canada	13	12
California	5	6
Central and Eastern U.S.	12	10
	30	28
Unconsolidated Entities	8	7
Total	38	35

(US$ millions)	As at December 31 2018	As at December 31 2017
Total assets		
Canada	$ 1,057	$ 1,177
California	1,253	1,254
Central and Eastern U.S.	1,666	1,252
Corporate and other	546	555
Total	$ 4,522	$ 4,238

For more detailed financial information with respect to our revenues, earnings and assets, please refer to the accompanying consolidated financial statements and related notes included elsewhere in this annual report.

Year Ended December 31, 2018 Compared with Year Ended December 31, 2017

Net Income

Net income attributable to Brookfield Residential for the year ended December 31, 2018 was $174 million compared to $166 million for the year ended December 31, 2017.

(US$ millions, except per share amounts)	Years Ended December 31 2018	Years Ended December 31 2017
Net income attributable to Brookfield Residential	$ 174	$ 166
Basic earnings per share	$ 1.34	$ 1.28
Diluted earnings per share	$ 1.34	$ 1.28

The increase of $8 million in net income attributable to Brookfield Residential for the year ended December 31, 2018, compared to the same period in 2017 was primarily the result of an increase in other income of $35 million, a decrease in interest expense of $19 million, a decrease in income tax expense of $12 million, a gain on sale of commercial properties of $6 million, and an increase in equity in earnings from unconsolidated entities of $3 million. This was partially offset by an increase in selling, general and administrative expense of $59 million, and an increase of $8 million of net income attributable to non-controlling interests.

A breakdown of the revenue and gross margin for the years ended December 31, 2018 and 2017 is as follows:

(US$ millions, except percentages)	Years Ended December 31 2018	Years Ended December 31 2017
Revenue		
Housing	$ 1,794	$ 1,733
Land	368	318
	$ 2,162	$ 2,051
Gross Margin		
Housing	$ 344	$ 347
Land	129	126
	$ 473	$ 473
Gross Margin (%)		
Housing	19%	20%
Land	35%	40%
	22%	23%

For the year ended December 31, 2018, total revenue was $2.2 billion and increased by $111 million while total gross margin remained consistent with 2017. The increase in total revenue was primarily the result of higher housing and land revenue due to 237 additional home closings as well as 489 additional single family lot closings with a 1% higher average selling price. This was partially offset by 609 fewer raw and partially finished acre sales. There was also a 4% decrease in the average home selling price. Total gross margin of $473 million remained consistent with 2017 while total gross margin percentage of 22% was down 1% as a result of mix of product sold.

Results of Operations – Housing

Housing revenue and gross margin were $1.8 billion and $344 million, respectively, for the year ended December 31, 2018, compared to $1.7 billion and $347 million for the same period in 2017. The increase in revenue was the result of 237 additional home closings, partially offset by a 4% decrease in the average home selling price. Revenues are affected by geographic, product mix and market conditions, which have an impact on the selling price per home. Gross margin decreased as a result of lower average home selling prices across our Canada and California operating segments.

A breakdown of our results from housing operations for the years ended December 31, 2018 and 2017 is as follows:

Consolidated

	Years Ended December 31	
(US$ millions, except unit activity, percentages and average selling price)	**2018**	**2017**
Home closings	3,411	3,174
Revenue	$ 1,794	$ 1,733
Gross margin	$ 344	$ 347
Gross margin (%)	19%	20%
Average home selling price	$ 526,000	$ 546,000

A breakdown of our results from housing operations for our three operating segments is as follows:

Canada

	Years Ended December 31	
(US$ millions, except unit activity, percentages and average selling price)	**2018**	**2017**
Home closings	1,215	1,413
Revenue	$ 458	$ 566
Gross margin	$ 87	$ 120
Gross margin (%)	19%	21%
Average home selling price	$ 377,000	$ 401,000

Housing revenue in our Canadian segment for the year ended December 31, 2018 decreased by $108 million when compared to 2017. The decrease in revenue resulted from 198 fewer home closings and a 6% decrease in the average home selling price when compared to the same period in 2017. The decrease in the average home selling price was primarily due to lower average selling prices in our Ontario market as a result of the mix of homes sold with a higher-proportion coming from entry-level products. When comparing the average home selling price in Canadian dollars for the year ended December 31, 2018 to 2017, the average home selling price was C$491,000 compared to C$519,000. Gross margin and gross margin percentage decreased when compared to 2017 due to lower home closings and lower average home selling prices.

California

	Years Ended December 31	
(US$ millions, except unit activity, percentages and average selling price)	**2018**	**2017**
Home closings	1,205	1,007
Revenue	$ 876	$ 818
Gross margin	$ 178	$ 169
Gross margin (%)	20%	21%
Average home selling price	$ 727,000	$ 812,000

Housing revenue in our California segment was $876 million for the year ended December 31, 2018, an increase of $58 million when compared to the same period in 2017. The increase in housing revenue was due to 198 additional home closings partially offset by a 10% decrease in the average home selling price as a result of the product mix of homes sold particularly in Southern California with a greater proportion of entry-level homes closing in 2018 compared to luxury home closings in 2017. Gross margin increased $9 million when compared to 2017, primarily as a result of higher home closings while gross margin percentage decreased 1% as a result of product mix when compared to 2017.

Central and Eastern U.S.

(US$ millions, except unit activity, percentages and average selling price)	Years Ended December 31 2018	2017
Home closings	991	754
Revenue	$ 460	$ 349
Gross margin	$ 79	$ 58
Gross margin (%)	17%	17%
Average home selling price	$ 464,000	$ 463,000

The Central and Eastern U.S. housing revenue increased by $111 million for the year ended December 31, 2018 when compared to the same period in 2017 as a result of 237 additional home closings, due to increased activity in all of our markets within this operating segment and a consistent average home selling price. Gross margin increased by $21 million when compared to 2017 primarily as a result of higher home closings and gross margin percentage of 17% remained consistent with 2017.

Home Sales – Incentives

We grant our homebuyers sales incentives from time-to-time in order to promote sales of our homes. The type and amount of incentives will vary on a community-by-community and home-by-home basis. Incentives that impact the value of the home or the sales price paid, such as additional options, are reflected as a reduction to sales revenue. Incentives that we pay to an outside party, such as paying some or all of a homebuyer's closing costs, are recorded as cost of sales. Incentives are recognized at the time title passes to the homebuyer and the sale is recognized. For the year ended December 31, 2018, total incentives recognized as a percentage of gross revenues remained consistent with 2017.

Our incentives on homes closed by operating segment for the years ended December 31, 2018 and 2017 were as follows:

	Years Ended December 31			
	2018		2017	
(US$ millions, except percentages)	Incentives Recognized	% of Gross Revenues	Incentives Recognized	% of Gross Revenues
Canada	$ 11	2%	$ 14	2%
California	16	2%	21	2%
Central and Eastern U.S.	19	4%	19	5%
	$ 46	3%	$ 54	3%

Home Sales – Net New Home Orders

Net new home orders for any period represent the aggregate of all homes ordered by customers, net of cancellations. Net new home orders, including our share of unconsolidated entities, for the year ended December 31, 2018 totalled 2,858 units, a decrease of 475 units or 14% when compared to the same period in 2017. The decrease in net new home orders was a result of lower net new orders in our Canadian and California operating segments, partially offset by higher net new orders in our Central and Eastern U.S. operating segment. The decrease in net new orders in our Canadian segment was the most significant where the decrease of 599 units or 46% was due to lower home orders in our Alberta and Ontario markets as a result of market conditions. A large portion of the decrease was from our Ontario market where we had limited our community openings in 2018 to not compete with our backlog. Net new orders in our California segment decreased by 117 units as a result of lower net new orders from our Bay Area and Southern California markets. Net new orders in our Central and Eastern U.S. segment increased mainly due to higher net new orders in our Austin and Washington D.C. markets. Average monthly sales per community by reportable segment for the year ended December 31, 2018 were: Canada – 2 units (2017 – 4 units); California – 3 units (2017 – 4 units); Central and Eastern U.S. – 3 units (2017 – 3 units); and Unconsolidated Entities – nil units (2017 – 1 unit). We were selling from 88 active housing communities, including our share of unconsolidated entities, at December 31, 2018 compared to 82 at December 31, 2017.

The net new home orders for the years ended December 31, 2018 and 2017 by our three operating segments were as follows:

	Years Ended December 31	
(Units)	**2018**	**2017**
Canada	717	1,316
California	1,051	1,168
Central and Eastern U.S.	1,087	842
	2,855	3,326
Unconsolidated entities	3	7
	2,858	3,333

The overall cancellation rates for the years ended December 31, 2018 and 2017 were 11% and 9%, respectively. The increase in the cancellation rate was primarily driven by a higher number of cancellations in our Ontario and Southern California markets. The cancellation rates for the years ended December 31, 2018 and 2017 by our three operating segments were as follows:

	Years Ended December 31			
	2018		**2017**	
(Units, except percentages)	**Units**	**% of Gross Home Orders**	**Units**	**% of Gross Home Orders**
Canada	39	5%	29	2%
California	146	12%	138	11%
Central and Eastern U.S.	172	14%	177	17%
	357	11%	344	9%
Unconsolidated entities	1	29%	2	22%
	358	11%	346	9%

Home Sales – Backlog

Our backlog, which represents the number of new homes subject to sales contracts, as at December 31, 2018 and 2017 by operating segment, were as follows:

	As at December 31			
	2018		**2017**	
(US$ millions, except unit activity)	**Units**	**Value**	**Units**	**Value**
Canada	451	$ 198	949	$ 455
California	261	202	415	308
Central and Eastern U.S.	425	212	329	165
	1,137	612	1,693	928
Unconsolidated entities	—	—	2	1
Total	1,137	$ 612	1,695	$ 929

We expect all of our backlog to close in 2019, 2020, or 2021, subject to future cancellations. The units in our backlog decreased compared to the prior year primarily due to lower net new home orders in our Canadian and California operating segments for the year ended December 31, 2018. Our units in backlog in our Canadian segment decreased by 498 units at December 31, 2018, when compared to December 31, 2017, mainly due to lower net new home orders in our Ontario and Alberta markets as a result of market conditions. Our California segment's units in backlog decreased mainly due to a 10% decrease in net new home orders for the year ended December 31, 2018 compared to 2017. The increase of 96 units in the Central and Eastern U.S. segment was primarily the result of an increase in net new orders primarily in our Austin and Washington D.C. markets. Total backlog value decreased by $317 million when compared to the same period in 2017 primarily as a result of lower backlog units, as well as product mix of homes in backlog.

Results of Operations – Land

Land revenue totalled $368 million for the year ended December 31, 2018, an increase of $50 million when compared to the same period in 2017, and land gross margin totalled $129 million, an increase of $3 million when compared to 2017. The increase in land revenue was primarily due to 489 additional single family lot closings with a 1% higher average selling price. This was partially offset by 609 fewer raw and partially finished acre sales, due to a bulk acre sale in 2017 with no comparative sale in 2018. Revenues are affected by geographic, product mix and market conditions, which have an impact on the selling price of land. Gross margin increased $3 million for the year ended December 31, 2018 primarily due to higher single family lot closings, partially offset by a 5% lower gross margin percentage due to the mix of land sold.

A breakdown of our results from land operations for the years ended December 31, 2018 and 2017 is as follows:

Consolidated

(US$ millions, except unit activity, percentages and average selling price)	Years Ended December 31 2018	2017
Lot closings (single family units)	2,838	2,349
Acre sales (multi-family, industrial and commercial)	79	84
Acre sales (raw and partially finished parcels)	19	628
Revenue	$ 368	$ 318
Gross margin	$ 129	$ 126
Gross margin (%)	35%	40%
Average lot selling price (single family units)	$ 112,000	$ 111,000
Average per acre selling price (multi-family, industrial and commercial)	$ 603,000	$ 591,000
Average per acre selling price (raw and partially finished parcels)	$ 94,000	$ 11,000

A breakdown of our results from land operations for our three operating segments is as follows:

Canada

(US$ millions, except unit activity, percentages and average selling price)	Years Ended December 31 2018	2017
Lot closings (single family units)	928	893
Acre sales (multi-family, industrial and commercial)	42	44
Acre sales (raw and partially finished parcels)	19	604
Revenue	$ 159	$ 163
Gross margin	$ 69	$ 78
Gross margin (%)	43%	48%
Average lot selling price (single family units)	$ 126,000	$ 131,000
Average per acre selling price (multi-family, industrial and commercial)	$ 945,000	$ 997,000
Average per acre selling price (raw and partially finished parcels)	$ 94,000	$ 4,000

Land revenue in Canada for the year ended December 31, 2018 was $159 million, a decrease of $4 million when compared to the same period in 2017. The decrease in revenue was primarily the result of 4% lower average single family lot selling prices, two fewer multi-family, industrial and commercial acres sold and 19 raw and partially finished acre sales in 2018 compared to 604 acre sales in 2017. This was partially offset by 35 additional single family lot closings. Gross margin decreased $9 million primarily as a result of lower activity in 2018 when compared to the same period in 2017. Gross margin percentage decreased 5% when compared to 2017, primarily due to the mix of land sold.

California

(US$ millions, except unit activity, percentages and average selling price)	Years Ended December 31 2018	2017
Lot closings (single family units)	674	546
Acre sales (multi-family, industrial and commercial)	24	—
Acre sales (raw and partially finished parcels)	—	16
Revenue	$ 114	$ 87
Gross margin	$ 35	$ 36
Gross margin (%)	31%	41%
Average lot selling price (single family units)	$ 167,000	$ 141,000
Average per acre selling price (multi-family, industrial and commercial)	$ 94,000	$ —
Average per acre selling price (raw and partially finished parcels)	$ —	$ 254,000

Land revenue for our California operating segment for the year ended December 31, 2018 increased $27 million when compared to the same period in 2017. This was primarily the result of 128 additional single family lot closings with an 18% higher average selling price for the year ended December 31, 2018 when compared to 2017. Additionally, there were 24 multi-family, industrial and commercial acre sales in 2018 compared to none in 2017. This was partially offset by 16 raw and partially finished acre sales in 2017 with no comparative sale in 2018. Gross margin decreased $1 million while gross margin percentage decreased 10% as a result of a change in the mix of land sold when compared to the same period in 2017.

Central and Eastern U.S.

	Years Ended December 31	
(US$ millions, except unit activity, percentages and average selling price)	**2018**	**2017**
Lot closings (single family units)	1,236	910
Acre sales (multi-family, industrial and commercial)	13	40
Acre sales (raw and partially finished parcels)	—	8
Revenue	$ 95	$ 68
Gross margin	$ 25	$ 12
Gross margin (%)	26%	18%
Average lot selling price (single family units)	$ 72,000	$ 68,000
Average per acre selling price (multi-family, industrial and commercial)	$ 427,000	$ 142,000
Average per acre selling price (raw and partially finished parcels)	$ —	$ 95,000

For the year ended December 31, 2018, Central and Eastern U.S. land revenue increased $27 million and gross margin increased $13 million, when compared to 2017. The increase in revenue was primarily from an additional 326 single family lot closings, which was primarily the result of higher single family lot sales in our Austin and Denver markets. This was partially offset by 27 fewer multi-family, industrial, and commercial acre sales and 8 raw and partially finished acre sales in 2017, with no comparative sales in 2018. Gross margin percentage increased 8% primarily as a result of increased gross margin due to the mix of land sold within the operating segment.

Equity in Earnings from Unconsolidated Entities

Equity in earnings from unconsolidated entities for the year ended December 31, 2018 totalled $18 million, compared to $15 million for the same period in 2017. The housing and land operations of our unconsolidated entities are discussed below.

Housing

A summary of Brookfield Residential's share of the housing operations from unconsolidated entities is as follows:

	Years Ended December 31	
(US$ millions, except unit activity, percentages and average selling price)	**2018**	**2017**
Home closings	4	7
Revenue	$ 5	$ 8
Gross margin	$ 1	$ 1
Gross margin (%)	20%	13%
Average home selling price	$ 1,328,000	$ 1,162,000

Housing revenue within unconsolidated entities decreased $3 million and gross margin remained consistent for the year ended December 31, 2018 when compared to the same period in 2017. The decrease in housing revenue and home closings is a result of acquiring the remaining 50% of our housing joint venture in Hawaii during the third quarter of 2018 which is now a wholly-owned subsidiary where results subsequent to the acquisition are included in the consolidated financial statements.

Land

A summary of Brookfield Residential's share of the land operations from unconsolidated entities is as follows:

(US$ millions, except unit activity, percentages and average selling price)	Years Ended December 31 2018		2017	
Lot closings (single family units)		554		467
Acre closings (multi-family, industrial and commercial)		16		46
Revenue	$	68	$	66
Gross margin	$	17	$	15
Gross margin (%)		25%		23%
Average lot selling price (single family units)	$	113,000	$	117,000
Average per acre selling price (multi-family, industrial and commercial)	$	350,000	$	242,000

Land revenue within unconsolidated entities increased $2 million and gross margin increased $2 million for the year ended December 31, 2018 when compared to the same period in 2017. This was primarily the result of 87 additional single family lot closings, primarily from our Phoenix and Southern California joint ventures and 45% higher average selling prices on multi-family, industrial and commercial acre sales. This was partially offset by a 3% decrease in the average single family lot selling price due to the geographic mix of land sold and 30 fewer multi-family, industrial and commercial acre sales.

Gain on Commercial Properties

The components of the gain on sale of commercial properties for the years ended December 31, 2018 and 2017 are summarized as follows:

(US$ millions)	Years Ended December 31 2018		2017	
Proceeds	$	8,324	$	—
Gain on commercial properties	$	6,331	$	—

Income was generated from the sale of a commercial property during the year ended December 31, 2018. The 4.92 acre property at Seton in Calgary, Alberta was sold for proceeds of $8 million and a gain of $6 million. There were no such sales of commercial properties in 2017.

Selling, General and Administrative Expense

The components of selling, general and administrative expense for the years ended December 31, 2018 and 2017 are summarized as follows:

(US$ millions)	Years Ended December 31 2018		2017	
General and administrative expense	$	165	$	133
Sales and marketing expense		112		88
Share-based compensation		19		16
	$	296	$	237

Selling, general and administrative expense was $296 million for the year ended December 31, 2018, an increase of $59 million when compared to the same period in 2017. General and administrative expense increased $32 million primarily due to higher salaries and benefits costs of $16 million as a result of an increase in headcount arising from the acquisition of OliverMcMillan and taking on the management of one of our joint ventures in the Phoenix market. Additionally, our general and administrative expense was impacted by a re-classification of joint venture management fee income into other income as a result of the adoption of ASC Topic 606, as well as increased transaction costs relating to the acquisition of OliverMcMillan in the first quarter of 2018. For the year ended December 31, 2017, there was $8 million of joint venture management fee income that was included as an offset to general and administrative expense. Sales and marketing expense increased $24 million primarily due to the $9 million reclassification of the amortization of capitalized sales and marketing costs that was previously classified as cost of sales as a result of the adoption of ASC Topic 606. Share-based compensation increased $3 million primarily resulting from the change in fair value of our share-based compensation liabilities for the year ended December 31, 2018 compared to the year ended December 31, 2017.

Other Income

The components of other income for the years ended December 31, 2018 and 2017 are summarized as follows:

	Years Ended December 31	
(US$ millions)	**2018**	**2017**
Investment income	$ 40	$ 23
Joint venture management fee income	15	—
Other	8	5
	$ 63	$ 28

For the year ended December 31, 2018, other income increased $35 million compared to the same period in 2017. This was primarily the result of a $14 million increase in interest revenue earned on our loan receivables, $3 million increase in dividends received on our held-to-maturity investment due to a higher dividend rate and a $15 million increase due to joint venture management fee income, which was reclassified from general and administrative expense in 2018. For more information, refer to Note 2 "Change in Accounting Policies" of the consolidated financial statements. Additionally, other income increased by $3 million primarily as a result of promote income earned on our Nashville mixed-use asset.

Income Tax Expense

Income tax expense was $40 million for the year ended December 31, 2018, compared to $52 million for the year ended December 31, 2017. The components of income tax expense are summarized as follows:

	Years Ended December 31	
(US$ millions)	**2018**	**2017**
Current income tax expense	$ 38	$ 37
Deferred income tax expense	2	15
	$ 40	$ 52

For the year ended December 31, 2018, current income tax expense increased $1 million, compared to the same period in 2017. This was primarily due to the increase in U.S. income from operations compared to the same period in 2017 and the elimination of the domestic production activities deduction, offset by the reduction in the U.S. federal corporate income tax rates from 35% to 21% and the favorable net impact of federal energy tax credits.

For the year ended December 31, 2018, deferred income tax expense decreased $13 million, compared to the same period in 2017. This was primarily due to the decrease in Canadian income from operations compared to the same period in 2017 and the re-measurement of our deferred tax assets in the U.S. of $4 million in 2017 due to the impact of the Tax Cuts and Jobs Act which was enacted into law on December 22, 2017.

Foreign Exchange Translation

The U.S. dollar is the functional and presentation currency of the Company. Each of the Company's subsidiaries, affiliates and jointly controlled entities determines its own functional currency and items included in the financial statements of each subsidiary, affiliate and jointly controlled entity are measured using that functional currency. The Company's Canadian operations are self-sustaining. The financial statements of its self-sustaining Canadian operations are translated into U.S. dollars using the current rate method.

Assets and liabilities of subsidiaries or unconsolidated entities having a functional currency other than the U.S. dollar are translated at the rate of exchange on the balance sheet date. As at December 31, 2018, the rate of exchange was C$1.3641 equivalent to US$1 (December 31, 2017 – C$1.2574 equivalent to US$1). Revenues and expenses are translated at average rates for the period, unless exchange rates fluctuated significantly during the period, in which case the exchange rates at the dates of the transaction are used. For the year ended December 31, 2018, the average rate of exchange was C$1.2957 equivalent to US$1 (December 31, 2017 – C$1.2969 equivalent to US$1). The resulting foreign currency translation adjustments are recognized in other comprehensive income ("OCI"). Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the date of the transactions. At the end of each reporting period, foreign currency denominated monetary assets and liabilities are translated to the functional currency using the prevailing rate of exchange at the balance sheet date. Gains and losses on translation of monetary items are recognized in the consolidated statements of operations as other income / (expense), except for those related to monetary liabilities qualifying as hedges of the Company's investment in foreign operations or certain intercompany loans to or from a foreign operation for which settlement is neither planned nor likely to occur in the foreseeable future, which are included in OCI.

The financial results of our Canadian operations are translated into U.S. dollars for financial reporting purposes. Foreign currency translation gains and losses are recorded as the exchange rate between the two currencies fluctuates. These gains and losses are included in OCI and accumulated OCI. The translation of our Canadian operations resulted in a loss of $64 million for the year ended December 31, 2018, compared to a gain of $53 million in the same period of 2017.

QUARTERLY OPERATING AND FINANCIAL DATA [(1)]

(US$ millions, except unit activity and per share amounts)	2018 Q4	2018 Q3	2018 Q2	2018 Q1	2017 Q4	2017 Q3	2017 Q2	2017 Q1
Quarterly Operating Data								
Home closings (units)	1,107	827	1,019	458	1,168	692	733	581
Lot closings (single family units)	1,655	552	367	264	1,076	467	597	209
Acre closings (multi-family, industrial and commercial)	27	42	1	9	59	15	8	1
Acre closings (raw and partially finished)	—	—	19	—	61	313	230	24
Net new home orders (units)	506	644	782	923	679	716	998	933
Backlog (units at end of period)	1,137	1,738	1,921	2,158	1,693	2,182	2,158	1,893
Backlog value	$ 612	$ 955	$1,038	$ 1,182	$ 928	$ 1,198	$1,166	$ 969
Quarterly Financial Data[(1)]								
Revenue	$ 796	$ 502	$ 589	$ 274	$ 818	$ 451	$ 443	$ 338
Direct cost of sales	(619)	(388)	(463)	(218)	(610)	(349)	(354)	(264)
Gross margin	177	114	126	56	208	102	89	74
Gain on sale of commercial properties	6	—	—	—	—	—	—	—
Selling, general and administrative expense	(93)	(72)	(71)	(60)	(74)	(56)	(56)	(51)
Interest expense	(9)	(8)	(9)	(12)	(13)	(15)	(14)	(15)
Equity in earnings from unconsolidated entities	5	4	4	5	7	5	1	2
Other income	15	18	14	12	8	7	5	4
Income before income taxes	101	56	64	1	136	43	25	14
Income tax (expense) / recovery	(22)	(8)	(12)	2	(42)	(8)	(3)	2
Net income	79	48	52	3	94	35	22	16
Net income attributable to non-controlling interest	2	4	2	—	—	—	—	—
Net income attributable to Brookfield Residential	$ 77	$ 44	$ 50	$ 3	$ 94	$ 35	$ 22	$ 16
Foreign currency translation	(42)	14	(15)	(21)	(8)	32	22	7
Comprehensive income / (loss)	$ 35	$ 58	$ 35	$ (18)	$ 86	$ 67	$ 44	$ 23
Basic	$ 0.59	$ 0.34	$ 0.38	$ 0.02	$ 0.72	$ 0.27	$ 0.17	$ 0.12
Diluted	$ 0.59	$ 0.34	$ 0.38	$ 0.02	$ 0.72	$ 0.27	$ 0.17	$ 0.12

(1) *The Company applied ASC Topic 606 Revenue from Contracts with Customers, ("ASC Topic 606") with an initial application date of January 1, 2018. ASC Topic 606 was applied using the modified retrospective approach and therefore, the comparative information has not been adjusted and continues to be reported under ASC Topic 605 Revenue Recognition. For more information, refer to Note 2 "Change in Accounting Policies" of the consolidated financial statements.*

We have historically experienced variability in our results of operations from quarter to quarter due to the seasonal nature of the homebuilding business and the timing of new community openings and the closing out of projects. We typically experience the highest rate of orders for new homes and lots in the first nine months of the calendar year, although the rate of orders for new homes is highly dependent upon the number of active communities. As new home deliveries trail orders for new homes by several months, we typically deliver a greater percentage of new homes in the second half of the year compared with the first half of the year. As a result, our revenues from the sales of homes are generally higher in the second half of the year. In terms of land sales, results are more variable from year to year given the nature of the development and monetization cycle.

Fourth Quarter Highlights

Key financial results and operating data for the three months ended December 31, 2018 compared to the three months ended December 31, 2017 were as follows:

(US$ millions, except percentages, unit activity, average selling price and per share amounts)	Three Months Ended December 31 2018	2017
Key Financial Results[1]		
Total revenue	$ 796	$ 818
Housing revenue	596	659
Land revenue	200	159
Gross margin ($)	177	208
Gross margin[2] (%)	22%	25%
Income before income taxes	101	136
Income tax expense	(22)	(42)
Net income attributable to Brookfield Residential	77	94
Basic earnings per share	$ 0.59	$ 0.72
Diluted earnings per share	$ 0.59	$ 0.72
Key Operating Data		
Home closings for Brookfield Residential (units)	1,107	1,168
Home closings for unconsolidated entities (units)	—	2
Average home selling price for Brookfield Residential (per unit)	$ 539,000	$ 564,000
Average home selling price for unconsolidated entities (per unit)	$ —	$ 983,000
Net new home orders for Brookfield Residential (units)	506	679
Net new home orders for unconsolidated entities (units)	—	—
Backlog for Brookfield Residential (units)	1,137	1,693
Backlog for unconsolidated entities (units)	—	2
Backlog value for Brookfield Residential	$ 612	$ 928
Backlog value for unconsolidated entities	$ —	$ 1
Lot closings for Brookfield Residential (single family units)	1,655	1,076
Lot closings for unconsolidated entities (single family units)	239	192
Acre closings for Brookfield Residential (multi-family, industrial and commercial)	27	59
Acre closings for unconsolidated entities (multi-family, industrial and commercial)	—	13
Acre closings for Brookfield Residential (raw and partially finished parcels)	—	61
Average lot selling price for Brookfield Residential (single family units)	$ 105,000	$ 122,000
Average lot selling price for unconsolidated entities (single family units)	$ 100,000	$ 156,000
Average per acre selling price for Brookfield Residential (multi-family, industrial and commercial)	$ 941,000	$ 465,000
Average per acre selling price for unconsolidated entities (multi-family, industrial and commercial)	$ —	$ 200,000
Average per acre selling price for Brookfield Residential (raw and partially finished parcels)	$ —	$ 2,000

(1) The Company applied ASC Topic 606 Revenue from Contracts with Customers, ("ASC Topic 606") with an initial application date of January 1, 2018. ASC Topic 606 was applied using the modified retrospective approach and therefore, the comparative information has not been adjusted and continues to be reported under ASC Topic 605 Revenue Recognition. For more information, refer to Note 2 "Change in Accounting Policies" of the consolidated financial statements.

(2) Gross margin percentage is a non-GAAP financial measure and has been presented as we find it useful in evaluating our performance and believe that it helps readers of our financial statements compare our operations with those of our competitors. However, gross margin percentage as presented may not be fully comparable to similarly-titled measures reported by our competitors. See the Non-GAAP Financial Measures section on page 31.

Net income attributable to Brookfield Residential for the three months ended December 31, 2018 was $77 million compared to $94 million for the same period in 2017.

For the three months ended December 31, 2018, total revenue decreased $22 million and gross margin decreased $31 million, when compared to the same period in 2017. The decrease in total revenue was the result of 61 fewer home closings, 32 fewer multi-family, commercial and industrial acre sales as well as having 61 raw and partially finished acre sales in 2017, compared to none in 2018. There was also a 14% decrease in the average single family lot selling price. This was partially offset by 579 additional single family lot closings. The decrease in total gross margin was primarily a result of lower housing gross margins, due to a lower gross margin percentage. This was partially offset by an increase in land gross margins due to higher single family lot closings and mix of land sold when compared to the same period in 2017.

For the three months ended December 31, 2018, housing revenue was $596 million compared to $659 million for the same period in 2017. Housing gross margin for the three months ended December 31, 2018 was $113 million, a $35 million decrease compared to the same period in 2017. The decrease in housing revenue was primarily due to 61 fewer home closings and a 4% decrease in the average home selling price as a result of product mix. The decrease in gross margin was primarily a result of a decrease in gross margin percentage in our California and Canadian operating segments due to geographic and product mix of homes sold within each operating segment.

Housing gross margin in the Canadian segment decreased $32 million when compared to the same period in 2017 primarily as a result of 179 fewer home closings and a 7% decrease in the housing gross margin percentage primarily due to 7% lower average home selling prices from the geographic mix of homes closed within the segment. The California segment's housing gross margin decreased $9 million due to a 14% decrease in average home selling price due to the mix of homes sold, partially offset by 50 additional home closings. Central and Eastern U.S. housing gross margin increased $6 million due to 68 additional home closings and partially offset by a 1% decrease in the average home selling price.

Land revenue for the three months ended December 31, 2018 was $200 million, an increase of $41 million compared to 2017. The increase in revenue was mainly the result of 579 additional single family closings, primarily from higher closings in our Central and Eastern U.S. operating segment. This was partially offset by 32 fewer multi-family, commercial and industrial acre sales and having 61 raw and partially finished acre sales in 2017 with no comparative sales for the three months ended December 31, 2018. There was also a 14% decrease in the average single family lot selling price due to the geographic mix of land sold.

Land gross margin was $64 million, a $4 million increase compared to the same period in 2017. Land gross margin in Canada remained consistent with 2017. California land gross margin decreased $12 million due to lower land margins in our Southern California market as a result of product mix and 128 fewer single family lot closings. Central and Eastern U.S. land gross margin increased $16 million due to 704 additional single family lot closings combined with 3% higher average single family lot selling prices.

For the three months ended December 31, 2018, equity in earnings from unconsolidated entities decreased $2 million when compared to the same period in 2017. The decrease in equity in earnings was primarily due to a 38% decrease in the average single family lot selling price in our Phoenix and California joint ventures, partially offset by 47 additional single family lot closings.

LIQUIDITY AND CAPITAL RESOURCES

Financial Position

The following is a summary of the Company's consolidated balance sheets as at December 31, 2018 and December 31, 2017:

(US$ millions)	As at December 31 2018	As at December 31 2017
Land and housing inventory	$ 2,974	$ 2,998
Investments in unconsolidated entities	347	313
Commercial properties	270	38
Receivables and other assets	480	413
Held-to-maturity investment	300	300
Cash and restricted cash	73	108
Deferred income tax assets	62	68
Goodwill	16	—
	$ 4,522	$ 4,238
Notes payable	$ 1,620	$ 1,632
Bank indebtedness and other financings	143	31
Accounts payable and other liabilities	636	561
Total equity	2,123	2,014
	$ 4,522	$ 4,238

Assets

Our assets as at December 31, 2018 totalled $4.5 billion. Our land and housing inventory and investments in unconsolidated entities are our most significant assets with a combined book value of $3.3 billion, or approximately 73% of our total assets. The land and housing assets decreased when compared to December 31, 2017 due to sales activity, partially offset by land acquisitions of $301 million and land development and home construction activity. Our land and housing assets include land under development and land held for development, finished lots ready for construction, homes completed and under construction and model homes.

A summary of our lots owned, excluding unconsolidated entities, and their stage of development as at December 31, 2018 compared with December 31, 2017 follows:

	As at December 31, 2018		As at December 31, 2017	
(US$ millions, except units)	Units	Book Value	Units	Book Value
Land held for development (lot equivalents)	67,104	$ 1,417	70,389	$ 1,448
Land under development and finished lots (single family units)	10,225	839	7,192	833
Housing units, including models	1,980	654	1,972	631
	79,309	$ 2,910	79,553	$ 2,912
Multi-family, industrial and commercial parcels (acres)	172	$ 64	139	$ 86

Notes Payable

Notes payable consist of the following:

(US$ millions)	As at December 31 2018	As at December 31 2017
6.50% unsecured senior notes due December 15, 2020 (a)	$ 600	$ 600
6.125% unsecured senior notes due July 1, 2022 (b)	500	500
6.125% unsecured senior notes due May 15, 2023 (c)	183	199
6.375% unsecured senior notes due May 15, 2025 (d)	350	350
	$ 1,633	$ 1,649
Transaction costs (e)	(13)	(17)
	$ 1,620	$ 1,632

(a) On December 14, 2012, Brookfield Residential issued $600 million of unsecured senior notes. The notes were offered in a private placement, with an eight-year term due December 15, 2020 at a fixed interest rate of 6.50%. The notes require semi-annual interest payments on June 15 and December 15 of each year until maturity. The Company's obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

(b) On June 25, 2013, the Company and Brookfield Residential US Corporation, a wholly-owned subsidiary of the Company, co-issued a private placement of $500 million of unsecured senior notes. The notes have a nine-year term, are due July 1, 2022 and bear interest at a fixed rate of 6.125%. The notes require semi-annual interest payments on January 1 and July 1 each year until maturity. The Company's and Brookfield Residential US Corporation's obligations to pay principal and interest on the unsecured notes are guaranteed by the Company and certain of the Company's subsidiaries.

(c) On May 12, 2015, Brookfield Residential issued C$250 million of unsecured senior notes. The notes were offered in a private placement, with an eight-year term due May 15, 2023 at a fixed interest rate of 6.125%. The notes require semi-annual interest payments on May 15 and November 15 of each year until maturity. The Company's obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

(d) On May 12, 2015, Brookfield Residential issued $350 million of unsecured senior notes. The notes were offered in a private placement, with a ten-year term due May 15, 2025 at a fixed interest rate of 6.375%. The notes require semi-annual interest payments on May 15 and November 15 of each year until maturity. The Company's obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

(e) The transaction costs are costs related to the issuance of the Company's notes payable and are amortized using the effective interest rate method over the life of the related debt instrument.

The indentures governing the notes include covenants that, among others, place limitations on incurring additional indebtedness and making restricted payments. Under the limitation on additional indebtedness, we are permitted to incur specified categories of indebtedness but are prohibited from incurring further indebtedness if we do not satisfy either an indebtedness to consolidated net tangible worth ratio or a fixed charge coverage ratio. Brookfield Residential was in compliance with these financial incurrence covenants as at December 31, 2018. Our actual fixed charge coverage and indebtedness to consolidated net tangible worth ratio as at December 31, 2018 are reflected in the table below:

	Covenant	Actual as at December 31 2018
Minimum fixed charge coverage	2.0 to 1	2.89 to 1
Maximum indebtedness to consolidated net tangible worth	2.25 to 1	0.85 to 1

Bank Indebtedness and Other Financings

Our bank indebtedness and other financings as at December 31, 2018 were $143 million, an increase of $112 million from December 31, 2017. The increase was primarily the result of borrowings to fund land development and home construction activity, land acquisitions as well as the acquisitions and development of OliverMcMillan, a mixed-use development company. Our bank indebtedness and other financings represent construction and development loans and facilities that are used to fund the operations of our communities as land is developed and homes are constructed. As of December 31, 2018, the weighted average interest rate on our bank indebtedness and other financings was 4.4% (December 31, 2017 – 3.9%).

The debt maturing in 2019 and onwards is expected to either be refinanced or repaid from home and/or lot closings over this period. Additionally, as at December 31, 2018, we had bank indebtedness capacity of $515 million that was available to complete land development and construction activities. The "Cash Flow" section below discusses future available capital resources should proceeds from our future home and/or lot closings not be sufficient to repay our debt obligations.

Bank indebtedness and other financings consists of the following:

(US$ millions)	As at	
	December 31 2018	**December 31 2017**
Bank indebtedness (a)	$ 89	$ —
Project-specific financings (b)	35	—
Secured vendor take back ("VTB") mortgages (c)	29	31
	153	31
Transaction costs (a)(b)	(10)	—
	$ 143	$ 31

(a) Bank indebtedness

(i) On March 8, 2018, the Company and Brookfield Residential US Corporation, a wholly owned subsidiary of the Company, entered into a three-year North American senior unsecured credit facility with various lenders, to replace its previously held Canadian secured credit facilities and its U.S. unsecured revolving credit facility. Brookfield Residential US Corporation and the Company are co-borrowers. The facility allows the Company to borrow in either Canadian or U.S. dollars with borrowings allowable up to $675 million.

As at December 31, 2018, the total borrowings outstanding under the North American unsecured credit facility were $89 million (December 31, 2017 - $nil).

For U.S. dollar denominated borrowings, interest is charged on the facility at a rate equal to, at the borrower's option, either the adjusted LIBOR plus an applicable rate between 1.75% and 2.25% per annum or an alternative base rate ("ABR") plus an applicable rate between 0.75% and 1.25% per annum. For Canadian dollar denominated borrowings, interest is charged on the facility at a rate equal to either the Canadian dollar offered rate ("CDOR") plus an applicable rate between 1.75% and 2.25% per annum or the Canadian prime rate plus an applicable rate between 0.75% and 1.25% per annum.

The facility contains certain restrictive covenants including limitations on liens, dividends and other distributions, investments in subsidiaries and joint ventures that are not party to the loan. The facility requires the Company to maintain a minimum consolidated tangible net worth of $1,253 million, as well as a consolidated total debt to consolidated total capitalization of no greater than 65%. As at December 31, 2018, the Company was in compliance with all of our covenants relating to this facility. The following table reflects consolidated tangible net worth and consolidated net debt to capitalization covenants:

(US$ millions, except percentages)	**Covenant**	**Actual as at December 31 2018**
Minimum tangible net worth	$ 1,253	$ 2,106
Maximum total debt to capitalization	65%	46%

The transaction costs are costs related to the issuance of the Company's facility, and are amortized using the effective interest rate method over the life of the facility.

(ii) On March 8, 2018, the Company had repaid and extinguished its secured Canadian credit facilities, which were previously outstanding as of December 31, 2017.

The Company has extinguished its four secured Canadian credit facilities, with various Canadian banks, which had no outstanding borrowings as of December 31, 2017. These facilities had allowed the Company to borrow up to approximately C$505 million (US$402 million) as of December 31, 2017. The facilities were previously secured by the land and housing inventory assets of the Alberta and Ontario operations and a general charge over the property of Brookfield Residential (Alberta) LP and Brookfield Residential (Ontario) LP, both wholly owned subsidiaries of the Company.

(iii) On March 8, 2018, the Company repaid and extinguished its U.S. unsecured revolving credit facility with various lenders, which had no outstanding borrowings as of December 31, 2017. Brookfield Residential US Corporation, a wholly-owned subsidiary of the Company, as borrower, and the Company, as the parent company to the borrower, had borrowings allowable up to $275 million.

(b) Project-specific financings

(i) At December 31, 2018, the Company has Canadian project-specific financings totaling $35 million (C$48 million) provided by various lenders (December 31, 2017 - $nil).

Project-specific financing totaling $8 million, has an interest rate of Canadian Prime + 0.5%, matures in 2020, and is unsecured without covenants. The debt is repayable in Canadian dollars of C$11 million.

Project-specific financing totaling $27 million has an interest rate of Canadian Prime + 0.5%, matures in 2019, and is secured by certain land and housing inventory assets of the Company's Alberta operations and a general charge over the property of South Seton Limited Partnership, a consolidated subsidiary of the Company. This debt is repayable in Canadian dollars of C$37 million (December 31, 2017 - C$nil). This borrowing includes a minimum debt to equity covenant for South Seton Limited Partnership of no greater than 1.50 to 1. The Company was in compliance with these covenants as at December 31, 2018. The following table reflects the debt to equity ratio covenant:

	Covenant	Actual as at December 31 2018
Maximum debt to equity ratio	1.50 to 1	0.43 to 1

(ii) On November 29, 2018, OliverMcMillan Spectrum Emery LLC, a wholly owned subsidiary of the Company, entered into a five-year secured construction loan with a Canadian federal corporation for the Nashville mixed-used project. The loan allows OliverMcMillan Spectrum Emery LLC to borrow up to $360 million in U.S. dollars.

As at December 31, 2018, there were no borrowings outstanding under the construction loan (December 31, 2017 - $nil).

Interest is charged on the loan at a rate equal to LIBOR plus 3.35%, with the ability to convert the interest charged to a prime rate loan.

The loan contains certain restrictive covenants including leasing and construction of the project. The loan requires Brookfield Residential US Corporation, as the parent company to the borrower and a wholly owned subsidiary of the Company, to maintain a minimum liquidity of $36 million and a minimum net worth of $360 million. The loan is secured by the assets of OliverMcMillan Spectrum Emery LLC. The Company was in compliance with these covenants as at December 31, 2018. The following table reflects the covenants:

(US$ millions)	Covenant	Actual as at December 31 2018
Minimum liquidity	$ 36	$ 570
Minimum net worth	360	1,074

The transaction costs are costs related to the issuance of the project facility, and are amortized using the straight-line method over the life of the project facility.

(c) Secured VTB mortgages

Nine secured VTB mortgages (December 31, 2017 – four secured VTB mortgages) in the amount of $25 million (December 31, 2017 – $12 million) relate to raw land held for development by Brookfield Residential (Alberta) LP and Brookfield Residential (Ontario) LP. This debt is repayable in Canadian dollars of C$34 million (December 31, 2017 – C$15 million). The interest rate on this debt ranges from fixed rates of 2.2% to 6.0% and variable rates of prime plus 2% and the debt is secured by related land. As at December 31, 2018, these borrowings are not subject to any financial covenants.

Three secured VTB mortgages (December 31, 2017 – six secured VTB mortgages) in the amount of $4 million (December 31, 2017 – $19 million) relate to raw land held for development by various wholly-owned U.S. subsidiaries of the Company. The interest rate on the debt ranges from fixed rates of 0% to 6% and the debt is secured by related land. As at December 31, 2018, these borrowings are not subject to any financial covenants.

Net Debt to Capitalization Calculation

Brookfield Residential's net debt to total capitalization ratio is defined as total interest-bearing debt less cash divided by total capitalization. We define capitalization to include total equity and interest bearing debt, less cash.

Our net debt to total capitalization ratio as at December 31, 2018 and December 31, 2017 was as follows:

	As at	
(US$ millions, except percentages)	**December 31 2018**	**December 31 2017**
Bank indebtedness and other financings	$ 143	$ 31
Notes payable	1,620	1,632
Total interest bearing debt	1,763	1,663
Less: cash	(70)	(105)
	1,693	1,558
Total equity	2,123	2,014
Total capitalization	$ 3,816	$ 3,572
Net debt to total capitalization	44%	44%

Credit Ratings

Our access to financing depends on, among other things, suitable market conditions and the maintenance of suitable long-term credit ratings. Our credit ratings may be adversely affected by various factors, including but not limited to, increased debt levels, decreased earnings, declines in our customer demand, increased competition, a further deterioration in general economic and business conditions and adverse publicity. Any downgrades in our credit rating may impede our access to capital markets or raise our borrowing rates. We are currently rated by two credit rating agencies, Moody's and Standard & Poor's ("S&P"). We are committed to maintaining these ratings and improving them further over time. Our credit ratings at December 31, 2018 and at the date of this annual report were as follows:

	Moody's	**S&P**
Corporate rating	B1	B
Outlook	Stable	Positive

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issuer of securities. Agency ratings are subject to change, and there can be no assurance that a rating agency will rate us and/or maintain our rating.

Cash Flow

Our principal uses of working capital include acquisitions of land, land development, home construction and mixed-use development. Cash flows for each of our communities depend upon the applicable stage of the development cycle and can differ substantially from reported earnings. Early stages of development require significant cash outlays for land acquisitions, site approvals and entitlements, construction of model homes, roads, certain utilities and other amenities and general landscaping. As these costs are capitalized, earnings reported for financial statement purposes during such early stages may significantly exceed cash flows. Later, cash flows can exceed earnings reported for financial statement purposes as cost of sales includes charges for substantial amounts of previously expended costs.

We believe that we currently have sufficient access to capital resources and will continue to use our available capital resources to fund our operations. Our future capital resources include cash flow from operations, borrowings under project-specific and other credit facilities and proceeds from potential future debt issues or equity offerings, if required.

At December 31, 2018, we had cash and cash equivalents, including restricted cash, of $73 million, compared to $108 million at December 31, 2017.

The net cash flows for the year ended December 31, 2018 and 2017 were as follows:

	Years Ended December 31	
(US$ millions)	**2018**	**2017**
Cash flows used in operating activities	$ (100)	$ 116
Cash flows used in investing activities	(28)	(87)
Cash flows provided by financing activities	95	(25)
Effect of foreign exchange rates on cash	(2)	5
	$ (35)	$ 9

Cash Flow Used in Operating Activities

Cash flows used in operating activities during the year ended December 31, 2018 totalled $100 million, compared to $116 million for the same period in 2017. During the year ended December 31, 2018, cash used in operating activities was impacted by our net income, a decrease in land and housing inventory due to inventory turnover, an increase in commercial properties, an increase in receivables and other assets and an increase in accounts payable and other liabilities. The increase in commercial properties of $192 million was largely due to the acquisition of the remaining 90% interest not already owned in a mixed-use development project as well as increased development of the project subsequent to acquisition. Acquisitions for the year ended December 31, 2018 totalled $301 million, consisting of $58 million in Canada, $182 million in California and $61 million in Central and Eastern U.S. During the year ended December 31, 2017, cash used in operating activities was impacted by our net income, an increase in land and housing inventory due to strategic land purchases, development and construction activity, a decrease in receivables and other assets, and an increase in accounts payable and other liabilities. Acquisitions for the year ended December 31, 2017 totalled $256 million consisting of $54 million in Canada, $138 million in California and $64 million in Central and Eastern U.S.

Cash Flow Used in Investing Activities

During the year ended December 31, 2018, cash flows used in investing activities totalled $28 million compared to $87 million for the same period in 2017. During the year ended December 31, 2018, we invested $93 million in unconsolidated entities primarily as a result of the OliverMcMillan acquisition and in our joint ventures in Southern California. This was partially offset by dividend income from our held-to-maturity investment, a decrease in loan receivables and distributions from unconsolidated entities. During the year ended December 31, 2017, we increased our loan receivables by $112 million, and invested $42 million in unconsolidated entities, primarily in our California and Phoenix joint ventures. This was partially offset by distributions from unconsolidated entities as well as an increase in dividend income from our held-to-maturity investment.

Cash Flow Provided by Financing Activities

Cash flows provided by our financing activities for the year ended December 31, 2018 totalled $95 million, compared to cash flows used in our financing activities of $25 million in the same period in 2017. The cash provided by our financing activities during the year ended December 31, 2018 was primarily from borrowings under bank indebtedness of $79 million, net drawings under project-specific and other financings of $25 million and net distributions from non-controlling interest of $8 million. For the year ended December 31, 2017, there were net repayments under project-specific and other financings of $26 million and net repayments under bank indebtedness of $2 million, partially offset by net contribution of non-controlling interest of $3 million.

Contractual Obligations and Other Commitments

A summary of our contractual obligations and purchase agreements as at December 31, 2018 is as follows:

	Payment Due By Period				
(US$ millions)	**Total**	**Less than 1 Years**	**1 – 3 Years**	**3 – 5 Years**	**More than 5 Years**
Notes payable[1]	$ 1,633	$ —	$ 600	$ 683	$ 350
Interest on notes payable	396	103	167	92	34
Secured VTB mortgages[2][3]	29	12	13	4	—
Bank indebtedness[2][3]	89	—	89	—	—
Accounts payable and other liabilities[4]	636	636	—	—	—
Operating lease obligations[5]	305	11	21	19	254
Purchase agreements and other obligations[6]	109	38	69	1	1

(1) Amounts are included on the consolidated balance sheets and exclude transaction costs. See Note 11 to the consolidated financial statements for additional information regarding unsecured senior notes payable.

(2) Amounts are included on the consolidated balance sheets. See Note 12 to the consolidated financial statements for additional information regarding bank indebtedness and other financings and related matters.

(3) Amounts do not include interest due to the floating nature of the interest on our debt. See Note 12 to the consolidated financial statements for additional information regarding our floating rate debt.

(4) Amounts are included on the consolidated balance sheets. See Note 13 to the consolidated financial statements for additional information regarding accounts payable and other liabilities.

(5) Amounts relate to non-cancellable operating leases involving office space, design centres and model homes. See Note 20 to the consolidated financial statements for additional information regarding lease agreements.

(6) See Note 20 to the consolidated financial statements for additional information regarding purchase agreements and other obligations.

Shareholders' Equity

At February 5, 2019, 129,756,910 Common Shares in the capital of the Company were issued and outstanding. In addition, Brookfield Residential has a stock option plan under which key officers and employees are granted options to purchase Non-Voting Class B Common Shares or settle the options in cash at the option of the holder. Each option granted can be exercised for one Non-Voting Class B Common Share or settled in cash for the fair value of one Common Share at the date of exercise. At February 5, 2019, 11,581,886 options were outstanding under the stock option plan.

There was no change in the Company's Common Shares outstanding for the year ended December 31, 2018.

Off-Balance Sheet Arrangements

In the ordinary course of business, and where market conditions permit, we enter into land and lot option contracts and invest in unconsolidated entities to acquire control of land to mitigate the risk of declining land values. Option contracts for the purchase of land permit us to control the land for an extended period of time until the options expire. This reduces our financial risk associated with land ownership and development and reduces our capital and financial commitments. As of December 31, 2018, we had $97 million of primarily non-refundable option deposits and advanced costs. The total remaining exercise price of these options was $110 million. Pursuant to the guidance in the United States Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810 *Consolidation*, as described in Note 4 "Land and Housing Inventory" to our consolidated financial statements included elsewhere in this annual report, we have consolidated $45 million of these option contracts where we consider the Company holds the majority economic interest in the assets held under the options.

We also own 8,374 lots and control under option 1,001 lots through our proportionate share of unconsolidated entities. As of December 31, 2018, our investment in unconsolidated entities totaled $347 million. We have provided varying levels of guarantees of debt in our unconsolidated entities. As of December 31, 2018, we had recourse guarantees of $8 million with respect to debt in our unconsolidated entities. During the year ended December 31, 2018, we did not make any loan re-margin repayments on the debt in our unconsolidated entities. Please refer to Note 5 "Investments in Unconsolidated Entities" to our consolidated financial statements included later in this annual report for additional information about our investments in unconsolidated entities.

We obtain letters of credit, performance bonds and other bonds to support our obligations with respect to the development of our projects. The amount of these obligations outstanding at any time varies in accordance with our development activities. If these letters of credit or bonds are drawn upon, we will be obligated to reimburse the issuer of the letter of credit or bonds. As of December 31, 2018, we had $70 million in letters of credit outstanding and $650 million in performance bonds for these purposes. The estimated costs to complete related to our letters of credit and performance bonds at December 31, 2018 are $35 million and $199 million, respectively.

Transactions Between Related Parties

Related parties include the directors, executive officers, director nominees or shareholders, and their respective immediate family members. There are agreements among our affiliates to which we are a party or subject to, including a name license. The Company's significant related party transactions as at and for the years ended December 31, 2018 and 2017 were as follows:

- During the year ended December 31, 2018, the Company received dividends of $21 million from the preferred shares of Brookfield BPY Holdings Inc. (2017 - $17 million). These transactions were recorded at the exchange amount.
- During the year ended December 31, 2018, the Company paid $0.2 million to Brookfield Asset Management Inc. for Canadian tax credits (year ended December 31, 2017 - $7 million). These transactions were recorded at the exchange amount.

Non-GAAP Financial Measures

Gross margin percentage on land and home sales are non-GAAP measures and are defined by the Company as gross margin of land and homes over respective revenues of land and homes. Management finds gross margin percentage to be an important and useful measurement, as the Company uses it to evaluate its performance and believes it is a widely accepted financial measure by users of its financial statements in analyzing its operating results. Gross margin percentage also provides comparability to similar calculations by its peers in the homebuilding industry. Additionally, gross margin percentage is important to the Company's management because it assists its management in making strategic decisions regarding its construction pace, product mix and product pricing based upon the profitability generated on homes and land actually delivered during previous periods. However, gross margin percentage as presented may not be fully comparable to similarly titled measures reported by other companies because not all companies calculate this metric in an identical manner.

This measure is not intended to represent GAAP gross margin percentage and it should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

BUSINESS ENVIRONMENT AND RISKS

The following is a review of certain risks that could adversely impact our financial condition and results of operations. Additional risks and uncertainties not previously known to the Company, or that the Company currently deems immaterial, may also impact our operations and financial results.

Risks Related to the Business and Industry of the Company

The land development and homebuilding industry is significantly affected by changes in general and local economic and political conditions as well as real estate markets, which could reduce sales and profits, cause cancellations of home sales orders and materially negatively affect our business, results of operations and financial condition.

The land development and homebuilding industry is cyclical and is significantly affected by changes in general and local economic, political and industry conditions such as:

- employment and wage levels;
- availability and cost of financing for homebuyers including private and federal mortgage financing and mortgage insurance programs, as well as federal, provincial and state regulation of lending practices;
- regulatory changes, including zoning laws;
- interest rates;
- competitive and market supply and demand dynamics in our key markets, including those enabling existing homeowners to sell their existing homes at acceptable prices;
- the supply of available new or existing homes for sale, as well as other housing alternatives, such as apartments and residential rental property;
- foreclosure rates;
- inflation;
- real estate taxes, federal, provincial and state property and income tax provisions (including provisions for the deduction of mortgage interest payments and state property taxes and income tax rates and brackets in the United States), and any adverse changes in tax laws;
- the level of household debt affecting our customer base;
- the cost and availability of labor, materials and supplies;
- the Canadian, U.S. and global financial system and credit markets, including stock market, commodities market, currency market and credit market volatility;
- the supply of land suitable for development in our markets in Canada and the United States;
- consumer confidence;
- demographic housing trends, including population rates in our key markets, immigration rates and urban and suburban migration rates;
- decreases in rental rates for our mixed-use projects;
- an increase in competition for tenants and customers or decrease in demand by tenants and customers of our mixed-use properties;
- the financial condition of tenants in our mixed-use developments;
- an increase in operating costs that cannot be passed through to tenants of our mixed-use properties; and
- an inability to secure tenants or anchors necessary to support our mixed-use projects.

These factors could have a negative impact on housing demand and supply, which would negatively affect our business, results of operations and financial condition. For example, an oversupply of housing in general, as well as new home alternatives such as foreclosed homes, rental properties and resale homes, including homes held for sale by investors and speculators, may reduce our sales, depress prices and reduce margins, which could materially negatively affect our business, results of operations and financial condition. Despite some recent recovery, the U.S. and Canadian land development and homebuilding industry continues to face a number of challenges, with home foreclosures and tight credit standards continuing to have an effect on inventory and new home sale rates and prices.

In fiscal 2018, we experienced a steadily improving housing market; however, especially in the U.S. market, the prior economic downturn resulted in reduced homebuyer confidence, due principally to price declines, the number of foreclosures and low wage growth, which led some homebuyers to cancel or fail to honor their home sales contracts altogether. With consumer confidence being affected by affordability due to the threat of rising interest rates and increased cost pressures leading to house price escalations, our U.S. operations may experience a slowdown of homebuyer traffic. We cannot predict whether recovery in the housing market will continue and improve these conditions. A more restrictive mortgage lending environment and the inability of some buyers to sell their existing homes has also impacted cancellations and reduced our ability to realize our backlog.

An economic downturn in Ontario or Alberta, Canada or challenging real estate markets in the United States could have a material adverse effect on our business, operating results and financial condition.

Our Canadian markets continue to be materially impacted by the changes to the mortgage rules as homebuyers adjust to what they can now afford as a result of the stress test combined with government policies relating to the Ontario real estate market and the Alberta energy sector surrounding pipeline approvals. Our Alberta operations will continue to be challenged due to the economic conditions. Any economic downturn, increase in unemployment, increase in interest rates, decrease in immigration or other changes in the general and local market, could have a material adverse effect on our Canadian operations and financial condition.

The housing market in the United States has experienced a severe downturn in previous years, exacerbated by, among other things, a decline in the overall economy, high unemployment, fear of job loss, volatility in the securities markets, an increase in the number of homes that are or will be available for sale due to foreclosures, an inability of homebuyers to sell their current homes, a deterioration in the credit markets and the direct and indirect impact of the turmoil in the mortgage loan market. For example, the significant number of home mortgage foreclosures made the purchase of a foreclosed home an attractive alternative to purchasing a new home in some markets, which increased supply of homes and drove prices down further. Homebuilders responded to declining sales and increased cancellation rates on home purchase contracts with significant concessions, further adding to the price declines. With the decline in the values of homes and the inability of many homeowners to make their mortgage payments, the credit markets were significantly disrupted, putting strains on many households and businesses. In the face of these conditions, the overall economy weakened significantly, with high unemployment levels and substantially reduced consumer spending and confidence. As a result, demand for new homes hit historically low levels.

Although the U.S. housing market has shown signs of recovery, many of the factors contributing to the downturn remain and improved conditions did not extend consistently to every market in which we operate. We expect these uneven conditions to continue.

If the current U.S. housing market does not continue to improve or improvement takes place over an extended period of time, or if similar conditions affect the Canadian homebuilding industry, our business, results of operations and financial condition may be materially adversely affected.

The current economic environment also continues to impact the industry for retail and office properties. Some commercial tenants are experiencing financial pressure and are continuing to place demands on landlords to provide rent concessions. The financial hardships on some tenants are so severe they may leave the market entirely or declare bankruptcy, creating fluctuating vacancy rates in commercial properties. Tenants in good financial condition often consider offers from competing projects and may wait for the best possible deal before committing. The foregoing conditions could adversely affect our results of operations from our mixed-use projects.

If the market value of our land and housing inventories declines, our business, results of operations and financial condition could be materially adversely affected by impairments and write-downs, as well as if we cannot recover our costs fully when selling homes.

We acquire land in the ordinary course of our business. There is an inherent risk that the value of our land may decline after purchase, which also may affect the value of our housing inventories and homes under construction. The valuation of property is inherently subjective and based on the individual characteristics of each property, as well as general and local real estate market conditions. The risks discussed elsewhere in this section can cause these conditions to change and thereby subject valuations to uncertainty.

Moreover, all valuations are made on the basis of assumptions that may not prove to reflect economic or demographic reality. We may acquire options on or buy and develop land at a cost we will not be able to recover fully or on which we cannot build and sell homes profitably. For example, if housing demand decreases below what we anticipated when we acquired or developed our inventory, we may not be able to recover the related costs when selling homes. In addition, our deposits for building lots under option or similar contracts may be put at risk.

We regularly review the value of our land holdings and will continue to do so on a periodic basis. If market conditions deteriorate, our assumptions prove to be inaccurate or the value of our property otherwise declines, some of our assets may be subject to impairments and write-down charges, which could materially adversely affect our business, results of operations and financial condition. In addition, if we sell land or homes at a loss, our results of operations and financial condition could be materially adversely affected.

Budget deficits in certain regions could result in tax increases or decreased public services, discouraging buyers in these markets.

In recent years, many provincial, state, regional and local government in our served markets have struggled to balance their budgets due to a number of factors. As a result, there have been significant cuts to government departments, subsidies, programs and public employee staffing levels, while taxes and fees have been increased. Lawmakers' efforts at all governmental levels to address these budget deficit issues and/or efforts to increase governmental revenues, could, among other things, cause businesses and residents to leave, or discourage businesses or households from coming to, affected served markets, thereby limiting economic growth and/or resulting in significant delays and/or higher costs in obtaining required inspections, permits or approvals with respect to the development of our communities located in such markets. These negative impacts could adversely affect our ability to generate orders and revenues and/or to maintain or increase our housing gross profit margins in such markets, and the impact could be material and adverse to our consolidated financial statements.

An increase in interest and mortgage rates or a reduction in the availability of mortgage financing could adversely affect our ability to sell new homes and the price at which we can sell them.

Virtually all of the purchasers of our homes finance their acquisitions through mortgage financing. The Federal Reserve Bank of the United States increased interest rates in December 2015 for the first time since 2006 and has increased interest rates again several times since then, including in 2018. In Canada, the Bank of Canada increased the interest rates in July 2017 for the first time since 2010 and increased interest rates again several times since then, including in 2018. A further increase in interest and mortgage rates, which may occur in both the United States and Canada in the near future, or a reduction in the availability of mortgage financing could depress new home sales because the increased effective monthly costs of mortgage financing would discourage potential homebuyers. Tax law changes can have a similar impact. See "Tax law changes could make home ownership more expensive or less attractive, which could have an adverse impact on demand for and sales prices of new homes." Even if potential purchasers do not need financing, these conditions could make it harder for them to resell their homes in the future, which would discourage potential homebuyers. These conditions could also increase cancellation rates on home purchase contracts, which would reduce our ability to realize our backlog. As a result, increased interest and mortgage rates and reduced mortgage availability could materially adversely affect our ability to sell new homes and the price at which we can sell them, which would have a material adverse effect on our business, results of operations and financial condition.

More restrictive mortgage regulation and fewer mortgage products could adversely affect our ability to sell new homes.

In Canada, bank regulators, the Ministry of Finance, CMHC and the Bank of Canada work in concert to manage mortgage lending practices. In addition, mortgage insurance is mandatory for mortgages with a loan-to-value ratio greater than 80%. This insurance covers the entire loan amount for its full duration. During the past seven years, mortgage insurance rules have been tightened to shorten amortization periods, increase minimum equity requirements and limit the insured loan amounts, all of which have made access to mortgages more difficult and have negatively impacted homebuyers' ability to purchase homes.

New Canadian mortgage rules that were announced by the Office of the Superintendent of Financial Institutions in October 2017, went into effect January 1, 2018, subjecting home buyers with down payments of 20% or more to stricter qualifying criteria that determine whether a homebuyer will be able to afford their principal and interest payments. The criteria uses the higher of the Bank of Canada's 5-year benchmark rate (currently 5.34%) or the potential home buyer's mortgage interest plus 2%. The rules apply to new mortgage loan agreements and have decreased the borrowing and purchasing power of home buyers. The new rules, along with the rising interest rates, have affected new potential homebuyer's ability to secure mortgage financing and their purchasing power, negatively impacting new home sales and the price at which we can sell them.

Prior to the recent volatility in the financial markets in the United States, a variety of mortgage products were available. As a result, more homebuyers were able to qualify for mortgage financing. Since 2007, however, there has been a significant decrease in the type of mortgage products available and a general increase in the qualification requirements for mortgages. Fewer loan products and tighter loan qualifications make it more difficult for some homebuyers to finance the purchase of new homes. This, coupled with higher mortgage interest rates for some mortgage products, has discouraged people from buying new homes. Beginning in January 2014, the U.S. Consumer Financial Protection Bureau began to enforce new rules regarding the origination of mortgages, including criteria for “qualified mortgages”. In December 2017, U.S. regulations regarding "risk retention" for securitizations, including securitizations of residential mortgages, went into effect. Other new regulations are forthcoming as required to be implemented pursuant to the U.S. Dodd-Frank Act of 2010. These new regulations could increase the difficulty of obtaining mortgage financing and result in higher mortgage interest rates, further discouraging new home purchases.

In both markets, even if potential purchasers do not need financing, these conditions could make it harder for them to resell their homes in the future, which would discourage potential homebuyers. Overall, more restrictive mortgage regulation and fewer mortgage products could materially adversely affect our ability to sell new homes and the price at which we can sell them, which would have a material adverse effect on our business, results of operations and financial condition.

Tax law changes could make home ownership more expensive or less attractive, which could have an adverse impact on demand for and sales prices of new homes.

In the United States, unlike in Canada, significant expenses incurred for purposes of owning a home, including mortgage interest expense and real estate taxes, generally are deductible expenses for an individual's U.S. federal and, in some cases, state income taxes, subject to various limitations under current tax law and policy. On December 22, 2017, the Tax Cuts and Jobs Act was enacted which limits the federal deduction for mortgage interest so that it only applies to the first $750,000 of a new mortgage (as compared to $1 million under previous tax law) and introduces a $10,000 cap on the federal deductions for state and local taxes. These changes are in effect for taxable years 2018 through 2025. These changes may adversely impact demand for and sales prices of new homes.

If the U.S. federal government or a state government further changes its income tax laws, eliminating or substantially modifying these income tax deductions, the after-tax cost of owning a new home would increase for many potential purchasers of our homes. Increases in property tax rates by local governmental authorities, as experienced in response to reduced federal, state and provincial funding, can adversely affect the ability of potential purchasers of our homes to obtain financing or their desire to purchase new homes. In addition, increases in sales and other taxes could discourage potential homebuyers from purchasing one of our homes.

Any resulting loss or reduction of homeowner tax deductions, if such tax law changes were enacted without offsetting provisions, or any other increase in any taxes affecting homeowners, would adversely impact demand for and sales prices of new homes.

We may be unable to renew leases or re-lease space in our mixed-use properties as leases expire

When our tenants decide not to renew their leases upon their expiration, we may not be able to re-lease the space. Even if tenants do renew or we can re-lease the space, the terms of renewal or new lease, taking into account, among other things, the cost of improvements to the property and leasing commissions, may be less favorable than the terms in the expired leases. In addition, changes in space utilization by our tenants may impact our ability to renew or re-lease space without the need to incur substantial costs in renovating or redesigning the internal configuration of the relevant property. If we are unable to promptly renew the leases or re-lease the space at similar rates or if we incur substantial costs in renewing or obtaining new leases for the space, our cash flow and results of operations could be adversely affected.

Our results of operations and cash flows may be adversely affected by vacancies and tenant defaults or bankruptcy in our mixed-use properties

Our results of operations and cash flows may be adversely affected if we are unable to continue leasing a significant portion of our mixed-use projects. We depend on office, retail and apartment tenants to generate income from these projects. The current market conditions have negatively impacted these tenants on many levels. Despite improvement in certain economic measures, it will take time for many of our current or prospective tenants to achieve a financial outlook similar to what they had prior to the recession, if ever. The downturn has been particularly hard on retail tenants, many of whom have announced store closings and scaled back growth plans. If we are unable to sustain historical occupancy levels in our mixed-use real estate portfolio, our cash flows and results of operations could be adversely affected.

Our results of operations and cash flows may be adversely affected if a significant number of our tenants in our mixed-use projects default on their obligations to us. A default by a tenant may result in the inability for that tenant to re-lease space from us on economically favorable terms, or at all. In the event of a default by a tenant, we may experience delays in payments and incur substantial costs in recovering our losses.

In addition, our ability to collect rents and other charges will be difficult if the tenant is bankrupt or insolvent. The potential bankruptcies of tenants could make it difficult for us to enforce our rights as lessor and protect our investment.

Residential land development and homebuilding is a highly competitive industry, and competitive conditions may adversely affect our results of operations.

The residential land development and homebuilding industry is highly competitive. Residential land developers and homebuilders compete not only for homebuyers, but also for desirable properties, building materials, labor and capital. We compete with other local, regional and national homebuilders, often within larger communities designed, planned and developed by those homebuilders. Any improvement in the cost structure or service of these competitors will increase the competition we face. We also compete with the resale of existing homes including foreclosed homes, sales by housing speculators and investors and rental housing. These competitive conditions could result in difficulty in acquiring suitable land at acceptable prices, increased selling incentives, lower sales volumes and prices, lower profit margins, impairments in the value of our inventory and other assets or increased construction costs and delays in construction, any of which could adversely affect our business, results of operations and financial condition.

Any increase in unemployment or underemployment may lead to an increase in the number of loan delinquencies and property repossessions and could reduce our sales.

People who are unemployed, underemployed or concerned about the loss, or potential loss, of their jobs are less likely to purchase new homes, may be forced to try to sell the homes they own and may face difficulties in making required mortgage payments. Therefore, any increase in unemployment or underemployment may lead to an increase in the number of loan delinquencies and property repossessions and may have an adverse impact on us both by reducing demand for the homes we build and by increasing the supply of homes for sale, which could reduce our sales, adversely affecting our business and results of operations.

Higher cancellation rates of home purchase contracts may have an adverse effect on our business, financial condition and results of operations.

Our backlog reflects agreements of sale with homebuyers for homes that have not yet been delivered. Particularly in the United States, if prices for new homes decline, interest rates increase, the availability of mortgage financing diminishes, current homeowners find it difficult to sell their current homes, there is a further downturn in local, regional or national economic conditions or competitors increase their use of sales incentives, homebuyers may cancel their existing home purchase contracts with us in order to negotiate a lower price or because they cannot, or become reluctant to, complete the purchase.

In cases of cancellation, we remarket the home and usually retain any deposits we are permitted to retain. We may not have any recourse against the homeowners other than retention of their deposit, and the deposits may not cover the additional costs involved in remarketing the home and carrying of higher inventory. A significant number of cancellations could adversely affect our business, results of operations and financial condition.

Our business is seasonal in nature and quarterly operating results can fluctuate.

Our quarterly operating results generally fluctuate by season. We typically experience the highest rate of orders for new homes in the first six months of the calendar year, although the rate of orders for new homes is highly dependent upon the number of active communities. Because new home deliveries trail orders for new homes by several months, we typically deliver a greater percentage of new homes in the second half of the year compared with the first half of the year, which is typically when we would receive payment. As a result, our revenues from sales of homes are generally higher in the second half of the year. If, due to construction delays or other reasons, including seasonal natural disasters such as hurricanes, tornadoes, floods and fires, we are unable to deliver our expected number of homes in the second half of the calendar year, the full year results of operations may be adversely affected. In many cases, we may not be able to recapture increased costs by raising prices because we fix our prices in advance of delivery by signing new sales contracts.

Our business, results of operations and financial condition could be adversely affected by significant inflation or deflation.

Inflation can adversely affect us by increasing costs of land, materials and labor. We may not be able to offset inflation-related cost increases because inflation can lead to an oversupply of homes relative to demand, which would make it difficult for us to increase the sales prices of homes. Moreover, our costs of capital could increase with inflation, and the purchasing power of our cash resources could decline. Governmental efforts to stimulate the economy have increased the risk of inflation and its resulting adverse impact on our business, results of operations and financial condition. In addition, inflation is often accompanied by higher interest rates as a result of changes to national monetary policies, which have a negative impact on mortgage financing and housing demand. In such an environment, we may not be able to raise home prices sufficiently to keep up with the rate of inflation.

On the other hand, a significant period of deflation could cause a decrease in overall spending and borrowing levels. This could lead to a further deterioration in economic conditions, including an increase in the rate of unemployment. Deflation could also cause the value of our inventories to decline or reduce the value of existing homes below the related mortgage loan balance, which could potentially limit market activity.

Any of these factors affecting one of our master-planned communities, a region or our business as a whole, many of which are beyond our control, could cause our business, results of operations and financial condition to deteriorate.

Extensive and complex regulation affecting the land development and homebuilding industry subject us to restrictions, additional costs and delays, which could limit our homebuilding or other activities or increase our expenses, which would adversely affect our business and results of operations.

We must comply with extensive and complex local, provincial, state and federal regulation affecting the land development and homebuilding industry. This includes regulation concerning building, health and safety, environmental and zoning matters, among others. Governmental regulation also affects sales activities, mortgage lending activities and other dealings with customers.

In particular, we are required to obtain the approval of numerous governmental authorities regulating matters such as permitted land uses, levels of density, the installation of utility services, zoning and building standards. These governmental authorities often have broad discretion to impose significant conditions to these approvals, if they are granted at all. The industry also has experienced an increase in regulation that limits the availability or use of land. Certain jurisdictions in which we operate have in the past approved, or approved for inclusion on their ballot, various “slow growth” or “no growth” initiatives that negatively impact the availability of land and building opportunities within those localities. Further similar initiatives would reduce our ability to operate in those areas, including where we may already own land, as well as cause delays and increase our costs and administration requirements.

In addition, new development projects may be subject to various assessments for schools, parks and other open spaces, new or improved streets and highways, adequate water and sewage facilities and other local services, and may be required to include low and moderate income housing. The costs of these services can be substantial, and if developers are required to fund some or all of the costs, our expenses would increase. These assessments may also raise the price that homebuyers must pay for our homes, which could reduce our sales. In addition, expanded energy efficiency regulation may be implemented in Canada or the United States, which, even if phased in over time, could significantly increase our costs of building homes and the prices of our homes, which could increase our expenses and reduce our sales. Furthermore, municipalities may restrict or place moratoriums on the availability of utilities such as water and sewage facilities.

We incur substantial costs related to compliance with regulatory requirements. Changes in applicable regulation or changes in circumstances may require us to apply for additional approvals or modify our existing approvals, and may impose other new restrictions or requirements that may cause us to determine that a property is not feasible for development or otherwise limit or delay our activities, or impose substantial additional costs and administration requirements. Legal challenges to our proposed communities brought by governmental authorities or private parties could have a similar impact. All of these consequences could materially adversely affect our business, results of operations or financial condition.

Regulation related to the protection of the environment, health and safety subject us to additional costs and delays which could adversely affect our business and results of operations.

We must comply with various regulations concerning the protection of the environment, health and safety. This regulation covers, for example, the discharge of pollutants, including asbestos, into the water and air; the handling of hazardous or toxic materials and the clean-up of contaminated sites currently or formerly owned, leased or occupied by us. This environmental regulation results in substantial potential risk and liability, whether or not we caused or knew of the pollution, and can severely restrict land development and homebuilding activity in environmentally sensitive regions or areas. The presence of hazardous or toxic substances, or the failure to remediate such substances properly, may also adversely affect our ability to sell the land or to borrow using the land as security. Environmental regulations sometimes result in delays and could cause us to implement time-consuming and expensive compliance programs. They can also have an adverse impact on the availability and price of certain raw materials, such as lumber.

Furthermore, we could incur substantial costs, including clean-up costs, fines, penalties and other sanctions and damages from third-party claims for property damage or personal injury, as a result of our failure to comply with, or liabilities under, applicable environmental laws and regulations. In addition, we are often subject to third-party challenges, such as by environmental groups, under environmental laws and regulations to the permits and other approvals required for our construction activities.

Difficulty in obtaining or retaining qualified trades workers and other labor relations issues could delay or increase the cost of home construction, which would adversely affect our business and results or operations.

Land developers and homebuilders are subject to risks related to labor and services, including shortages of qualified tradespeople. They may also face challenges as a result of unionization and labor disputes, for example, in the context of collective bargaining.

We depend on the continued availability of and satisfactory performance by subcontractors for the construction of our homes. In addition, the difficult operating environment over the last nine years in the United States has resulted in the failure of some subcontractors’ businesses and may result in further failures. Furthermore, restrictions on immigration can create a shortage of skilled labor which may be exacerbated by policies and reforms implemented by the current U.S. federal government.

We are party to a collective bargaining agreement with the Universal Workers Union L.I.U.N.A. Local 183 pursuant to which we are required to use union members in connection with construction projects undertaken in Simcoe County, an area north of Toronto. Although we believe our relations with the union to be good, we may be affected in the future by strikes, work stoppages or other labor disputes. Any such events could have a material adverse effect on our business and results of operations. Moreover, our non-union laborers may become subject to labor union organizing efforts. If any current non-union laborers were to unionize, we would incur increased risk of work stoppages and possibly higher labor costs.

When any of these difficulties occur, it causes delays and increases our costs, which could have an adverse effect on our business and results of operations.

Increases in minimum wage laws could adversely impact our labor costs for our projects in the United States and Canada

Minimum wage laws in the provinces and states where we operate increased beyond inflation in 2018 and will continue to increase over the next number of years. In multiple provinces and states including Ontario, Alberta, Arizona and California, expanded minimum wages up to $15 per hour will result in increased labor costs for skilled laborers on our projects. If our ability to mitigate the financial impact of these increases through cost saving measures does not adequately counterbalance the increase in labor costs, our operating results on the sales of our properties may be adversely affected.

Our success depends on the availability of suitable undeveloped land and lots at acceptable prices and having sufficient liquidity to acquire those properties.

Our success in developing land and in building and selling homes depends in part upon the continued availability of suitable undeveloped land and lots at acceptable prices. The availability of undeveloped land and lots for purchase at favorable prices depends on a number of factors outside of our control, including the risk of competitive over-bidding on land and lots and restrictive governmental regulation. Should suitable land opportunities become less available, the number of homes we may be able to build and sell would be reduced, which would reduce our sales and profits, and have a material adverse effect on our business, results of operations and financial condition. In addition, our ability to make land purchases will depend upon whether we have sufficient liquidity to fund them.

If we are not able to develop and market our master-planned communities successfully or within expected timeframes, our business and results of operations will be adversely affected.

Before a master-planned community generates any revenues, material expenditures are incurred to acquire land, obtain development approvals and construct significant portions of project infrastructure, amenities, model homes and sales facilities. It generally takes several years for a master-planned community development to achieve cumulative positive cash flow. If we are unable to develop and market our master-planned communities successfully or to generate positive cash flows from these operations within expected timeframes, including as a result of unexpected costs or regulatory delay, it will have a material adverse effect on our business and results of operations.

Our business and results of operations will be adversely affected if poor relations with the residents of our communities negatively impact our sales.

As a master-planned community developer, we will sometimes be expected by community residents to resolve any issues or disputes that arise in connection with the development of our communities, including with respect to actions by subcontractors. Our sales may be negatively affected if any efforts we undertake to resolve these issues or disputes are unsatisfactory to the affected residents, which in turn would adversely affect our business and results of operations. In addition, our business and results of operations would be adversely affected if we are required to make material expenditures related to the settlement of these issues or disputes or to modify our community development plans.

A lack of availability or increased cost of required materials, supplies, utilities and resources, as well as unforeseen environmental and engineering problems, could delay or increase the cost of home construction, which would adversely affect our business and results of operations.

Land developers and homebuilders are subject to risks related to:

- the availability and cost of materials and supplies (and particularly increases in the price of lumber, wall board and cement, which are significant components of home construction costs);
- the availability of adequate utility infrastructure and services;
- material fluctuations in utility and resource costs; and
- unforeseen environmental and engineering problems.

Any of these issues could cause delays and increase our costs, which could have an adverse effect on our business and results of operations. In particular, the cost of petroleum products fluctuates and may increase as a result of natural disasters, geopolitical events or accidents. This could result in higher prices for any product utilizing petrochemicals, increased building material delivery costs and higher land development costs.

Furthermore, certain areas in which we operate have historically been subject to utility and resource shortages, including significant changes to the availability of electricity and water. These areas have also experienced material fluctuations in utility and resource costs. Shortages of natural resources, particularly water, in our markets, may make it more difficult for us to obtain regulatory approval of new developments, increase our costs and cause delays in completing construction. Utility shortages and rate fluctuations may also adversely affect the regional economies in which we operate, which may have an adverse effect on our sales.

We may incur a variety of costs to engage in future growth or expansion of our operations or acquisitions or disposals of businesses, and may not be able to realize anticipated synergies and benefits from any such endeavors.

As a part of our business strategy, we may make acquisitions of, significant investments in, or disposals of businesses. Any future acquisitions, investments or disposals would be accompanied by risks such as:

- difficulties in assimilating the operations and personnel of acquired companies or businesses;
- diversion of our management's attention and financial resources from ongoing business concerns;
- our potential inability to maximize our financial and strategic position through the successful incorporation or disposition of operations;
- receipt of consent or approval from governmental authorities that could delay or prevent the completion of the acquisition;
- maintenance of uniform standards, controls, procedures and policies; and
- impairment of existing relationships with employees, contractors, suppliers and customers as a result of the integration of new management personnel and cost-saving initiatives.

In addition, acquisitions or other major investments can expose us to valuation risks, including the risk of writing off goodwill or impairing inventory and other assets related to such acquisitions. The risk of goodwill and other asset impairments increases during a cyclical housing downturn in which our profitability declines.

While we seek protection through warranties and indemnities in the case of acquisitions, for example, significant liabilities may not be identified in due diligence or come to light after the expiry of warranty or indemnity periods. Additionally, while we seek to limit our ongoing exposure, for example, through liability caps and period limits on warranties and indemnities in the case of disposals, some warranties and indemnities may give rise to unexpected and significant liabilities.

Any of these factors could have a material adverse effect on our business, results of operations and financial condition.

Home warranty and construction defect claims may subject us to liabilities as a general contractor and other losses.

As a homebuilder, we are subject to construction defect and home warranty claims arising in the ordinary course of our business. These claims are common in the homebuilding industry and can be costly.

Where we act as the general contractor, we are responsible for the performance of the entire contract, including work assigned to subcontractors. Claims may be asserted against us for construction defects, personal injury or property damage caused by the subcontractors, and if successful, these claims give rise to liability. We may not be indemnified against substantive claims, and even if we are, we may not be able to collect from the subcontracted party. Subcontractors are independent of the homebuilders that contract with them under normal management practices and the terms of trade contracts and subcontracts within the industry; however, if Canadian or U.S. regulatory agencies or courts reclassify the employees of subcontractors as employees of homebuilders, homebuilders using subcontractors could be responsible for wage, hour and other employment-related liabilities of their subcontractors.

We will sometimes become responsible for the losses or other obligations of general contractors we hire if there are unforeseen events like their bankruptcy, or an uninsured or under-insured loss claimed against them. The costs of insuring against construction defect and product liability claims are high, and the amount of coverage offered by insurance companies may be limited. There can be no assurance that this coverage will not be further restricted and become more costly. If we are not able to obtain adequate insurance against these claims in the future, our business and results of operations will be adversely affected.

Increasingly in recent years, individual and class action lawsuits have been filed against homebuilders asserting claims of personal injury and property damage caused by a variety of issues, including faulty materials and the presence of mold in residential dwellings. Furthermore, decreases in home values as a result of general economic conditions may result in an increase in both non-meritorious and meritorious construction defect claims, as well as claims based on marketing and sales practices. Our insurance may not cover all of the claims arising from such issues, or such coverage may become prohibitively expensive. If we are not able to obtain adequate insurance against these claims, we may experience significant litigation costs and losses that could reduce our net income, even if we are successful in defending such claims.

We conduct certain of our operations through unconsolidated joint ventures with independent third parties in which we do not have a controlling interest.

These investments involve risks and are highly illiquid. We currently operate through a number of unconsolidated homebuilding and land development joint ventures with independent third parties in which we do not have a controlling interest. At December 31, 2018, we had invested an aggregate of $347.3 million in these joint ventures. In addition, as part of our strategy, we intend to continue to evaluate additional joint venture opportunities.

There are a limited number of sources willing to provide acquisition, development, and construction financing to land development and homebuilding joint ventures, and if market conditions become more challenging, it may be difficult to obtain financing for our joint ventures on commercially reasonable terms.

In addition, we lack a controlling interest in some of these joint ventures and, therefore, are usually unable to require that our joint ventures sell assets or return invested capital, make additional capital contributions, or take any other action without the vote of at least one of our venture partners. Therefore, in some instances, absent partner agreement, we may be limited in our buy and sell decisions of assets and in such event will be unable to liquidate our joint venture investments to generate cash.

Our joint ventures typically obtain secured acquisition, development and construction financing. Historically, we and our joint ventures partners provided varying levels of guarantees of debt or other obligations of our unconsolidated joint ventures. These guarantees include construction completion guarantees, repayment guarantees and environmental indemnities. We accrue for guarantees we determine are probable and reasonably estimated, but we do not record a liability for the contingent aspects of any guarantees that we determine are reasonably possible but not probable. As of December 31, 2018, we had no outstanding repayment guarantees related to our joint ventures.

Increased insurance risk will adversely affect our business, and, as a consequence, may result in uninsured losses or cause us to suffer material losses in excess of insurance limits, which could affect our business, results of operations and financial condition.

We are confronting reduced insurance capacity, and generally lower limits for insurance against some of the risks associated with our business. Some of the actions that have been or could be taken by insurance companies include increasing insurance premiums; requiring higher self-insured retention and deductibles; requiring collateral on surety bonds; imposing additional exclusions, such as with respect to sabotage and terrorism; and refusing to underwrite certain risks and classes of business. The imposition of any of the preceding actions will adversely affect our ability to obtain appropriate insurance coverage at reasonable costs.

In addition, certain types of risks, such as personal injury claims, may be, or may become in the future, either uninsurable or not economically insurable, or may not be currently or in the future covered by our insurance policies. Should an uninsured loss or a loss in excess of insured limits occur, we could sustain financial loss or lose capital invested in the affected property as well as anticipated future income from that property. In the United States, the coverage offered and the availability of general liability insurance for construction defects is currently limited and costly. These risks associated with insurance costs increases could affect our business, results of operations and financial condition.

We may face substantial damages or be enjoined from pursuing important activities as a result of existing or future litigation, arbitration or other claims.

In our land development and homebuilding activities, we are exposed to potentially significant litigation, arbitration proceedings and other claims, including breach of contract, contractual disputes and disputes relating to defective title, property misdescription or construction defects. Class action lawsuits can be costly to defend, and if we were to lose any certified class action suit, it could result in substantial liability for us. With respect to certain general liability exposures, including construction defect and product liability claims, due to the complex nature of these exposures, we are required to exercise significant judgment in interpretation of underlying current and future trends, assessment of claims and the related liability and reserve estimation. Furthermore, it is difficult to determine the extent to which the assertion of construction defect claims will expand geographically. As a result, our insurance policies may not be available or adequate to cover any liability for damages.

Failure in our financial and commercial controls could result in significant cost overruns or errors in valuing sites.

We own and may purchase a number of sites each year and are therefore dependent on our ability to process a number of transactions (which include, among other things, evaluating the site purchase, designing the layout of the development, sourcing materials and subcontractors and managing contractual commitments) efficiently and accurately. Errors by employees, failure to comply with regulatory requirements and conduct of business rules, failings or inadequacies in internal control processes, equipment failures, natural disasters or the failure of external systems, including those of our suppliers or counterparties, could result in operational losses that could adversely affect our business, financial condition and operating results and our relationships with our customers.

Our business is susceptible to adverse weather conditions, other environmental conditions and natural and man-made disasters, including cyber-security incidents, which could adversely affect our business and results of operations.

Adverse weather conditions and natural and man-made disasters such as hurricanes, tornadoes, storms, earthquakes, floods, droughts, fires, snow, blizzards and other environmental conditions, as well as terrorist attacks, riots, cyber-security incidents and electrical outages, can have a significant effect on our ability to develop and market our communities. These adverse conditions can cause physical damage to work in progress and new homes, delays and increased costs in the construction of new homes and disruptions and suspensions of our operations, whether caused directly or by disrupting or suspending operations of those upon whom we rely in our operations. For example, in fiscal 2017, Hurricane Harvey disrupted our businesses in Texas, which resulted in temporary reductions in sales and closings. While none of our U.S. properties were directly affected by the recent significant wildfires throughout Southern California, we could experience labor shortages, construction delays, or utility company delays, which in turn could impact our results. If fires are again experienced, our properties may be affected in which event we may suffer losses to our properties and land value which may be difficult to realize. In such event, we cannot be certain insurance will adequately cover the damage which may result in certain unrecoverable losses. These conditions can mutually cause or aggravate each other, and their incidence and severity are unpredictable. Cyber incidents can result from deliberate attacks or unintentional events. These incidents can include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data or causing operational disruption. The result of these incidents could include, but are not limited to, disrupted operations, misstated financial data, liability for stolen assets or information, increased cyber-security protection costs, litigation and reputational damage adversely affecting our business and results of operations all of which may result in us incurring expenses to rectify and resolve.

Certain areas in which we operate, particularly parts of Arizona and California, are susceptible to extreme or exceptional drought conditions. In response to these conditions and concerns when such conditions arise and may continue for an extended period of time or worsen, government officials have taken, or have proposed taking, a number of steps to preserve potable water supplies.

To address the governmental mandates and their own available potable water supplies, local water agencies/suppliers could potentially restrict, delay the issuance of, or proscribe new water connection permits for homes or businesses; increase the costs for securing such permits, either directly or by requiring participation in impact mitigation programs; adopt higher efficiency requirements for water-using appliances or fixtures; limit or ban the use of water for construction activities; impose requirements as to the types of allowed plant material or irrigation for outdoor landscaping that are more strict than state standards and less desired by consumers; and/or impose fines and penalties for noncompliance with any such measures. These local water agencies/suppliers could also increase rates and charges to residential users for the water they use, potentially increasing the cost of homeownership. We can offer no assurance whether, where and the extent to which these or additional conservation measures might be imposed by local water agencies/suppliers in California or by other federal, state or local lawmakers or regulators in Arizona and California. However, if potable water supplies become further constrained due to persistent drought conditions, tighter conservation requirements may be imposed that could limit, impair or delay our ability to acquire and develop land, and/or build and deliver homes (even if we have obtained water connection permits); increase our production costs; or cause the fair value of affected land or land interests in our inventory to decline, which could result in inventory impairment or land option contract abandonment charges, or both; or negatively affect the economies of, or diminish consumer interest in living in, water-constrained areas. These impacts, individually or collectively, could adversely affect our business and consolidated financial statements, and the effect could be material.

If insurance is unavailable to us or is unavailable on acceptable terms, or if our insurance is not adequate to cover business interruptions or losses resulting from these conditions, our business and results of operations will be adversely affected. In addition, damage to new homes caused by these conditions may cause our insurance costs to increase.

We cannot predict the impact that changing climate conditions, including legal, regulatory and social responses thereto, may have on our business.

Various scientists, environmentalists, international organizations, regulators and other commentators believe that global climate change has added, and will continue to add, to the unpredictability, frequency and severity of natural disasters in certain parts of the world, which may cause delays in land development and construction which could increase our operating expenses and reduce our revenues. A number of legal and regulatory measures as well as social initiatives have been introduced in an effort to reduce greenhouse gas and other carbon emissions which some believe may be chief contributors to global climate change. We cannot predict the impact that changing climate conditions, if any, will have on our results of operations or our financial condition. Moreover, we cannot predict how legal, regulatory and social responses to concerns about global climate change will impact our business.

A major health and safety incident relating to our business could be costly in terms of potential liabilities and reputational damage.

Building sites are inherently dangerous, and operating in the homebuilding industry poses certain inherent health and safety risks. Due to health and safety regulatory requirements and the number of projects we work on, health and safety performance is critical to the success of our business. Any failure in health and safety performance may result in penalties for non-compliance with relevant regulatory requirements, and a failure that results in a major or significant health and safety incident is likely to be costly in terms of potential liabilities and workers' compensation claims incurred as a result. Such a failure could also generate significant negative publicity and have a corresponding impact on our reputation, our relationships with relevant regulatory agencies or governmental authorities and our ability to win new business, which in turn could have a material adverse effect on our business, results of operation and financial condition.

Risks Related to Financing and Liquidity

If we are not able to raise capital on favourable terms or at all, our business and results of operations will be adversely affected.

We operate in a capital intensive industry and require capital to maintain our competitive position. The failure to secure additional debt or equity financing or the failure to do so on favorable terms will limit our ability to grow our business, which in turn will adversely affect our business and results of operations. We expect to make significant capital expenditures in the future to enhance and maintain the operations of our properties and to expand and develop our real estate inventory. If our plans or assumptions change or prove to be inaccurate, or if cash flow from operations proves to be insufficient due to unanticipated expenses or otherwise, we will likely seek to minimize cash expenditures and/or obtain additional financing in order to support our plan of operations.

The availability of financing from banks and the public debt markets has experienced significant volatility in the United States in recent years. Due to the uncertainties that exist in the credit markets, economy and for homebuilders in general, we cannot be certain that we will be able to replace existing financing or find additional sources of financing. If sufficient funding, whether obtained through public or private debt, equity financing or from strategic alliances, is not available when needed or is not available on acceptable terms, our business and results of operations will be adversely affected.

Our access to capital and our ability to obtain additional financing could be affected by any downgrade of our credit ratings.

The Company's corporate credit rating and ratings on the Company's senior unsecured notes and our current credit condition affect, among other things, our ability to access new capital, especially debt. Negative changes in these ratings may result in more stringent covenants and higher interest rates under the terms of any new debt. If our credit ratings are lowered or rating agencies issue adverse commentaries in the future, it could have a material adverse effect on our business, results of operations, financial condition and liquidity. In particular, a weakening of our financial condition, including a significant increase in our leverage or decrease in our profitability or cash flows, could adversely affect our ability to obtain necessary funds, result in a credit rating downgrade or change in outlook, or otherwise increase our cost of borrowing.

An inability to obtain additional performance, payment, completion and surety bonds and letters of credit could limit our future growth.

We are often required to provide performance, payment, completion and surety bonds or letters of credit to secure the completion of our construction contracts, development agreements and other arrangements. We have obtained facilities to provide the required volume of performance, payment, completion and surety bonds and letters of credit for our expected growth in the medium term; however, unexpected growth may require additional facilities. Our ability to obtain additional performance, payment, completion and surety bonds and letters of credit primarily depends on our capitalization, working capital, past performance, management expertise and certain external factors, including the capacity of the performance bond market. Performance, payment, completion and surety bond and letter of credit providers consider these factors, in addition to our performance and claims record and provider-specific underwriting standards, which may change from time to time.

If our claims record or our providers' requirements or policies change or if the market's capacity to provide performance and completion bonds is not sufficient and we are unable to renew or amend our existing facilities on favorable terms or at all, we could be unable to obtain additional performance, payment, completion and surety bonds or letters of credit when required, which could limit our future growth or have a material adverse effect on our existing business, results of operations and financial condition.

Changes to foreign currency exchange rates could adversely affect the value of our results of operations and financial condition.

We have businesses with earnings in both the United States and Canada. Our financial results are reported in U.S. dollars. Changes in the U.S. dollar/Canadian dollar exchange rate will affect the value of the reported earnings and the value of those assets and liabilities denominated in foreign currencies. For example, an increase in the value of the U.S. dollar compared to the Canadian dollar would reduce our Canadian dollar-denominated revenue when reported in U.S. dollars, as occurred several times in 2018, and vice versa. Our results of operations and financial condition may be adversely affected by such exchange rate fluctuations.

Our significant levels of debt and leverage could adversely affect our business, financial condition or results of operations and prevent us from fulfilling our obligations under our debt instruments.

We have a significant amount of debt. As of December 31, 2018, the total principal amount of our debt outstanding was $1.8 billion and we had $8.0 million of guarantees of obligations of unconsolidated joint ventures. We also had $515.0 million in undrawn commitments under our Canadian and U.S. credit facilities as of that date.

Subject to the limits under our debt instruments, we may be able to incur substantial additional debt from time to time, including but not limited to new credit facilities, to finance working capital, capital expenditures, investments or acquisitions or for other purposes. If we incur additional debt, the risks related to our level of debt and leverage could intensify. Specifically, a high level of debt and leverage could have important consequences, including:

- making it more difficult for us to satisfy our obligations with respect to our debt;
- increasing our vulnerability to adverse economic or industry conditions, reducing our ability to withstand competitive pressures and making us more vulnerable to a general economic downturn;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions or other general corporate requirements, or requiring us to make non-strategic divestitures, particularly when the availability of financing in the capital markets is limited;
- requiring a substantial portion of our cash flows from operations for the payment of interest on our debt and reducing our ability to use our cash flows to fund working capital, capital expenditures, acquisitions and general corporate requirements;
- exposing us to the risk of increased interest rates, since some of our borrowings are and will continue to be at variable rates of interest;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage to less leveraged competitors; and
- increasing our cost of borrowing.

If any of these conditions occur, or should we be unable to repay these obligations as they become due, our financial condition will be adversely affected.

In addition, our various debt instruments contain financial and other restrictive covenants that may limit our ability to, among other things, borrow additional funds that might be needed in the future. We also guarantee shortfalls under some of our community bond debt, when the revenues, fees and assessments which are designed to cover principal and interest and other operating costs of the bonds are not paid. Historically, we financed many of our projects located in the United States individually through certain of our subsidiaries, and we expect to do so to a greater extent in the future, particularly in connection with our mixed-use development business. As a result, to the extent we increase the number of projects and our related investments, our total debt obligations may increase. In general, we repay the principal of our project debt from the proceeds of home and lot closings.

An increase in interest rates under our existing credit facilities and mortgages would increase the cost of servicing our debt and could have a material adverse effect on our financial condition and ability to pay interest on our debt obligations.

A significant amount of our existing borrowings consist of secured and unsecured credit facilities, some of which bears interest at variable rates. Our secured credit facilities bear interest at rates of Canadian prime +0.5%. Our unsecured credit facility bears interest at either the adjusted LIBOR plus the applicable rate between 1.75% and 2.25% per annum or the alternate base rate plus the applicable rate between 0.75% and 1.25% per annum. This amount of variable interest rate debt exposes us to interest rate risk. As of December 31, 2018, a 1% change up or down in interest rates would have a $1.2 million impact on our cash flows. If interest rates increase under the terms of these credit facilities or mortgages, our debt service obligations will increase even though the amount of our borrowings will remain the same, which could have a material adverse effect on our net income and our ability to make timely interest payments on our debt.

We may not be able to generate sufficient cash to service all of our debt and may be forced to take other actions to satisfy our obligations under such debt, which may not be successful.

Our ability to make scheduled payments on or refinance our debt obligations depends on our financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business, legislative, regulatory and other factors beyond our control. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us under our credit facilities or otherwise in an amount sufficient to enable us to pay the principal, premium, if any, and interest on our debt obligations or to fund our other liquidity needs.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we could face substantial liquidity problems and could be forced to reduce or delay investments, strategic acquisitions and capital expenditures or to dispose of material assets or operations, seek additional debt or equity capital or restructure or refinance all or a portion of our debt obligations. We may not be able to effect any such alternative measures, if necessary, on commercially reasonable terms or at all, or on terms that would not be disadvantageous to us or on terms that would not require us to breach the terms and conditions of our existing or future debt agreements. Even if successful, those alternatives may not allow us to meet our scheduled debt service obligations. The terms of some of our indebtedness restrict our ability to dispose of assets and use the proceeds from those dispositions and may also restrict our ability to raise debt or equity capital to be used to repay other indebtedness when it becomes due. We may not be able to consummate those dispositions or to obtain proceeds in an amount sufficient to meet any debt service obligations then due.

Our inability to generate sufficient cash flows to satisfy our debt obligations, or to refinance our debt obligations on commercially reasonable terms or at all, would materially and adversely affect our financial position and results of operations and our ability to satisfy our obligations.

If we cannot make scheduled payments on our debt, we will be in default under our relevant debt agreements and holders of that debt could declare all outstanding principal and interest on that debt to be due and payable, causing a cross-acceleration or cross-default under certain of our debt agreements, and we could be forced into bankruptcy, liquidation or restructuring proceedings.

We are a holding company and depend on our subsidiaries for our cash flow. Because a significant portion of our operations are conducted through our subsidiaries, our financial condition and ability to service our debt is partly dependent on our receipt of distributions or other payments from our subsidiaries.

We are a holding company and depend on our subsidiaries for our cash flow. A significant portion of our operations are conducted through our subsidiaries. As a result, our ability to service our debt is partly dependent on the earnings of our subsidiaries and the payment of those earnings to us in the form of dividends, loans or advances and through repayment of loans or advances from us. Our subsidiaries are legally distinct from us and our subsidiaries that are not guarantors of our debt, have no obligation to pay amounts due on our debt or to make funds available to us for such payment. The ability of our subsidiaries to pay dividends, repay intercompany notes or make other advances to us are subject to restrictions imposed by applicable laws, tax considerations and the agreements governing our subsidiaries, including financial maintenance covenants, affiliate transaction restrictions, covenants related to the payment of dividends, limitations on liens and limitations on loans and investments. In addition, such payments may be restricted by obligations to and against our subsidiaries by their creditors, including the holders of any debt securities they may issue, suppliers, vendors, lessors and employees.

Restrictive covenants and financial maintenance covenants in our financing agreements may restrict our ability to pursue our business strategy, react to market conditions or meet our capital or liquidity needs and increase the risk of default on our debt obligations.

The agreements governing our credit facilities and our other debt obligations will limit our ability, and the terms of any future indebtedness may limit our ability, among other things, to:

- incur or permit to exist liens;
- enter into sale and leaseback transactions;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;
- incur or guarantee additional debt;
- pay dividends or make distributions on our capital stock;
- make certain loans and investments;
- sell assets, including capital stock of restricted subsidiaries;
- agree to payment restrictions affecting our restricted subsidiaries;
- enter into transactions with our affiliates;
- enter into swap agreements; and
- designate any of our subsidiaries as unrestricted subsidiaries.

A breach of any of these restrictive covenants or our inability to comply with the applicable financial covenants could result in a default under the agreements governing our credit facilities, other borrowings or future borrowings. If a default occurs, lenders under our credit facilities or other debt instruments may elect to declare all borrowings outstanding, together with accrued interest and other fees, to be immediately due and payable. The lenders will also have the right in these circumstances to terminate any commitments they have to provide further borrowings. If we are unable to repay outstanding borrowings when due, the lenders under our credit facilities and holders of our other debt obligations will also have the right to proceed against the collateral granted to them to secure such debt obligations, if any. If the indebtedness under our credit facilities or our other indebtedness were to be accelerated, we cannot assure you that our assets would be sufficient to repay in full that indebtedness. The instruments governing certain of our credit facilities and our other debt obligations also contain cross-default provisions. Under these provisions, a default under one instrument governing our debt obligations may constitute a default under our other debt instruments.

Our guarantor subsidiaries and our U.S. project subsidiaries are also subject to financial maintenance covenants and certain default provisions that may be triggered upon a material adverse change to our business, among other events, in a number of our financing agreements. We could breach these financial maintenance covenants or default provisions due to circumstances beyond our control, such as a decline in the value of our assets.

Risks Relating to Our Structure

Brookfield Asset Management Inc. currently controls Brookfield Properties Development, a management company that employs our senior executive officers and certain shared services employees (the "Manager"), which manages both our business and mixed use development opportunities and those at other entities within the Brookfield group. Brookfield Asset Management Inc. may from time to time have conflicts of interest with us and may, through the Manager, favor its own interests to the detriment of our business.

Brookfield Asset Management Inc. owns 100% of our Manager, which manages our land development and homebuilding business, as well as mixed use development opportunities for us and for other entities within the Brookfield group. Our Manager and, through it, Brookfield Asset Management Inc. have other business interests besides ours and, as a result, may at times have potential or actual conflicts of interest with us. In resolving these conflicts of interest, the Manager may favor the interests of the other Brookfield entities that pursue mixed use development opportunities or other interests of Brookfield Asset Management and its affiliates over our interests and those of our lenders or holders of our debt instruments.

All of our executive officers are now employees of Brookfield Properties Development as of January 1, 2019 and are responsible for managing both our business and the mixed use development opportunities across the Brookfield group. Their compensation is designed to reward performance in both of these areas. Accordingly, they may not have as much time to devote to our business and like the Manager, may at times have potential or actual conflicts of interest with us.

Potential conflict of interest situations for the Manager and our executive officers may include the following:

- no agreement requires the Manager or our executive officers to pursue a business strategy that favors us, our lenders or holders of our debt instruments;
- Brookfield Asset Management Inc. and its affiliates (including the Manager), are not limited in their ability to compete with us;
- our Manager and executive officers are not restricted from favoring the interests of parties other than us, including Brookfield Asset Management Inc. and its affiliates, in resolving conflicts of interest with us; and
- the Manager decides whether to retain separate counsel, accountants or others to perform services for us.

Affiliates of our Manager are not limited in their ability to compete with us and are not obligated to offer us the opportunity to pursue additional assets or businesses.

The Manager, Brookfield Asset Management Inc., or any of its other affiliates are not prohibited from owning assets or engaging in businesses that compete directly or indirectly with us. Any of these entities may pursue opportunities to acquire or develop properties in the future, including but not limited to opportunities for mixed use developments, without any obligation to offer us the opportunity.

Our sole shareholder, Brookfield Asset Management Inc., may have interests as an equity holder that may conflict with the interests of creditors.

Brookfield Asset Management Inc. beneficially owns, or controls or directs, directly or indirectly 100% of our outstanding Common Shares. Accordingly, Brookfield Asset Management Inc. has the ability to control our policies and operations. The interests of Brookfield Asset Management Inc. may not in all cases be aligned with our creditors' interests. For example, if we encounter financial difficulties or are unable to pay our debts as they mature, the interests of Brookfield Asset Management Inc. might conflict with our creditors' interests. In addition, Brookfield Asset Management Inc. may have an interest in pursuing acquisitions, divestitures, financings or other transactions that, in its judgment, could enhance its equity investment, even though such transactions might involve risks to holders of the notes. Furthermore, Brookfield Asset Management Inc. may in the future own businesses that directly or indirectly compete with us. Brookfield Asset Management Inc. also may pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us.

Our relationship with our sole shareholder, Brookfield Asset Management Inc., and other affiliates may be on terms more or less favorable than those that could be obtained from third parties.

Brookfield Asset Management Inc. beneficially owns, or controls or directs, directly or indirectly, 100% of our outstanding Common Shares. Our relationship with Brookfield Asset Management Inc. and its affiliates includes certain related party transactions. See Note 25 to the consolidated financial statements for additional information on related party transactions. Additionally, we have the right to use the names "Brookfield" and "Brookfield Residential" pursuant to a license agreement between Brookfield Office Properties and Brookfield Global Asset Management Limited, a subsidiary of Brookfield Asset Management Inc. These and other arrangements with affiliates may not be on terms at least as favorable to us as those that could be negotiated with third parties, despite procedural protections to simulate arm's length negotiations, such as the prior approval of related party transactions by our independent directors. Conversely, the terms of our agreements with affiliates could be more favorable to us than would be available from a third party. In such event, should we be required to replace these arrangements, we might not be able to obtain terms as least at favorable as those with affiliates.

Management's Responsibility for Financial Reporting

Management of Brookfield Residential Properties Inc. ("Brookfield Residential") is responsible for the integrity and fair presentation of the financial information, including the consolidated financial statements and management's discussion and analysis and review, contained in this annual report. To fulfill this responsibility, the Company maintains a system of internal controls to ensure that its reporting practices and accounting and administrative procedures are appropriate and provide assurance that relevant and reliable information is produced. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and include some amounts based on management's best estimates and careful judgment in the circumstances. The consolidated financial statements include the accounts of Brookfield Residential and all of its subsidiaries (collectively, the "Company"). The financial information of the Company included in the Company's Annual Report is consistent with that in the consolidated financial statements.

Deloitte LLP, the independent auditors appointed by the shareholders, have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the Board of Directors and shareholders their opinion on the consolidated financial statements. Their report as an independent auditor is set out on the following page.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements and for overseeing management's performance of its financial reporting. The Board of Directors carries out these responsibilities and meets periodically with management, our internal auditors and independent auditors to review the scope and results of the annual audit and to review the consolidated financial statements and related reporting and internal control matters before the financial statements are approved by the Board of Directors and submitted to the shareholders.

/s/ Alan Norris

Alan Norris
Chairman and Chief Executive Officer

/s/ Thomas Lui

Thomas Lui
Executive Vice President and Chief Financial Officer

Calgary, Canada
February 5, 2019

Independent Auditor's Report

To the Board of Directors and Shareholders of Brookfield Residential Properties Inc.

Opinion

We have audited the consolidated financial statements of Brookfield Residential Properties Inc. (the "Company"), which comprise the consolidated balance sheets as at December 31, 2018 and 2017, and the consolidated statements of operations, consolidated statements of equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (collectively referred to as the "consolidated financial statements").

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the Annual Report prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

/s/ Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
February 5, 2019

CONSOLIDATED FINANCIAL STATEMENTS

BROOKFIELD RESIDENTIAL PROPERTIES INC.
CONSOLIDATED BALANCE SHEETS
(all dollar amounts are in thousands of U.S. dollars)

	Note	As at December 31 2018	As at December 31 2017
Assets			
Land and housing inventory	4	$ 2,974,249	$ 2,998,024
Investments in unconsolidated entities	5	347,325	312,857
Commercial properties	6	269,829	37,958
Held-to-maturity investment	8	300,000	300,000
Receivables and other assets	9	478,932	413,228
Restricted cash	10	3,200	3,351
Cash and cash equivalents		69,932	104,504
Deferred income tax assets	15	61,847	68,363
Goodwill	7	16,479	—
Total assets		$ 4,521,793	$ 4,238,285
Liabilities and Equity			
Notes payable	11	$ 1,619,918	$ 1,631,584
Bank indebtedness and other financings	12	143,480	31,407
Accounts payable and other liabilities	13	635,800	560,821
Total liabilities		2,399,198	2,223,812
Common Shares – 129,756,910 shares outstanding (December 31, 2017 – 129,756,910 shares outstanding)	17	626,594	626,594
Additional paid-in-capital		367,433	367,433
Retained earnings		1,236,092	1,063,623
Non-controlling interest	16	53,832	54,216
Accumulated other comprehensive loss		(161,356)	(97,393)
Total equity		2,122,595	2,014,473
Total liabilities and equity		$ 4,521,793	$ 4,238,285
Commitments, contingent liabilities and other	20		
Guarantees	21		

See accompanying notes to the consolidated financial statements

BROOKFIELD RESIDENTIAL PROPERTIES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(all dollar amounts are in thousands of U.S. dollars, except per share amounts)

	Note	Years Ended December 31 2018	2017
Revenue			
Housing		$ 1,794,077	$ 1,733,247
Land		368,273	317,734
Total revenue		2,162,350	2,050,981
Direct Cost of Sales			
Housing		(1,450,393)	(1,386,050)
Land		(238,990)	(191,556)
Total direct cost of sales		(1,689,383)	(1,577,606)
Gross margin		472,967	473,375
Gain on sale of commercial properties	6	6,331	—
Selling, general and administrative expense		(296,035)	(237,238)
Interest expense		(37,912)	(57,275)
Equity in earnings from unconsolidated entities	5	18,360	14,830
Other income	14	62,891	28,358
Depreciation		(4,379)	(4,106)
Income Before Income Taxes		222,223	217,944
Current income tax expense	15	(38,056)	(36,435)
Deferred income tax expense	15	(1,813)	(15,204)
Net Income		182,354	166,305
Other Comprehensive Income / (Loss)			
Unrealized foreign exchange gain / (loss) on:			
Translation of the net investment in Canadian subsidiaries		(79,514)	65,872
Translation of the Canadian dollar denominated debt designated as a hedge of the net investment in Canadian subsidiaries		15,550	(12,850)
Comprehensive Income		$ 118,390	$ 219,327
Net Income Attributable To:			
Consolidated		$ 182,354	$ 166,305
Non-controlling interest	16	7,952	133
Brookfield Residential		$ 174,402	$ 166,172
Comprehensive Income Attributable To:			
Consolidated		$ 118,390	$ 219,327
Non-controlling interest	16	7,952	133
Brookfield Residential		$ 110,438	$ 219,194
Common Shareholders Earnings Per Share			
Basic	19	$ 1.34	$ 1.28
Diluted	19	$ 1.34	$ 1.28
Weighted Average Common Shares Outstanding *(in thousands)*			
Basic	19	129,757	129,757
Diluted	19	129,922	129,767

See accompanying notes to the consolidated financial statements

BROOKFIELD RESIDENTIAL PROPERTIES INC.
CONSOLIDATED STATEMENTS OF EQUITY
(all dollar amounts are in thousands of U.S. dollars)

	Note	Years Ended December 31 2018	2017
Common Shares	17		
Opening balance		$ 626,594	$ 626,594
Ending balance		626,594	626,594
Additional Paid-in-Capital			
Opening balance		367,433	367,433
Ending balance		367,433	367,433
Retained Earnings			
Opening balance		1,063,623	897,451
Adjustment due to adoption of ASC Topic 606	2	(1,933)	—
Adjusted opening balance		1,061,690	897,451
Net income attributable to Brookfield Residential		174,402	166,172
Ending balance		1,236,092	1,063,623
Accumulated Other Comprehensive Loss			
Opening balance		(97,393)	(150,415)
Other comprehensive (loss) / income		(63,963)	53,022
Ending balance		(161,356)	(97,393)
Total Brookfield Residential Equity		$ 2,068,763	$ 1,960,257
Non-Controlling Interest	16		
Opening balance		$ 54,216	$ 43,387
Acquisitions		174	7,587
Net income attributable to non-controlling interest		7,952	133
(Distributions) / Contributions		(8,510)	3,109
Ending balance		$ 53,832	$ 54,216
Total Equity		$ 2,122,595	$ 2,014,473

See accompanying notes to the consolidated financial statements

BROOKFIELD RESIDENTIAL PROPERTIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(all dollar amounts are in thousands of U.S. dollars)

	Years Ended December 31	
Cash Flows Provided by / (Used in) Operating Activities	**2018**	**2017**
Net income	$ 182,354	$ 166,305
Adjustments to reconcile net income to net cash used in operating activities:		
Undistributed earnings from unconsolidated entities	(13,545)	(10,183)
Deferred income tax expense	1,813	15,204
Share-based compensation costs	19,418	15,620
Depreciation	4,379	4,106
Amortization of non-cash interest	4,480	3,622
Dividend income on held-to-maturity investment	(21,093)	(17,057)
Changes in operating assets and liabilities:		
Increase in receivables and other assets	(121,329)	(45,271)
Increase in land and housing inventory	(20,829)	(46,848)
Increase in commercial properties	(192,145)	—
Increase in accounts payable and other liabilities	56,510	30,933
Net cash used in operating activities	(99,987)	116,431
Cash Flows Provided by / (Used in) Investing Activities		
Investments in unconsolidated entities	(92,609)	(41,960)
Distributions from unconsolidated entities	26,660	51,585
Increase in commercial properties	—	(1,954)
Dividend income on held-to-maturity investment	21,093	17,057
Decrease (increase) in loan receivable	17,101	(112,000)
Net cash used in investing activities	(27,755)	(87,272)
Cash Flows Provided by / (Used in) Financing Activities		
Drawings under project-specific and other financings	40,865	16,832
Repayments under project-specific and other financings	(16,148)	(42,617)
Drawings on bank indebtedness	78,896	—
Repayments on bank indebtedness	—	(2,232)
Net (distributions) / contributions from non-controlling interest	(8,430)	3,084
Net cash provided by / (used in) financing activities	95,183	(24,933)
Effect of foreign exchange rates on cash and cash equivalents	(2,164)	4,510
Change in cash and cash equivalents	(34,723)	8,736
Cash and cash equivalents at beginning of year	107,855	99,119
Cash and cash equivalents at end of year	$ 73,132	$ 107,855

Supplemental Cash Flow Information		
Cash interest paid	$ 114,483	$ 108,490
Cash taxes paid	$ 51,085	$ 38,772

See accompanying notes to the consolidated financial statements

Note 1. Significant Accounting Policies

(a) Basis of Presentation

Brookfield Residential Properties Inc. (the "Company" or "Brookfield Residential") was incorporated in Ontario, Canada and is a wholly-owned subsidiary of Brookfield Asset Management Inc. and has been developing land and building homes for over 60 years.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and include the consolidated accounts of Brookfield Residential, its subsidiaries, investments in unconsolidated entities and variable interest entities in which the Company is the primary beneficiary. All intercompany accounts, transactions and balances have been eliminated upon consolidation.

All dollar amounts discussed herein are in U.S. dollars and in thousands, unless otherwise stated. Amounts in Canadian dollars are identified as "C$."

(b) Revenue Recognition

Revenue is measured based on the consideration specified in a contract with a customer. The Company recognizes revenue when it satisfies a performance obligation by transferring control of a product or service to a customer. Taxes collected on behalf of a Government authority for a revenue-producing transaction are excluded from revenue.

Land sales are recognized when title passes to the purchaser upon closing, all material conditions of the sales contract have been met and a significant cash down payment or appropriate security is received and collectability is reasonably assured. Revenues from the sale of homes are recognized when title passes to the purchaser upon closing, wherein all proceeds are received or collectability is reasonably assured. In certain circumstances, when title transfers but material future development is required, revenue will either be recognized at a point in time or as the performance obligation is satisfied.

The Company grants homebuyers sales incentives from time-to-time in order to promote sales of its homes. These incentives will vary by type and by amount on a community-by-community and home-by-home basis. Incentives that impact the value of the home or the sales price paid, such as additional options, are reflected as a reduction to sales revenue. Incentives that are paid to an outside party, such as paying some or all of a homebuyer's closing costs, are recorded as cost of sales. Incentives are recognized at the time title passes to the homebuyer and the sale is recognized.

The following are descriptions of principal activities, from which the Company generates its revenue. See Note 24 "Segmented Information" for detailed information about the Company's reportable segments.

(i) *Land Sales:* The land operations of the Company principally generate revenue from developing land for its own communities and selling lots to other homebuilders and third parties. The Company's duration of land contracts vary; however, the typical length of a contract is less than one year. Revenues from land sales are recognized at a point in time when the Company's performance obligations are achieved. Performance obligations are satisfied when title has transferred and all material conditions of the sales contract have been met. Generally, all elements of the transaction price are allocated to one performance obligation. Certain components of the transaction price that are considered constrained at the time the performance obligation is satisfied are recognized when it is determined that it is likely that a significant reversal in the amount of cumulative revenue recognized will not occur. Certain contracts may have a significant financing component in the form of a vendor take back ("VTB") mortgage receivable. These amounts are recognized as receivables, see Note 9 "Receivables and Other Assets" for more detailed information. Certain contracts may have a component of variable consideration, in the form of profit participation. When a contract includes profit participation, the Company will receive consideration from the builder who purchased the land, as a percentage of the ultimate sale of the home. Profit participation is determined to be constrained at the time the revenue contract is recognized. The Company will reassess and recognize profit participation at the end of each reporting period. See Note 3 "Revenue from Contracts with Customers" for recognized and constrained profit participation.

(ii) *Housing Sales:* The homebuilding operations of the Company principally generate revenue from designing, constructing, and marketing single family and multi-family homes in its own and its developers' communities. The typical contract duration for housing contracts is less than one year. Revenues from the sale of homes are recognized at a point in time when the Company's performance obligations are achieved. Performance obligations are satisfied when the home is complete, consideration has been received, and title has transferred. All elements of the transaction price are allocated to the Company's one performance obligation.

(c) Land and Housing Inventory

(i) Carrying values: Inventories consist of land held for development, land under development, homes under construction, completed homes and model homes and are stated at cost, net of impairment losses. In accordance with the United States Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 360 *Property, Plant and Equipment*, land and housing assets owned directly by the Company are reviewed for recoverability on a regular basis; the Company assesses these assets no less than quarterly for recoverability and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Indicators of impairment include, but are not limited to: significant decreases in local housing market values and selling prices of comparable homes; significant decreases in gross margins and sales absorption rates; accumulation of costs in excess of budget; actual or projected operating or cash flow losses; and current expectations that a real estate asset will more likely than not be sold before its previously estimated useful life. For communities where the current competitive and market dynamics indicate that these factors may be other than temporary, which may call into question the recoverability of the Company's investment, a formal impairment analysis is performed. The formal impairment analysis consists of both qualitative competitive market analysis and a quantitative analysis reflecting market and asset specific information.

The qualitative competitive market analysis includes review of factors such as the target buyer and the macroeconomic characteristics that impact the performance of the Company's assets, such as unemployment and the availability of mortgage financing, among other things. Based on this qualitative competitive market analysis, adjustments to sales prices may be required in order to make the Company's communities competitive. The Company incorporates these adjusted prices in the quantitative analysis for the specific community.

Recoverability is measured by comparing the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. To arrive at the estimated fair value of land and housing inventory, the Company estimates the cash flow for the life of each project. Specifically, on a land project, the Company estimates the timing of future land sales and the estimated revenue per lot, as well as estimated margins with respect to future land sales. On a housing project, the Company evaluates the margins on homes that have been closed, margins on sales contracts which are in backlog and estimated margins with regard to future home sales over the life of the project. For the land and housing inventory, the Company continuously evaluates projects where inventory is turning over more slowly than expected or whose average sales price and margins are declining and are expected to continue to decline. These projections take into account the specific business plans for each project and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market area. Such projections generally assume current home selling prices, cost estimates and sales rates for short-term projects are consistent with recent sales activity. For longer-term projects, planned sales rates for 2019 generally assume recent sales activity and normalized sales rates beyond 2019. In some instances, the Company may incorporate a certain level of inflation or deflation into the projected revenue and cost assumptions for these longer term projects. Management identifies potentially impaired land and housing projects based on these quantitative factors as well as qualitative factors obtained from the local market areas. If the future undiscounted cash flows are less than the carrying amount, the asset is considered to be impaired and is then written down to fair value less estimated selling costs using a discounted cash flow methodology which incorporates market participant assumptions.

Due to uncertainties in the estimation process, particularly with respect to projected home sales prices and absorption rates, the timing and amount of the estimated future cash flows and discount rates, it is reasonably possible that actual results could differ from the estimates used in the impairment analysis. Assumptions about future home sales prices and absorption rates require significant judgment because the residential homebuilding industry is cyclical and is highly sensitive to changes in economic conditions. Because the projected cash flows used to evaluate the fair value of inventory are significantly impacted by changes in market conditions including reduced sales prices, a change in sales prices or changes in absorption estimates based on current market conditions and management's assumptions relative to future results could lead to additional impairments in certain communities during any given period.

The Company has also entered into a number of option contracts to acquire land or lots in the future in accordance with specific terms and conditions. The majority of the option contracts require a non-refundable cash deposit based on a percentage of the purchase price of the property. Option contracts are recorded at cost. In determining whether to pursue an option contract, the Company estimates the option primarily based upon the expected cash flows from the optioned property. If the intent is to no longer pursue an option contract, the Company records a charge to earnings of the deposit amounts and any other related pre-acquisition entitlement costs in the period the decision is made.

(ii) *Capitalized costs:* In addition to direct land acquisitions, land development and improvement costs and home construction costs, costs also include interest, real estate taxes and direct overhead related to development and construction, which are capitalized to inventory during the period beginning with the commencement of development and ending with the completion of construction or development.

The Company capitalizes certain interest costs to qualified inventory during the development and construction period in accordance with ASC Topic 835-20 *Capitalization of Interest.* Capitalized interest is charged to cost of sales when the related inventory is delivered. Interest incurred on home building indebtedness in excess of qualified inventory, as defined in ASC 835-20, is charged to the consolidated statement of operations in the period incurred.

(d) Commercial Properties

Commercial properties include any properties that are currently leased out by Brookfield Residential and produce leasing revenue for the Company, or are being developed to produce leasing revenue. Acquisitions of operating commercial properties are accounted for utilizing the acquisition method of accounting. Estimates of future cash flows and other valuation techniques are used to allocate the purchase price of acquired property between land, buildings and improvements, equipment, debt, liabilities assumed and identifiable intangible assets and liabilities, if applicable. Expenditures for significant betterments and improvements are capitalized. Maintenance and repairs are charged to expense when incurred. Construction and improvement costs incurred in connection with the development of new properties or the redevelopment of existing properties are capitalized. Completed commercial properties are carried at the cost basis less accumulated depreciation. Commercial properties under development are stated at cost and are not depreciated until available for use. Real estate taxes and interest costs incurred during development periods are capitalized. Capitalized interest costs are based on qualified expenditures and interest rates in place during the development period. Capitalized real estate taxes and interest costs are amortized over lives which are consistent with the developed assets.

Pre-development costs, which generally include legal and professional fees and other directly-related third party costs, are capitalized as part of the property being developed. In the event a development is no longer deemed to be probable, the costs previously capitalized are expensed.

Depreciation of completed commercial properties are recorded over the estimated useful life using the straight-line method.

(e) Loans and notes receivable

Loans and notes receivable are carried at the lower of amortized cost or fair value, with interest income recognized using the effective interest rate method. The effective interest rate method is used to recognize interest income on loan receivables on the basis of the contractual cash flows over the contractual term of the loan. A provision for impairment is established when there is objective evidence that the Company will not be able to collect all amounts due for both principal and interest according to the contractual terms of the agreement. Interest income received on loans receivable is recorded as other income.

(f) Assets Held for Sale

Long-lived assets and groups of assets and liabilities which are considered to be disposal groups are presented as assets held for sale when the criteria in ASC Topic 360 *Property, Plant and Equipment* are met. Assets are reclassified as held for sale when management commits to a plan to sell the asset, the asset is available for immediate sale in its present condition subject to usual and customary terms, an active program to find a buyer is in place, the sale of the asset is probable within one year, the asset is being actively marketed at a price that is reasonable in relation to its fair value and it is unlikely that significant changes to the plan will be made.

While classified as held for sale, assets are carried at the lower of their carrying value and the fair value less costs to sell. Assets held for sale are not depreciated.

(g) Unconsolidated Entities

The Company participates in a number of unconsolidated entities in which it has less than a controlling interest to build homes or to develop and sell land to the unconsolidated entity members and other third parties. These unconsolidated entities are accounted for using the equity method. The Company recognizes its proportionate share of the earnings from the sale of lots and homes to other third parties. The Company does not recognize earnings from the purchase of lots from its unconsolidated entities and reduces its cost basis of the land purchased accordingly.

(h) Use of Estimates

The preparation of financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the carrying amounts of particular assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas where judgment is applied include asset valuations, investments in unconsolidated entities, assessment of variable interest entities, assets and liabilities associated with assets held for sale, tax provisions, warranty costs, valuation of financial instruments, deferred income tax assets and liabilities, accrued liabilities, variable consideration, share-based compensation, contingent liabilities including litigation and the purchase price allocated to the assets acquired and the liabilities assumed of an acquisition. Actual results could differ materially from these estimates.

(i) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits, and all highly liquid short-term investments with original maturity less than 90 days. The carrying value of these investments approximates their fair value.

(j) Restricted Cash

Restricted cash includes cash collateralization of development letters of credit, as well as funds in various cash accounts reserved for letters of credit, guarantees on completion of certain improvements, and guarantees on future insurance loss deductible payments.

(k) Income Taxes

Income taxes are accounted for in accordance with ASC Topic 740 *Income Taxes*. The provision for, or benefit from, income taxes is calculated using the asset and liability method, under which deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the years in which the differences are expected to reverse.

Provisions (benefits) for federal, state and provincial income taxes are calculated on reported pretax income (losses) based on current tax law and also include, in the applicable period, the cumulative effect of any changes in tax rates from those used previously in determining deferred tax assets and liabilities. Such provisions (benefits) differ from the amounts currently receivable or payable because certain items of income and expense are recognized for financial reporting purposes in different periods than for income tax purposes. Significant judgment is required in determining income tax provisions (benefits) and evaluating tax positions. The Company establishes reserves for income taxes when, despite the belief that its tax positions are fully supportable, it believes that its positions may be challenged and disallowed by various tax authorities. The consolidated tax provisions (benefits) and related accruals include the impact of such reasonably estimable disallowances as deemed appropriate. To the extent that the probable tax outcome of these matters changes, such changes in estimates will impact the income tax provision (benefit) in the period in which such determination is made.

In accordance with ASC Topic 740, the Company assesses on a quarterly basis the realizability of its deferred tax assets. Significant judgment is required in estimating valuation allowances for deferred tax assets. A valuation allowance is established against a deferred tax asset if, based on the available evidence, it is more-likely-than-not that such asset will not be realized. The Company's assessment includes evaluating the following significant factors: an assessment of recent years' profitability and losses which considers the nature, frequency, and severity of current and cumulative losses; management's forecasts or expectation of profits based on margins and volumes expected to be realized; the long duration of twenty years in Canada before the expiry of non-capital losses, and taking into consideration that a portion of the deferred tax asset is composed of deductible temporary differences that are not subject to an expiry period until realized under tax law.

The Company bases its estimate of deferred tax assets and liabilities on current tax laws and rates and, in certain cases, on business plans and other expectations about future outcomes. Changes in existing tax laws or rates could affect actual tax results, and future business results may affect the amount of deferred tax liabilities or the valuation of deferred tax assets over time. The Company's accounting for deferred tax assets represents its best estimate of future events using the guidance provided by ASC Topic 740.

(l) Share-Based Compensation

The Company accounts for option grants and deferred share unit grants in accordance with ASC Topic 718 *Compensation-Stock Compensation*.

All options granted under the Management Share Option Plan have exercise prices equal to the assessed market value of the Company's Common Shares on the grant date, determined in accordance with the Company's Management Share Option Plan. Participants in the Management Share Option Plan can exercise their options to purchase Non-Voting Class B Common Shares at the exercise price or settle the options in cash at the option of the holder as options vest. The Company records the options as a liability and they are disclosed in accounts payable and other liabilities. The fair value of the options is determined and a true-up for compensation costs is recorded each reporting period for the changes in fair value prorated for the portion of the requisite service period rendered. The Company determines the fair value of the options using the Black-Scholes option pricing model.

The Company records the deferred share units as a liability and they are disclosed in accounts payable and other liabilities.

See Note 18 "Share-Based Compensation" for further discussion.

(m) Foreign Currency Translation

The functional and presentation currency of the Company is the U.S. dollar. Each of the Company's subsidiaries, affiliates and jointly controlled entities determines its own functional currency and items included in the financial statements of each subsidiary and affiliate are measured using that functional currency. The Company's Canadian operations are self-sustaining and have a Canadian dollar functional currency. The financial statements of its self-sustaining Canadian operations are translated into U.S. dollars using the current rate method.

Assets and liabilities of subsidiaries or unconsolidated entities having a functional currency other than the U.S. dollar are translated at the rate of exchange on the balance sheet date. Revenues and expenses are translated at average rates for the period, unless exchange rates fluctuated significantly during the period, in which case the exchange rates at the dates of the transaction are used. The resulting foreign currency translation adjustments are recognized in other comprehensive income ("OCI").

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the date of the transactions. At the end of each reporting period, foreign currency denominated monetary assets and liabilities are translated to the functional currency using the prevailing rate of exchange at the balance sheet date. Gains and losses on translation of monetary items are recognized in the consolidated statements of operations as other income / (expense), except for those related to monetary liabilities qualifying as hedges of the Company's investment in foreign operations or certain intercompany loans to or from a foreign operation for which settlement is neither planned nor likely to occur in the foreseeable future, which are included in OCI.

(n) Earnings Per Share

Earnings per share is computed in accordance with ASC Topic 260 *Earnings Per Share*. Basic earnings per share is calculated by dividing net income attributable to Brookfield Residential by the weighted average number of Common Shares outstanding for the period. Diluted earnings per share is calculated by dividing net income attributable to Brookfield Residential for the period by the average number of Common Shares outstanding including all potentially dilutive issuable Non-Voting Class B Common Shares under the option plan.

(o) Advertising Costs

The Company expenses advertising costs as incurred, which are included in the consolidated statements of operations as selling, general and administrative expense.

(p) Warranty Costs

Estimated future warranty costs are accrued and charged to cost of sales at the time the revenue associated with the sale of each home is recognized. Factors that affect the Company's warranty liability include the number of homes sold, historical and anticipated rates of warranty claims, and cost per claim. Costs are accrued based upon historical experience.

(q) Variable Interest Entities

The Company accounts for its variable interest entities ("VIE") in accordance with ASC Topic 810 *Consolidation*. The decision to consolidate a VIE begins with establishing that a VIE exists. A VIE exists when either the total equity investment at risk is not sufficient to permit the entity to finance its activities by itself, or the equity investor lacks one of three characteristics associated with owning a controlling financial interest. Those characteristics are the power to direct the activities of an entity that most significantly impact the entity's economic performance, the obligation to absorb the expected losses of the entity, and the right to receive the expected residual returns of the entity. The entity that has (i) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE is considered to have a controlling financial interest in a VIE and is required to consolidate such entity. The Company has determined that it has a controlling financial interest in certain VIEs which are included in these financial statements as a component of "land and housing inventory". The interests of others are included in accounts payable and other liabilities. See Note 4 "Land and Housing Inventory" and Note 5 "Investments in Unconsolidated Entities" for further discussion on the consolidation of land option contracts and unconsolidated entities.

(r) Derivative Financial Instruments and Risk Management Activities

The Company accounts for its derivative and hedging activities in accordance with ASC Topic 815 *Derivatives and Hedging*, which requires the Company to recognize all derivative instruments at their fair values as either assets or liabilities on its balance sheet. The accounting for changes in fair value (i.e. gains or losses) of a derivative instrument depends on whether the Company has designated it, and whether it qualifies, as part of a hedging relationship and on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that are attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings (i.e. in "interest expense" when the hedged transactions are interest cash flows associated with floating-rate debt). The remaining gain or loss on the derivative instrument in excess of the cumulative changes in the present value of future cash flows of the hedged item, if any, is recognized in the realized and unrealized gain / (loss) on derivatives in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in realized and unrealized gain / (loss) on derivatives in current earnings during the period of change. Income and/or expense from changes in fair value on interest rate swaps are recognized as an adjustment to other income. The exchanges of payments on interest rate swap contracts are recorded as an adjustment to interest expense.

For hedges of net investments in foreign operations, any foreign exchange gains or losses on the hedging instrument relating to the effective portion of the hedge are initially recorded in other comprehensive income. Gains and losses are recognized in current earnings on the ineffective portion of the hedge, or when there is a disposal or partial disposal of a foreign operation being hedged.

(s) Held-to-Maturity Investment

Held-to-maturity investments are recorded initially at fair value and are subsequently measured at amortized cost using the effective interest method, less any applicable provision for impairment. A provision for impairment is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Dividends received on held-to-maturity investments are recorded as other income.

(t) Fair Value Instruments

The FASB's authoritative guidance for fair value measurements establishes a three-level hierarchy based upon the inputs to the valuation model of an asset or liability. The fair value hierarchy and its application to the Company's assets and liabilities is as follows:

- Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 – Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market.
- Level 3 – Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on management's estimates about the assumptions that market participants would use to value the asset or liability.

When available, the Company uses quoted market prices in active markets to determine fair value. The Company considers the principal market and non-performance risks associated with its counterparties when determining the fair value measurements, if applicable. Fair value measurements are used for its interest rate and equity swaps, as well as for inventories when events and circumstances indicate that the carrying value may not be recoverable.

(u) Common Control Transactions

The Company accounts for the purchase and sale of assets between entities under common control in accordance with ASC Topic 805 *Business Combinations,* which requires the Company to record assets and liabilities transferred between entities under common control at carrying value. Differences between the carrying amount of the consideration given or received and the carrying amount of the assets and liabilities transferred are recorded directly in additional paid-in-capital.

(v) Recent Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update ("ASU") 2016-02 *Leases* ("ASU 2016-02"). ASU 2016-02, codified in ASC 842, amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and makes targeted changes to lessor accounting. The new standard is effective for calendar periods beginning on January 1, 2019, for public business entities. Early adoption of ASU 2016-02 is permitted. The new leases standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company's consolidated balance sheets will be impacted by adoption of ASU 2016-02, by the recognition of a lease liability and right of use asset for most of its current operating leases. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on the consolidated statement of operations and consolidated statements of cash flows.

In January 2018, the FASB issued ASU 2018-01 *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842* ("ASU 2018-01"). ASU 2018-01 amends the new leasing standard, ASU 2016-02, to provide a transition practical expedient for existing or expired land easements that were previously not accounted for in accordance with ASC 840. The practical expedient allows entities to elect not to assess whether those land easements are leases in accordance with ASC 842 when transitioning to the new standard. ASU 2018-01 is effective for the same calendar periods as ASU 2016-02. The Company is currently evaluating the impact of the adoption of ASU 2018-01 on the consolidated financial statements.

In July 2018, the FASB issued ASU 2018-11 *Leases (Topic 842): Targets Improvements* ("ASU 2018-11"). ASU 2018-11 provides entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU 2016-02; through providing elections to not recast the comparative periods presented when transitioning to ASC 842, and for lessors to elect not to separate lease and non-lease components when certain conditions are met. ASU 2018-11 is effective for the same calendar periods as ASU 2016-02. The Company is currently evaluating the impact of the adoption of ASU 2018-11 on the consolidated financial statements.

In December 2018, the FASB issued ASU 2018-20 *Leases (Topic 842): Narrow-scope Improvements for Lessors* ("ASU 2018-20"). ASU 2018-20 provides entities with clarification of the allocation of variable payments for contracts with lease and nonlease components. ASU 2018-20 is effective for the same calendar periods as ASU 2016-02. The Company is currently evaluating the impact of the adoption of ASU 2018-20 on the consolidated financial statements.

Note 2. Change in Accounting Policies

ASC Topic 606 "Revenue from Contracts with Customers"

The Company applied ASC Topic 606 *Revenue from Contracts with Customers*, ("ASC Topic 606") with an initial application date of January 1, 2018. As a result, the Company has changed its accounting policy for revenue recognition as detailed below. The Company has applied the practical expedient in paragraph 606-10-50-14 of ASC Topic 606 and has not disclosed remaining performance obligations where performance obligations are part of contracts that have an original expected duration of one year or less. Consideration from contracts with customers does not include any estimated amounts of variable consideration that are constrained. The Company has also applied the practical expedient in paragraph 606-10-32-18 of ASC Topic 606 and has not assessed whether a contract has a significant financing component if the Company expects, at contract inception, that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.

The Company applied ASC Topic 606 using the modified retrospective approach, under the cumulative effect method by recognizing the cumulative effect of initially applying ASC Topic 606 as an adjustment to the opening balance of retained earnings at January 1, 2018. Therefore, the comparative information has not been adjusted and continues to be reported under ASC Topic 605 *Revenue Recognition*. The details of the significant changes are disclosed below.

Under ASC Topic 606 revenue is recognized based on the satisfaction of performance obligations. In applying ASC Topic 606, the Company has evaluated its contracts to determine the related performance obligation and when to recognize revenue as the performance obligations are satisfied. While this change did not impact the timing of recognizing revenue on the majority of the Company's revenue contracts, it did have an effect on select land sale contracts. This has resulted in a quantitative impact to the Company's consolidated financial statements.

ASC Topic 606 also provided additional clarity that resulted in reclassification to or from revenue, cost of sales, selling, general and administrative expense and other income.

(all dollar amounts are in thousands of U.S. dollars)

The following tables summarize the quantitative impact of the adoption of ASC Topic 606 on the Company's consolidated financial statements:

Consolidated Balance Sheet

	As at December 31, 2018		
	As Reported	Balances without ASC 606	Effect of Change Increase / (Decrease)
Land and housing inventory (a)	$ 2,974,249	$ 2,995,458	$ (21,209)
Investment in unconsolidated entities (b)	347,325	345,832	1,493
Receivables and other assets (a)	478,932	457,723	21,209
Deferred income tax asset (b)	61,847	62,250	(403)
Total equity (a)(c)(d)	2,122,595	2,123,685	(1,090)

(a) The impact is due to the reclassification of capitalized sales and marketing expenditures from land and housing inventory to property, plant and equipment, which is included in receivables and other assets.

(b) The impact is due to the recognition of revenue previously deferred in 2017, as under ASC Topic 606, the performance obligation is met.

(c) The impact is due to the recognition of deferred revenue previously recognized in 2017. Under ASC Topic 606, the performance obligation was not met as of January 1, 2018. As of December 31, 2018, the performance obligation has been met and the deferred revenue and related costs have been recognized.

(d) The impact to opening retained earnings has been detailed below in the "Consolidated Statement of Equity".

Consolidated Statement of Operations

	Year Ended December 31, 2018		
	As Reported	Balances without ASC 606	Effect of Change Increase / (Decrease)
Revenue (a)(b)	$ 2,162,350	$ 2,135,501	$ 26,849
Cost of sales (b)(c)	(1,689,383)	(1,680,258)	(9,125)
Selling, general and administrative expense (c)(d)	(296,035)	(272,033)	(24,002)
Other income (a)(c)	62,891	52,554	10,337
Other expense and equity earnings (e)	(17,600)	(17,600)	—
Income before income taxes	$ 222,223	$ 218,164	$ 4,059

(a) The impact is due to the reclassification of forfeited deposits from other income to revenue.

(b) The impact is due to the recognition of deferred revenue previously recognized in 2017. Under ASC Topic 606, the performance obligation was not met as of January 1, 2018. As of December 31, 2018, the performance obligation has been met and the deferred revenue and related costs, have been recognized.

(c) The impact is due to the reclassification of the amortization of capitalized sales and marketing expenditures from cost of sales to selling, general and administrative expense.

(d) The impact is due to the reclassification of joint venture management fee income from selling, general and administrative expense to other income. When looking at the comparative period, selling, general and administrative expense for the year ended December 31, 2017, included $8.0 million of joint venture management fee income that was offset against the expense. Excluding joint venture management fee income, selling, general and administrative expense for the year ended December 31, 2017, was $245.3 million.

(e) Other expenses and equity earnings include interest expense, equity earnings from unconsolidated entities, and depreciation, which were not impacted by the implementation of ASC Topic 606.

(all dollar amounts are in thousands of U.S. dollars)

Consolidated Statement of Equity

	As at January 1, 2018						
	Common Shares	**Additional Paid-in-Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Total Brookfield Residential Equity**	**Non-Controlling Interest**	**Total Equity**
Balance at Jan 1, 2018, as previously reported	$ 626,594	$ 367,433	$ 1,063,623	$ (97,393)	$ 1,960,257	$ 54,216	$ 2,014,473
Impact of change in accounting policy (a)	—	—	(1,933)	—	(1,933)	—	(1,933)
Adjusted Balance at Jan 1, 2018	$ 626,594	$ 367,433	$ 1,061,690	$ (97,393)	$ 1,958,324	$ 54,216	$ 2,012,540

(a) One of the impacts of the change in accounting policy resulted in the deferral of revenue and related costs previously recognized.

ASC Topic 805 "Business Combinations"

The Company applied ASC Topic 805 *Business Combinations*, ("ASC Topic 805") with a date of the initial application of January 1, 2018. As a result, the Company has changed its accounting policy for recognition of a business combination, and has applied this policy in recognizing the acquisition of OliverMcMillan Inc. Refer to Note 7 "Business Combinations".

Note 3. Revenue from Contracts with Customers

Profit participation revenue, which is considered a form of variable consideration, is considered constrained in accordance with ASC Topic 606. The Company will not include an amount for profit participation when recognizing revenue on the contract at the time the lot is closed, due to constraints. The Company has reassessed, at the end of this reporting period, whether an amount can be estimated for profit participation and whether it meets the probability threshold.

For the year ended December 31, 2018, the Company recognized $1.7 million in revenue from performance obligations satisfied in prior periods. This cumulative catch-up adjustment resulted from a change in transaction price related to variable consideration that was constrained in previous periods. For amounts not recognized due to constraints, the Company has determined the amounts cannot be reliably estimated due to the following factors outside of the Company's control: economic volatility, period of time between the lot sale and the ultimate home closing, fluctuations and difficult prediction of profits and pricing of the ultimate home closing.

The Company has elected to apply the practical expedient under ASC Topic 606, to not disclose information for unsatisfied performance obligations, for housing or land contracts where the performance obligation will be settled within one year.

Note 4. Land and Housing Inventory

Land and housing inventory includes land held for development and land under development, which will be used in the Company’s homebuilding operations or sold as building lots to other homebuilders, homes completed or under construction and model homes.

The following summarizes the components of land and housing inventory:

	As at	
	December 31 2018	**December 31 2017**
Land held for development	$ 1,417,372	$ 1,447,583
Land under development	903,315	918,748
Housing inventory	554,140	528,627
Model homes	99,422	103,066
	$ 2,974,249	$ 2,998,024

(all dollar amounts are in thousands of U.S. dollars)

The Company has reviewed all of its projects for impairment in accordance with the provisions of ASC Topic 360 *Property, Plant and Equipment* and ASC Topic 820 *Fair Value Measurements and Disclosures*. For the years ended December 31, 2018 and 2017, no impairment charges were recognized. Refer to Note 22 "Fair Value Measurements".

The Company capitalizes interest which is expensed as housing units and building lots are sold. Interest capitalized and expensed during the years ended December 31, 2018 and 2017 was as follows:

	Years Ended December 31	
	2018	**2017**
Interest capitalized, beginning of the year	$ 180,650	$ 175,590
Interest capitalized	71,860	50,859
Interest expensed to cost of sales	(54,823)	(45,799)
Interest capitalized, end of the year	$ 197,687	$ 180,650

In the ordinary course of business, the Company has entered into a number of option contracts to acquire land or lots in the future in accordance with specific terms and conditions. As such, the Company has advanced deposits to secure these rights. The Company is required by ASC Topic 810 *Consolidation* to qualitatively assess whether it is the primary beneficiary of these options based on whether it has the power to control the significant activities of the VIE and an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. The Company has evaluated its option contracts in accordance with this guidance and determined that, for those entities considered to be VIEs, it is the primary beneficiary of options with an aggregate exercise price of $44.6 million (December 31, 2017 – $45.2 million), which are required to be consolidated. In these cases, the only asset recorded is the Company's exercise price for the option to purchase, with an increase in accounts payable and other liabilities of $44.6 million (December 31, 2017 – $45.2 million) for the assumed third-party investment in the VIE. Where the land sellers are not required to provide the Company with financial information related to the VIE, certain assumptions by the Company are required in its assessment as to whether or not it is the primary beneficiary.

Land and housing inventory includes non-refundable deposits and other entitlement costs totalling $96.8 million (December 31, 2017 – $90.5 million) in connection with options that are not required to be consolidated in terms of the guidance incorporated in ASC Topic 810. The total remaining exercise price of these options is $110.1 million (December 31, 2017 – $104.9 million), including the non-refundable deposits and other entitlement costs identified above. The number of lots in which the Company has obtained an option to purchase, excluding those already consolidated and those held through investment in unconsolidated entities, and their respective dates of expiry and aggregate exercise prices follow:

Years of Expiry	**Number of Lots**	**Total Exercise Price**
2019	2,938	$ 42,544
2020	1,277	28,019
2021	298	9,887
2022	100	2,948
2023	1,003	7,539
Thereafter	566	19,157
	6,182	$ 110,094

The Company holds agreements for a further 3,641 acres (December 31, 2017 – 2,765 acres) of longer-term land, with non-refundable deposits and other entitlement costs of $18.6 million (December 31, 2017 – $6.8 million), which is included in land and housing inventory that may provide additional lots upon obtaining entitlements with an aggregate exercise price of $87.9 million (December 31, 2017 – $56.6 million). However, given that the Company is in the initial stage of land entitlement, the Company has concluded at this time that the level of uncertainty in entitling these properties does not warrant including them in the above totals.

(all dollar amounts are in thousands of U.S. dollars)

Note 5. Investments in Unconsolidated Entities

As part of its operations, the Company participates in joint ventures and partnerships to explore opportunities while minimizing risk. As of December 31, 2018, the Company was involved with 12 unconsolidated entities (December 31, 2017 – 13 unconsolidated entities) in which it has less than a controlling interest. Investments in unconsolidated entities includes $18.1 million (December 31, 2017 – $30.4 million) of the Company's share of non-refundable deposits and other entitlement costs in connection with 1,001 lots (December 31, 2017 – 1,001 lots) under option. The Company's share of the total exercise price of these options is $36.2 million (December 31, 2017 – $58.3 million). Summarized financial information on a 100% basis for the combined unconsolidated entities follows:

	As at	
	December 31 2018	**December 31 2017**
Assets		
Land and housing inventory	$ 840,418	$ 556,779
Investments in unconsolidated entities	131,260	147,996
Other assets	70,450	63,548
	$ 1,042,128	$ 768,323
Liabilities and Equity		
Bank indebtedness and other financings	$ 127,376	$ 78,168
Accounts payable and other liabilities	112,584	73,628
Brookfield Residential's interest	347,325	312,857
Others' interest	454,843	303,670
	$ 1,042,128	$ 768,323

	Twelve Months Ended December 31	
	2018	**2017**
Revenue and Expenses		
Revenue	$ 127,494	$ 141,545
Direct cost of sales	(88,576)	(113,217)
Other income / (expense)	8,485	9,542
Net income	$ 47,403	$ 37,870
Brookfield Residential's share of net income	$ 18,360	$ 14,830

In reporting the Company's share of net income, all intercompany profits from unconsolidated entities are eliminated on lots purchased by the Company from unconsolidated entities.

Unconsolidated entities in which the Company has a non-controlling interest are accounted for using the equity method. In addition, the Company has performed an evaluation of its existing unconsolidated entity relationships by applying the provisions of ASC Topic 810.

The Company and/or its unconsolidated entity partners have provided varying levels of guarantees of debt of its unconsolidated entities. At December 31, 2018, the Company had recourse guarantees of $8.0 million (December 31, 2017 – $34.4 million) with respect to debt of its unconsolidated entities.

Note 6. Commercial Properties

Commercial properties include any properties that are currently leased out by the Company and produce leasing revenue for the Company, or are being developed to produce leasing revenue. Completed commercial properties are stated at cost, less accumulated depreciation. Commercial properties under development are stated at cost. The Company's components of commercial properties consist of the following:

(all dollar amounts are in thousands of U.S. dollars)

	As at	
	December 31 2018	**December 31 2017**
Commercial properties	$ 271,428	$ 38,897
Less: accumulated depreciation	(1,599)	(939)
	$ 269,829	$ 37,958

Commercial properties consists of the following properties:

	As at	
	December 31 2018	**December 31 2017**
Commercial properties under development	$ 239,271	$ —
Commercial properties producing leasing revenue	32,157	37,958
	$ 271,428	$ 37,958

The Company sold a commercial property for proceeds of $8.3 million and a gain of $6.3 million for the year ended December 31, 2018 (2017 - $nil).

Note 7. Business Combinations

On January 31, 2018, the Company acquired various assets of OliverMcMillan Inc. ("OliverMcMillan"), a mixed-use developer, for an aggregate purchase consideration of $39.5 million. The purchase of OliverMcMillan allows the Company to expand its presence in the mixed-use market and infill business.

The acquisition was accounted for as a business combination under the provisions of ASC Topic 805 *Business Combinations* which, among other things, requires assets acquired and liabilities assumed to be measured at their acquisition date fair values.

The following table summarizes the measurement of the assets acquired and liabilities assumed:

	Fair Value at Acquisition Date
Assets	
Land and housing inventory	$ 4,979
Investments in unconsolidated entities	15,234
Receivables and other assets	3,129
Total assets acquired	$ 23,342
Liabilities	
Accounts payable and other liabilities	$ 350
Total liabilities acquired	$ 350
Net assets acquired	$ 22,992
Total consideration (a)	$ 39,471
Goodwill (b)	$ 16,479

(a) The Company paid $14.1 million of the total consideration in cash and had consideration payable outstanding of $25.4 million upon acquisition.

(b) Goodwill represents the residual asset value of the net assets acquired less the total consideration. The total amount of goodwill that is expected to be deductible for tax purposes is $33.8 million.

(all dollar amounts are in thousands of U.S. dollars)

The following table presents the revenue and loss of OliverMcMillan that are included in the consolidated statements of operations from the acquisition date of January 31, 2018 through December 31, 2018:

Revenue	$	—
Net loss	$	(11,355)

The following table presents supplemental pro forma information as if the acquisition of OliverMcMillan occurred on January 1, 2018. The pro forma consolidated results do not purport to project the future results of the combined Company nor do they reflect the expected realization of any cost savings associated with the OliverMcMillan acquisition.

		Year Ended December 31, 2018
Total revenues	$	—
Net loss attributable to Brookfield Residential	$	(12,254)

Note 8. Held-to-Maturity Investment

	As at			
		December 31 2018		December 31 2017
Brookfield BPY Holdings Inc. Class B Junior Preferred Shares ("preferred shares")	$	300,000	$	300,000
	$	300,000	$	300,000

The Company holds preferred shares in Brookfield BPY Holdings Inc., a subsidiary of Brookfield Asset Management. The preferred shares entitle their holders to receive a cumulative preferential dividend equal to 5.75% of their redemption value until the fifth anniversary of their issuance, after which the preferred shares will entitle their holders to receive a cumulative preferential dividend equal to 5.00% plus the prevailing yield for the 5-year U.S. Treasury Notes. The preferred shares are redeemable at any time and must be redeemed on the tenth anniversary of their issuance. The preferred shares have a right of retraction after the fifth anniversary of the issuance.

During the year ended December 31, 2018, $21.1 million of dividends were recorded in the statement of operations as other income (2017 - $17.1 million).

Note 9. Receivables and Other Assets

The components of receivables and other assets are summarized as follows:

	As at			
		December 31 2018		December 31 2017
Receivables (a)	$	371,197	$	361,796
Other assets (b)		107,735		51,432
	$	478,932	$	413,228

(all dollar amounts are in thousands of U.S. dollars)

(a) The components of receivables are summarized as follows:

	As at	
	December 31 2018	**December 31 2017**
Development recovery receivables (i)	$ 105,905	$ 67,651
Real estate receivables (ii)	104,507	99,074
Loan receivables (iii)	94,899	112,000
Sundry receivables (iv)	30,812	34,655
Proceeds and escrow receivables (v)	24,950	43,555
Refundable deposits	10,124	4,861
	$ 371,197	$ 361,796

(i) The Company has entered into development and cost sharing arrangements for the recovery of development expenditures with certain metropolitan districts and developers whereby the Company has undertaken to put in place the infrastructure for certain communities. These receivables will be collected over the development life of the community and bear interest rates ranging from U.S prime plus 0.5% to a fixed rate of 6.0% (December 31, 2017 – U.S. prime plus 0.5% to a fixed rate of 6.0%).

(ii) Real estate receivables include vendor take back ("VTB") mortgage receivables. The VTB collection terms range from three months to five years and bear interest at prime plus 3.0% or a fixed interest rate of 0.0% to 6.0% (December 31, 2017 – Canadian prime plus 2.0% or a fixed interest rate of 0.5% to 6.0%, whichever is greater).

(iii) The Company entered into an agreement in 2017 to provide financing of $112.0 million in the form of a senior secured term loan that is secured by the underlying land to which it relates. The loan bears interest at 13% and matures in 2021. During the year ended December 31, 2018, $17.1 million of principal was collected (2017 - $nil).

(iv) Sundry receivables are comprised of lot interest receivables and miscellaneous amounts.

(v) Proceeds and escrow receivables relate to receivables held in trust due to timing of homes and lots closed at the period end date. The collections of these receivables typically occur shortly after the period end once the funds are released by the trust or escrow company.

As at December 31, 2018, allowances for doubtful accounts were $nil (December 31, 2017 - $nil).

(b) The components of other assets are summarized as follows:

	As at	
	December 31 2018	**December 31 2017**
Non-refundable earnest funds and investigation fees (i)	$ 29,148	$ 26,358
Capital assets (ii)	23,532	13,865
Other	21,836	1,917
Capitalized sales and marketing costs (iii)	21,209	—
Prepaid expenses	12,010	9,292
	$ 107,735	$ 51,432

(i) Non-refundable earnest funds and investigation fees relate to non-refundable deposits and due-diligence costs on potential acquisitions and options that are incurred prior to taking title of a property.

(ii) Capital assets are recorded at cost less accumulated depreciation. The Company provides for depreciation using the straight-line method. Leasehold improvements are depreciated over the term of the lease and equipment is depreciated over three to five years. Included in capital assets is accumulated depreciation of $21.1 million (December 31, 2017 – $19.1 million).

(iii) Capitalized sales and marketing costs are recorded at cost less accumulated amortization. Capitalized sales and marketing costs are amortized over unit closings and are included in selling, general and administrative expense on the consolidated statement of operations. Included in capitalized sales and marketing is accumulated amortization of $16.9 million (December 31, 2017 – $23.3 million of capitalized sales and marketing was included in land and housing inventory, which was net of $6.3 million of accumulated amortization).

(all dollar amounts are in thousands of U.S. dollars)

Note 10. Restricted Cash

At December 31, 2018, the Company has restricted cash consisting of (i) $0.2 million (December 31, 2017 – $0.1 million) relating to cash collateralization of development letters of credit and (ii) $3.0 million (December 31, 2017 – $3.3 million) of restricted cash relating to funds in various cash accounts reserved for guarantees on completion of certain improvements, and guarantees on future insurance loss deductible payments.

Note 11. Notes Payable

	As at	
	December 31 2018	**December 31 2017**
6.50% unsecured senior notes due December 15, 2020 (a)	$ 600,000	$ 600,000
6.125% unsecured senior notes due July 1, 2022 (b)	500,000	500,000
6.125% unsecured senior notes due May 15, 2023 (c)	183,275	198,825
6.375% unsecured senior notes due May 15, 2025 (d)	350,000	350,000
	1,633,275	1,648,825
Transaction costs (e)	(13,357)	(17,241)
	$ 1,619,918	$ 1,631,584

(a) On December 14, 2012, the Company issued a private placement of $600.0 million of unsecured senior notes. The notes have an eight-year term, are due December 15, 2020, and bear a fixed interest rate of 6.50%. The notes require semi-annual interest payments on June 15 and December 15 of each year until maturity. Obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

On or after December 14th of the year noted in the below table, the Company is entitled to redeem all or part of the notes at the redemption prices (expressed as percentages of principal amount) set forth in the table below, plus accrued and unpaid interest on the notes redeemed:

	Notes Redemption Price
2018 and thereafter	100.00%

(b) On June 25, 2013, the Company and Brookfield Residential US Corporation, a wholly-owned subsidiary of the Company, co-issued a private placement of $500.0 million of unsecured senior notes. The notes have a nine-year term, are due July 1, 2022 and bear interest at a fixed rate of 6.125%. The notes require semi-annual interest payments on January 1 and July 1 of each year until maturity. Obligations to pay principal and interest on the unsecured notes are guaranteed by the Company and certain of the Company's subsidiaries.

On or after July 1st of the year noted in the below table, the Company is entitled to redeem all or part of the notes at the redemption prices (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest on the notes redeemed:

	Notes Redemption Price
2018	103.06%
2019	101.53%
2020 and thereafter	100.00%

(c) On May 12, 2015, the Company issued a private placement of C$250.0 million of unsecured senior notes. The notes have an eight-year term, are due May 15, 2023, and bear a fixed interest rate of 6.125%. The notes require semi-annual interest payments on May 15 and November 15 of each year until maturity. Obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

(all dollar amounts are in thousands of U.S. dollars)

On or after May 15th of the year noted in the table below the Company is entitled to redeem all or part of the notes at the redemption prices (expressed as percentages of principal amount) set forth in the table below, plus accrued and unpaid interest on the notes redeemed:

	Notes Redemption Price
2018	104.59%
2019	103.06%
2020	101.53%
2021 and thereafter	100.00%

(d) On May 12, 2015, the Company issued a private placement of $350.0 million of unsecured senior notes. The notes have a ten-year term, are due May 15, 2025, and bear a fixed interest rate of 6.375%. The notes require semi-annual interest payments on May 15 and November 15 of each year until maturity. Obligations to pay principal and interest on the unsecured senior notes are guaranteed by certain of the Company's subsidiaries.

At any time prior to May 15, 2020, the Company may also redeem all or part of the notes at a redemption price equal to 100% of the principal amount of the notes to be redeemed plus the applicable premiums as of and accrued and unpaid interest to the date of redemption, in certain circumstances in which Brookfield Residential would become obligated to pay additional amounts under the notes.

On or after May 15th of the year noted in the table below the Company is entitled to redeem all or part of the notes at the redemption prices (expressed as percentages of principal amount) set forth in the table below, plus accrued and unpaid interest on the notes redeemed:

	Notes Redemption Price
2020	103.19%
2021	102.13%
2022	101.06%
2023 and thereafter	100.00%

(e) The transaction costs are costs related to the issuance of the Company's notes payable and are amortized using the effective interest rate method over the life of the related debt instrument.

All unsecured senior notes include covenants that, among others, place limitations on incurring additional indebtedness and restricted payments. Under the limitation on additional indebtedness, Brookfield Residential is permitted to incur specified categories of indebtedness but is prohibited from incurring further indebtedness if it does not satisfy either an indebtedness to consolidated net tangible worth ratio condition of 2.25 to 1 or a fixed coverage ratio of 2.0 to 1. The Company was in compliance with these financial covenants as at December 31, 2018.

Certain derivative instruments, including redemption call options, have been identified as embedded in the notes payable, but as they are considered clearly and closely related to the unsecured senior notes payable, the derivatives are not accounted for separately.

(all dollar amounts are in thousands of U.S. dollars)

Note 12. Bank Indebtedness and Other Financings

Bank indebtedness and other financings consist of the following:

	As at	
	December 31 2018	December 31 2017
Bank indebtedness (a)	$ 88,822	$ —
Project-specific financings (b)	34,834	—
Secured VTB mortgages (c)	29,247	31,407
	152,903	31,407
Transaction costs (a)(b)	(9,423)	—
	$ 143,480	$ 31,407

(a) Bank indebtedness

(i) On March 8, 2018, the Company and Brookfield Residential US Corporation, a wholly owned subsidiary of the Company, entered into a three-year North American senior unsecured credit facility with various lenders, to replace its previously held Canadian secured credit facilities and its U.S. unsecured revolving credit facility. Brookfield Residential US Corporation and the Company are co-borrowers. The facility allows the Company to borrow in either Canadian or U.S. dollars with borrowings allowable up to $675.0 million.

As at December 31, 2018, the total borrowings outstanding under the North American unsecured credit facility were $88.8 million (December 31, 2017 - $nil).

For U.S. dollar denominated borrowings, interest is charged on the facility at a rate equal to, at the borrower's option, either an adjusted LIBOR plus an applicable rate between 1.75% and 2.25% per annum or the alternative base rate ("ABR") plus an applicable rate between 0.75% and 1.25% per annum. For Canadian dollar denominated borrowings, interest is charged on the facility at a rate equal to either the Canadian dollar offered rate ("CDOR") plus an applicable rate between 1.75% and 2.25% per annum or the Canadian prime rate plus an applicable rate between 0.75% and 1.25% per annum.

The facility contains certain restrictive covenants including limitations on liens, dividends and other distributions, investments in subsidiaries and joint ventures that are not party to the loan. The facility requires the Company to maintain a minimum consolidated tangible net worth of $1,253 million, as well as a consolidated total debt to consolidated total capitalization of no greater than 65%. As at December 31, 2018, the Company was in compliance with all of its covenants relating to this facility.

The transaction costs are costs related to the issuance of the Company's facility, and are amortized using the effective interest rate method over the life of the facility.

(ii) On March 8, 2018, the Company had repaid and extinguished its Canadian credit facilities, which were previously outstanding as of December 31, 2017.

The Company has extinguished its four Canadian credit facilities, with various Canadian banks, which had no outstanding borrowings as of December 31, 2017. These facilities had allowed the Company to borrow up to approximately C$505.0 million (US$401.6 million) as of December 31, 2017. The facilities were previously secured by the land and housing inventory assets of the Alberta and Ontario operations and had a general charge over the property of Brookfield Residential (Alberta) LP and Brookfield Residential (Ontario) LP, both wholly owned subsidiaries of the Company.

(iii) On March 8, 2018, the Company repaid and extinguished its U.S. unsecured revolving credit facility with various lenders, which had no outstanding borrowings as of December 31, 2017. Brookfield Residential US Corporation, a wholly-owned subsidiary of the Company, as borrower, and the Company, as the parent company to the borrower, had borrowings allowable up to $275.0 million.

(b) Project-specific financings

(i) At December 31, 2018, the Company has Canadian project-specific financings totaling $34.8 million (C$47.5 million) provided by various lenders (December 31, 2017 - $nil).

Project-specific financing totaling $26.8 million has an interest rate of Canadian Prime + 0.5%, matures in 2019, and is secured by certain land and housing inventory assets of the Company's Alberta operations and a general charge over the property of South Seton Limited Partnership, a consolidated subsidiary of the Company. This debt is repayable in Canadian dollars of C$36.7 million (December 31, 2017 - C$nil). This borrowing includes a minimum debt to equity covenant for South Seton Limited Partnership of no greater than 1.50 to 1. The Company was in compliance with these covenants as at December 31, 2018.

(all dollar amounts are in thousands of U.S. dollars)

Project-specific financing totaling $8.0 million, has an interest rate of Canadian Prime + 0.5%, matures in 2020, and is unsecured without covenants. The debt is repayable in Canadian dollars of C$10.8 million.

(ii) On November 29, 2018, OliverMcMillan Spectrum Emery LLC, a wholly-owned subsidiary of the Company, entered into a five-year secured construction loan with a Canadian federal corporation for the Nashville mixed-used project. The loan allows OliverMcMillan Spectrum Emery LLC to borrow up to $360.0 million in U.S. dollars.

As at December 31, 2018, there were no borrowings outstanding under the construction loan (December 31, 2017 - $nil).

Interest is charged on the loan at a rate equal to LIBOR plus 3.35%, with the ability to convert the interest charged to a prime rate loan.

The loan contains certain restrictive covenants including leasing and construction of the project. The loan requires Brookfield Residential US Corporation, as the parent company to the borrower and a wholly owned subsidiary of the Company, to maintain a minimum liquidity of $36.0 million and a minimum net worth of $360.0 million. The loan is secured by the assets of OliverMcMillan Spectrum Emery LLC. The Company was in compliance with these covenants as at December 31, 2018.

The transaction costs are costs related to the issuance of the project facility, and are amortized using the straight-line method over the life of the project facility.

(c) Secured VTB mortgages

The Company has 12 secured VTB mortgages (December 31, 2017 – 10 secured VTB mortgages) in the amount of $29.2 million (December 31, 2017 – $31.4 million). Secured VTB mortgages are repayable as follows: 2019 - $12.3 million; 2020 – $7.7 million; 2021 – $5.7 million, 2022 – $1.2 million and thereafter – $2.3 million.

Nine secured VTB mortgages (December 31, 2017 – four secured VTB mortgages) in the amount of $24.7 million (December 31, 2017 – $12.2 million) relate to raw land held for development by Brookfield Residential (Alberta) LP and Brookfield Residential (Ontario) LP. This debt is repayable in Canadian dollars of C$33.7 million (December 31, 2017 – C$15.3 million). The interest rates on the debt range from fixed rates of 2.2% to 6.0% and variable rates of prime plus 2% and the debt is secured by the related land. As at December 31, 2018, these borrowings are not subject to any financial covenants.

Three secured VTB mortgages (December 31, 2017 – six secured VTB mortgages) in the amount of $4.6 million (December 31, 2017 – $19.2 million) relate to raw land held for development by various wholly-owned U.S. subsidiaries of the Company. The interest rate on the debt ranges from fixed rates of 0.0% to 6.0% and the debt is secured by related land. As at December 31, 2018, these borrowings are not subject to any financial covenants.

Note 13. Accounts Payable and Other Liabilities

The components of accounts payable and other liabilities are summarized as follows:

	As at	
	December 31 2018	**December 31 2017**
Accounts payable (a)	$ 410,593	$ 409,513
Other liabilities (b)	225,207	151,308
	$ 635,800	$ 560,821

(all dollar amounts are in thousands of U.S. dollars)

(a) The components of accounts payable are summarized as follows:

	As at	
	December 31 2018	**December 31 2017**
Trade payables and other accruals	$ 169,554	$ 147,597
Development costs payable (i)	77,897	99,296
Customer deposits	76,407	58,524
Accrued and deferred compensation	45,187	46,243
Interest on notes payable	21,021	21,196
Current income taxes payable	14,309	27,339
Real estate payables	6,218	9,318
	$ 410,593	$ 409,513

(i) Development costs payable relate to provisions accrued for costs yet to be incurred within a subdivision where sales have taken place. The provision is based on the sold lots pro rata share of costs to be incurred for specified areas within each subdivision phase.

(b) The components of other liabilities are summarized as follows:

	As at	
	December 31 2018	**December 31 2017**
Share-based compensation (Note 18)	78,513	59,095
Other (i)	67,215	4,367
Consolidated land option contracts (ii)	44,557	45,211
Warranty costs (Note 20 (a))	21,515	20,863
Deferred revenue (iii)	13,407	21,772
	$ 225,207	$ 151,308

(i) Included in other is $23.9 million for the remainder of the purchase price for the acquisition of various assets of OliverMcMillan.

(ii) Consolidated land option contracts are the total future purchase price of land options contracts required to be consolidated under ASC Topic 810 *Consolidation*, with a corresponding amount recorded in land and housing inventory. See Note 4 “Land and Housing Inventory.”

(iii) The amount of deferred revenue recognized as revenue in the year ended December 31, 2018 was $89.9 million (2017 - $5.4 million).

Note 14. Other Income

The Company’s components of other income consist of the following:

	Years Ended December 31	
(US$ millions)	**2018**	**2017**
Investment income	$ 39,873	$ 22,942
Joint venture management fee income (i)	15,160	—
Other	7,858	5,416
	$ 62,891	$ 28,358

(i) Joint venture management fee income was reclassified to other income for the year-ended December 31, 2018. See Note 2 "Changes in Accounting Policies".

(all dollar amounts are in thousands of U.S. dollars)

Note 15. Income Taxes

A reconciliation of the Company's effective tax rate from the Canadian statutory tax rate for the year ended December 31, 2018 and 2017 is as follows:

	Years Ended December 31	
	2018	**2017**
Statutory rate	27.0%	27.0%
Non-temporary differences	3.2	1.8
Rate difference from statutory rate	(8.1)	(2.1)
Change in statutory tax rate	—	1.6
Withholding tax	—	(0.4)
Non-taxable preferred share dividend	(2.6)	(2.1)
Domestic production activities deduction	—	(1.4)
Other	(0.9)	(0.7)
Effective tax rate	18.6%	23.7%

The Company currently operates in thirteen different states in the U.S. and is subject to various state tax jurisdictions. The Company estimates its tax liability based upon the individual taxing authorities' regulations, estimates of income by taxing jurisdiction and the Company's ability to utilize certain tax-saving strategies. The Company also operates in Alberta and Ontario, Canada, and is therefore subject to provincial tax as well as federal tax legislation. Based on the Company's estimate of the allocation of income or loss, as the case may be, among the various taxing jurisdictions, the estimated effective tax rate for the Company is 18.6% for the year ended December 31, 2018 (December 31, 2017 - 23.7%). The effective tax rate for the year ended December 31, 2018 and December 31, 2017 reflects the impact of the Tax Cuts and Jobs Act ("TCJA"), which was enacted into law on December 22, 2017. The TCJA made comprehensive reforms to the U.S. tax code, which among other things, reduced the U.S. federal corporate income tax rate from 35% to 21% effective January 1, 2018 and eliminated the domestic production activities deduction for tax years beginning after December 31, 2017. As a result of the reduction in the U.S. corporate income tax rate, the effective tax rate for the year ended December 31, 2017 included a one-time non-cash write down of the company's deferred tax assets in the U.S. of $3.5 million. The decrease in the 2018 effective tax rate when compared to the same period in 2017 was primarily due to the reduction of the U.S. corporate income tax rate including the 2017 re-measurement of the company's deferred tax asset, an increase in the non-taxable preferred share dividends, and the favorable net impact of the federal energy tax credit, which was extended under the Bipartisan Budget Act of 2018 to retroactively include homes closed in 2017. This decrease was partially offset by an increase in non-deductible share-based compensation costs, a decrease in withholding tax refunds, and the elimination of the domestic production activities deduction.

The provision for income taxes for the years ended December 31, 2018 and 2017 is set forth below:

	Year ended December 31,	
	2018	**2017**
Current		
Canada	$ (189)	$ 958
U.S.	(35,370)	(37,000)
International	(2,497)	(393)
Current income tax (expense) / recovery	(38,056)	(36,435)
Deferred		
Canada	(6,946)	(10,911)
U.S.	5,133	(4,293)
Deferred income tax (expense) / recovery	(1,813)	(15,204)
Total income tax (expense) / recovery	$ (39,869)	$ (51,639)

(all dollar amounts are in thousands of U.S. dollars)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The differences that give rise to the net deferred tax assets / (liabilities) are as follows:

	As at	
Net deferred tax assets / (liabilities)	December 31 2018	December 31 2017
Differences relating to land and housing inventory	$ (4,888)	$ (3,451)
Compensation deductible for tax purposes when paid	12,471	10,416
Operating loss carry-forwards	46,657	58,358
Capital loss carry-forwards	2,501	—
Impact of foreign exchange	28,180	19,687
Other	7,607	3,040
Net deferred tax assets before valuation allowance	92,528	88,050
Cumulative valuation allowance	(30,681)	(19,687)
Net deferred tax assets	$ 61,847	$ 68,363

The Company has Canadian federal non-capital loss carryforwards of approximately $170.3 million (C$232.3 million) as at December 31, 2018 (December 31, 2017 – $211.2 million (C$265.5 million)). Federal non-capital loss carryforwards attributable to Canada may be carried forward up to 20 years to offset future taxable income and expire between 2032 and 2038. At December 31, 2018, the Company has U.S. federal capital loss carryforwards of $9.3 million (December 31, 2017 - nil) that expire between 2022 and 2023 and state loss carryforwards of approximately $18.3 million (December 31, 2017 - $28.9 million) that may be carried forward up to 20 years and expire between 2029 and 2032.

The Company records net deferred tax assets to the extent it believes these assets will more-likely-than-not be realized. At each reporting period, the Company evaluates the recoverability of its deferred tax assets by tax jurisdiction to determine if a valuation allowance is required. In making such determinations, the Company considers all available positive and negative evidence, including future reversals of existing temporary differences, projected future taxable income, tax planning strategies and recent financial operations. This evaluation considers, among other factors, the nature, frequency and severity of cumulative losses, actual earnings, forecasts of future operating results, the duration of statutory carryforward periods, the Company's experience with loss carryforwards not expiring and the outlook of the housing industry and the broader economy.

In evaluating the need for a valuation allowance against the Company's deferred tax assets at December 31, 2018, the Company considered all available and objectively verifiable positive and negative evidence. The valuation allowance of $30.7 million mainly relates to the unrealized foreign exchange capital losses in Canada and the realized capital losses in the U.S. that have not met the more-likely-than not realization threshold. The Company concluded it is more-likely-than-not that all of its remaining U.S. and Canadian deferred tax assets will be realized in the future.

Undistributed earnings of the Company's non-Canadian affiliates as of December 31, 2018 were considered to be permanently reinvested. A determination of the amount of unrecognized deferred tax liability on these undistributed earnings is not practicable.

Note 16. Non-Controlling Interest

Non-controlling interest includes third-party investments in consolidated entities of $53.8 million at December 31, 2018 (December 31, 2017 – $54.2 million).

In accordance with ASC Topic 810, non-controlling interest has been classified as a component of total equity and the net income on the consolidated statements of operations have been adjusted to include the net income attributable to non-controlling interest, which for the year ended December 31, 2018 was $8.0 million (2017 – $0.1 million).

Note 17. Equity

Common Shares

The authorized Common Share capital of the Company consists of an unlimited number of voting Common Shares and Non-Voting Class B Common Shares.

(all dollar amounts are in thousands of U.S. dollars)

There were no Common Shares issued during the year ended December 31, 2018 and year ended December 31, 2017.

	For the Years Ended	
	December 31 2018	**December 31 2017**
Common Shares issued, beginning of the year	129,756,910	129,756,910
Common Shares issued	—	—
Common Shares issued and outstanding, end of the year	129,756,910	129,756,910

The Company had no Non-Voting Class B Common Shares issued and outstanding as at December 31, 2018 and December 31, 2017.

Note 18. Share-Based Compensation

(a) Management Share Option Plan

Options issued under the Management Share Option Plan vest over a period of up to five years, expire 10 years after the grant date, and are settled through issuance of Non-Voting Class B Common Shares or in cash at the option of the holder. The exercise price of the options is the fair value of one Common Share at the grant date.

The fair value of the Company's stock option awards is estimated at the grant date using the Black-Scholes option-pricing model that uses the assumptions noted in the table below. The fair value of the Company's stock option awards is expensed over the vesting period of the stock options. Expected volatility is measured using the historical volatility of the Company's publicly traded peer group. The risk-free rate for periods within the contractual life of the option award is based on the yield curve of a zero-coupon U.S. Treasury bond with a maturity equal to the expected term of the option award granted. The Company uses historical Brookfield Residential data to estimate option exercises and forfeitures within its valuation model. The expected term of the option awards granted is derived from historical exercise experience under the Company's option plan and represents the period of time that option awards granted are expected to be outstanding.

During the year ended December 31, 2018, there were no options granted to eligible employees (year ended December 31, 2017 - 2,310,000 options granted). The significant weighted average assumptions relating to the valuation of the Company's options outstanding during the year ended December 31, 2018 and 2017 are as follows:

	December 31 2018	**December 31 2017**
Dividend yield	—%	—%
Volatility rate	29.12%	30.61%
Risk-free interest rate	2.48%	2.23%
Expected option life (years)	4.5	5.7

The liability of $45.2 million (December 31, 2017 - $28.3 million) relating to stock options is included in accounts payable and other liabilities. The total compensation cost recognized in selling, general and administrative expense relating to normal course vesting of the Company's options during the year ended December 31, 2018 was $16.9 million (2017 - $12.2 million).

(all dollar amounts are in thousands of U.S. dollars)

The following tables set out the number of Non-Voting Class B Common Shares that employees of the Company may acquire under options granted under the Company's Management Share Option Plan for the year ended December 31, 2018 and 2017:

	December 31, 2018		December 31, 2017	
	Shares	Weighted Average Per Share Exercise Price	Shares	Weighted Average Per Share Exercise Price
Outstanding, beginning of the year	11,581,886	$ 22.15	9,321,886	$ 22.38
Granted	—	—	2,310,000	22.15
Exercised	—	—	—	—
Cancelled	—	—	(50,000)	5.53
Outstanding, end of the year	11,581,886	22.15	11,581,886	22.15
Options exercisable, end of the year	5,937,130	$ 22.34	3,620,754	$ 22.46

A summary of the status of the Company's unvested options for the year ended December 31, 2018 and 2017 are as follows:

	December 31, 2018		December 31, 2017	
	Shares	Weighted Average Fair Value Per Option	Shares	Weighted Average Fair Value Per Option
Unvested options outstanding, beginning of the year	7,961,132	$ 6.84	7,545,509	$ 5.91
Granted	—	—	2,310,000	8.54
Vested	(2,316,376)	6.86	(1,864,377)	6.13
Cancelled	—	—	(30,000)	5.53
Unvested options outstanding, end of the year	5,644,756	$ 7.21	7,961,132	$ 6.84

At December 31, 2018, there was $34.2 million (December 31, 2017 - $48.1 million) of unrecognized expense related to unvested options, which is expected to be recognized over the remaining weighted average period of 2.7 years (December 31, 2017 - 3.6 years).

(b) Deferred Share Unit Plan

Brookfield Residential has a Deferred Share Unit Plan ("DSUP") under which certain of its executive officers and directors can, at their option, receive all or a portion of their annual bonus awards or retainers in the form of deferred share units. The Company can also make additional grants of units to its executives and directors pursuant to the DSUP.

The following table sets out changes in and the number of deferred share units that executives, directors and senior operating management employees may redeem under Brookfield Residential's DSUP at December 31, 2018 and December 31, 2017:

	For the Years Ended	
	December 31 2018	December 31 2017
Outstanding, beginning of the year	1,448,638	1,448,638
Granted and reinvested	—	—
Redeemed	—	—
Outstanding, end of the year	1,448,638	1,448,638
Deferred share units vested	1,448,638	1,448,638

The liability of $33.3 million (December 31, 2017 – $30.8 million) relating to the DSUP is included in accounts payable and other liabilities. The financial statement impact relating to the DSUP for the year ended December 31, 2018 was an expense of $2.5 million (2017 - expense of $3.4 million) which has been included in selling, general, and administrative expense.

Note 19. Earnings Per Share

Basic and diluted earnings per share for the years ended December 31, 2018 and 2017 were calculated as follows:

	Years Ended December 31	
	2018	**2017**
Numerator:		
Net income attributable to Brookfield Residential	$ 174,402	$ 166,172
Denominator (in ‘000s of shares):		
Basic weighted average shares outstanding	129,757	129,757
Diluted weighted average shares outstanding	129,922	129,767
Basic earnings per share	$ 1.34	$ 1.28
Diluted earnings per share	$ 1.34	$ 1.28

Note 20. Commitments, Contingent Liabilities and Other

(a) When selling a home, the Company’s subsidiaries provide customers with a limited warranty. The Company has always maintained a strategy of being highly active in addressing construction defect claims through its customer service operation. Through this approach, the Company is able to connect with homeowners, provide maintenance advice, fix problems as they arise and prevent future defects from occurring, with the objective of addressing whatever situation presents itself before any litigation is necessary. The Company estimates the costs that may be incurred under each limited warranty and records a liability in the amount of such costs at the time the revenue associated with the sale of each home is recognized. In addition, the Company has insurance in place where its subsidiaries are subject to the respective warranty statutes in the state or province where the Company conducts business, which range up to ten years for latent construction defects. Factors that affect the Company’s warranty liability include the number of homes sold, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The following table reflects the changes in the Company’s estimated warranty liability for the year ended December 31, 2018 and 2017:

	Years Ended December 31	
	2018	**2017**
Balance, beginning of the year	$ 20,863	$ 23,217
Payments and other adjustments made during the year	(9,441)	(10,072)
Warranties issued during the year	15,366	13,715
Adjustments made for pre-existing warranties	(5,273)	(5,997)
Balance, end of the year	$ 21,515	$ 20,863

(b) The Company has committed to future minimum payments for lease and other obligations as follows:

Years of Expiry	
2019	$ 10,895
2020	11,225
2021	9,892
2022	9,704
2023	8,856
Thereafter	254,042
	$ 304,614

(c) As at December 31, 2018, $13.1 million (December 31, 2017 - $17.9 million) of the amount held in other assets related to land purchase obligations. The total amount owing on these obligations is $108.5 million (December 31, 2017 - $33.1 million).

Note 21. Guarantees

In the ordinary course of business, the Company has provided construction guarantees in the form of letters of credit and performance bonds. As at December 31, 2018, these guarantees amounted to $720.0 million (December 31, 2017 – $646.3 million) and have not been recognized in the consolidated financial statements. However, the proportionate development costs that relate to lots that have been sold are accrued in accounts payable and other liabilities. Such guarantees are required by the municipalities in which the Company operates before construction permission is granted.

The scope of these guarantees covers specific construction obligations of individual projects as they are developed, and the terms of these guarantees span the life of the projects, which range from three to ten years. The values of the guarantees are reduced as completion milestones are achieved on the projects.

These guarantees are terminated only when the municipality has issued conditions to release a Final Acceptance Certificate or similar document to the Company, which verifies that the Company has fulfilled all its contractual obligations. Payments of the guarantees are triggered in the event expired letters of credit or performance bonds are not renewed and the contractual obligations have not been fulfilled. The Company historically has not been required to make any payments under these construction guarantees.

Note 22. Fair Value Measurements

The fair value of a financial instrument 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. Fair values are determined by reference to quoted bid or ask prices, as appropriate. Where bid and ask prices are unavailable, the closing price of the most recent transaction of that instrument is used. In the absence of an active market, fair values are determined based on prevailing market rates for instruments with similar characteristics and risk profiles or internal or external valuation models, such as option pricing models and discounted cash flow analysis, using observable market inputs.

Fair values determined using valuation models require the use of assumptions concerning the amount and timing of estimated future cash flows and discount rates. In determining those assumptions, the Company looks primarily to external readily observable market inputs such as interest rate yield curves, currency rates and price and rate volatilities as applicable.

The fair value measurements for land and housing inventory were determined by comparing the carrying amount of an asset to its expected future cash flows. To arrive at the estimated fair value of land and housing inventory deemed to be impaired during the year ended December 31, 2018, the Company estimated the cash flow for the life of each project. Specifically, project by project, the Company evaluated the margins on homes that have been closed, margins on sales contracts which are in backlog and estimated margins with regard to future home sales over the life of the projects, as well as estimated margins with respect to future land sales. The Company evaluated and continues to evaluate projects where inventory is turning over more slowly than expected or whose average sales price and margins are declining and are expected to continue to decline. These projections take into account the specific business plans for each project and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market area. Such projections generally assume current home selling prices, with cost estimates and sales rates for short-term projects consistent with recent sales activity. For longer-term projects, planned sales rates for 2019 generally assume recent sales activity and normalized sales rates beyond 2019. If the future undiscounted cash flows are less than the carrying amount, the asset is considered to be impaired and is then written down to fair value less estimated selling costs.

There are several factors that could lead to changes in the estimate of future cash flows for a given project. The most significant of these include the sales pricing levels actually realized by the project, the sales rate, and the costs incurred to construct the homes. The sales pricing levels are often inter-related with sales rates for a project, as a price reduction usually results in an increase in the sales rate. Further, pricing is heavily influenced by the competitive pressures facing a given community from both new homes and existing homes, including foreclosures.

The Company has reviewed all of its projects for impairment in accordance with the provisions of ASC Topic 360 *Property, Plant and Equipment* and ASC Topic 820 *Fair Value Measurements and Disclosures*. For the years ended December 31, 2018 and 2017, no impairment charges were recognized.

(all dollar amounts are in thousands of U.S. dollars)

The locations of the projects reviewed are as follows:

	Number of Projects
Canada	42
California	50
Central and Eastern U.S.	35
	127
Unconsolidated entities	15
Total	142

Hedging Activities

The Company uses derivative and non-derivative financial instruments to manage or maintain exposures to interest, currency, credit and other market risks. For certain derivatives which are used to manage exposures, the Company determines whether hedge accounting can be applied. To qualify for hedge accounting, the derivative must be highly effective in accomplishing the objective of offsetting changes in the fair value or cash flows attributable to the hedged risk both at inception and over the life of the hedge. If it is determined that the derivative is not highly effective as a hedge, hedge accounting is discontinued prospectively.

Net Investment Hedges

The Company uses foreign currency denominated debt instruments to manage its foreign currency exposures arising from net investments in foreign operations. For the year ended December 31, 2018, unrealized pre-tax gains of $15.6 million (2017 – loss of $12.9 million), were recorded in other comprehensive income for the effective portion of hedges of net investments in foreign operations.

Fair Value Hierarchy

Fair value hierarchical levels are directly determined by the amount of subjectivity associated with the valuation inputs of these assets and liabilities. The fair value hierarchy requires a company to prioritize the use of observable inputs and minimize the use of unobservable inputs in measuring fair value.

As at December 31, 2018, all of the Company's financial assets and liabilities are recorded at their carrying value as it approximates fair value due to their short term nature. Assets and liabilities measured at fair value on a recurring basis include $nil (December 31, 2017 – $nil) of financial assets based on management's best estimates and $nil (December 31, 2017 – $nil) of financial liabilities which are measured at fair value using valuation inputs based on model-based techniques or similar instruments in markets that are not active.

The following table categorizes financial assets and liabilities, which are carried at fair value, based upon the level of input to the valuations as described in Note 1 "Significant Accounting Policies":

	December 31, 2018			December 31, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Financial assets						
Loan receivables	$ 94,899	$ —	$ —	$ 112,000	$ —	$ —
Restricted cash	3,200	—	—	3,351	—	—
Cash and cash equivalents	69,932	—	—	104,504	—	—
	$ 168,031	$ —	$ —	$ 219,855	$ —	$ —
Financial liabilities						
Accounts payable and other liabilities	$ —	$ —	$ —	$ —	$ —	$ —
	$ —	$ —	$ —	$ —	$ —	$ —

Note 23. Managing Risks

The Company is exposed to the following risks as a result of holding financial instruments: (a) market risk (i.e. interest rate risk, currency risk and other price risk that impact the fair values of financial instruments); (b) credit risk; and (c) liquidity risk. The following is a description of these risks and how they are managed:

(a) Market Risk

Market risk is defined for these purposes as the risk that the fair value or future cash flows of a financial instrument held by the Company will fluctuate because of changes in market prices. Market risk includes the risk of changes in interest rates, currency exchange rates and changes in market prices due to factors other than interest rates or currency exchange rates, such as changes in equity prices, commodity prices or credit spreads.

The Company manages market risk from foreign currency assets and liabilities and the impact of changes in currency exchange rates and interest rates, by funding assets with financial liabilities in the same currency and with similar interest rate characteristics, and holding financial contracts such as interest rate derivatives to minimize residual exposures.

Interest Rate Risk

The Company is exposed to financial risk that arises from fluctuations in interest rates. The interest-bearing assets and liabilities of the Company are at floating rates and, accordingly, their fair values approximate their carrying value. The Company would be negatively impacted on balance, if interest rates were to increase. Based on net debt levels as at December 31, 2018, a 1% change in interest rates would have a $1.2 million impact on the Company's cash flows.

The fair value of debt with fixed interest rates is determined by discounting contractual principal and interest payments at estimated current market interest rates determined with reference to current benchmark rates for a similar term and current credit spreads for debt with similar terms and risk. As at December 31, 2018, the book value of all outstanding debt exceeded its fair value by $60.5 million (December 31, 2017 – fair value of all outstanding debt exceeded its book value by $63.8 million).

Currency Exchange Rate Risk

The Company conducts business in both Canadian and U.S. dollars and, therefore, is exposed to currency risks. Cash flows from Canadian and U.S. operations are exposed to foreign exchange risk as sales and operating expenses are denominated in local currencies. Changes in currency rates will impact the carrying value of financial instruments denominated in currencies other than the U.S. dollar.

The Company holds financial instruments to hedge the net investment in foreign operations whose functional and reporting currencies are other than the U.S. dollar. A 1% increase in the U.S. dollar would result in a $2.5 million gain on these hedging instruments as at December 31, 2018 (December 31, 2017 – $2.5 million gain). See Note 22 "Fair Value Measurements" for additional disclosure.

Other Price Risk

Other price risk is the risk of variability in fair value due to movements in equity prices or other market prices such as commodity prices and credit spreads.

(b) Credit Risk

Credit risk is the risk of loss due to the failure of a borrower or counterparty to fulfill its contractual obligations. The Company's exposure to credit risk in respect of financial instruments relates primarily to counterparty obligations regarding derivative contracts and receivables.

The Company assesses the credit worthiness of each counterparty before entering into contracts and ensures that counterparties meet minimum credit quality requirements. The credit risk of derivative financial instruments is generally limited to the positive fair value of the instruments, which, in general, tends to be a relatively small proportion of the notional value. Substantially all of the Company's derivative financial instruments involve either counterparties that are banks or other financial institutions in North America that have embedded credit risk mitigation features. The Company does not expect to incur credit losses in respect of any of these counterparties. The maximum exposure in respect of receivables is equal to the carrying value.

(c) Liquidity Risk

Liquidity risk is the risk that the Company cannot meet a demand for cash or fund an obligation as it comes due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

To ensure the Company is able to react to contingencies and investment opportunities quickly, the Company maintains sources of liquidity at the corporate and subsidiary levels. The primary source of liquidity consists of cash and other financial assets, net of deposits and other associated liabilities, and undrawn committed credit facilities.

(all dollar amounts are in thousands of U.S. dollars)

The Company is subject to the risks associated with debt financing, including the ability to refinance indebtedness at maturity. The Company believes these risks are mitigated through the use of long-term debt secured by high quality assets, maintaining debt levels that are in management's opinion relatively conservative, and by diversifying maturities over an extended period of time. The Company also seeks to include in its agreements terms that protect the Company from liquidity issues of counterparties that might otherwise impact the Company's liquidity.

A summary of the Company's contractual obligations and purchase agreements as at December 31, 2018 is as follows:

	Payment Due by Period				
	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	More than 5 Years
Notes payable(1)	$ 1,633,275	$ —	$ 600,000	$ 683,275	$ 350,000
Interest on notes payable	396,046	103,163	167,326	92,088	33,469
Secured VTB mortgages(2)(3)	29,247	12,257	13,419	3,571	—
Bank indebtedness(2)(3)	88,822	—	88,822	—	—
Accounts payable and other liabilities(4)	635,800	635,800	—	—	—
Operating lease obligations(5)	304,614	10,895	21,117	18,560	254,042
Purchase agreements and other obligations(6)	108,520	38,352	69,005	389	774

(1) Amounts are included on the consolidated balance sheets and exclude transaction costs. See Note 11 for additional information regarding notes payable.

(2) Amounts are included on the consolidated balance sheets. See Note 12 for additional information regarding bank indebtedness and other financings and related matters.

(3) Amounts do not include interest due to the floating nature of the interest on the debt. See Note 12 for additional information regarding floating rate debt.

(4) Amounts are included on the consolidated balance sheets. See Note 13 for additional information regarding accounts payable and other liabilities.

(5) Amounts relate to non-cancellable operating leases involving office space, design centres and model homes. See Note 20 for additional information regarding lease agreements.

(6) See Note 20 for additional information regarding purchase agreements and other obligations.

Note 24. Segmented Information

As determined under ASC Topic 280 *Segment Reporting*, the Company has the following operating segments: Canada, California and Central and Eastern U.S.

The Company is a land developer and residential homebuilder. The Company is organized and manages its business based on the geographical areas in which it operates. Each of the Company's operating segments specializes in lot entitlement and development for master-planned communities and mixed-use properties and the construction of single family and multi-family homes. The Company evaluates performance and allocates capital based primarily on return on assets together with a number of other risk factors. Earnings performance is measured using income before income taxes. The accounting policies of the segments are the same as those referred to in Note 1, "Significant Accounting Policies."

Corporate and other is a non-operating segment that develops and implements strategic initiatives and supports the operating divisions by centralizing key administrative functions, such as accounting, finance and treasury, information technology, compliance, risk management, litigation, marketing and human resources. Corporate also provides the necessary administrative functions to support the Company.

(all dollar amounts are in thousands of U.S. dollars)

The following tables summarize select information on the Company's consolidated statements of operations by reportable segments:

	Year Ended December 31, 2018				
	Canada	**California**	**Central and Eastern U.S.**	**Corporate and Other**	**Total**
Revenues	$ 617,165	$ 990,350	$ 554,835	$ —	$ 2,162,350
Direct cost of sales	(461,234)	(777,798)	(450,351)	—	(1,689,383)
	155,931	212,552	104,484	—	472,967
Gain on sale of commercial properties	6,331	—	—	—	6,331
Equity in earnings	408	4,865	13,097	(10)	18,360
Expenses	(63,180)	(86,960)	(62,691)	(62,604)	(275,435)
Income / (loss) before income taxes	$ 99,490	$ 130,457	$ 54,890	$ (62,614)	$ 222,223

	Year Ended December 31, 2017				
	Canada	**California**	**Central and Eastern U.S.**	**Corporate and Other**	**Total**
Revenues	$ 729,451	$ 904,625	$ 416,905	$ —	$ 2,050,981
Direct cost of sales	(531,891)	(699,146)	(346,569)	—	(1,577,606)
	197,560	205,479	70,336	—	473,375
Gain on sale of commercial properties	—	—	—	—	—
Equity in earnings	(337)	4,440	10,727	—	14,830
Expenses	(64,936)	(76,782)	(55,265)	(73,278)	(270,261)
Income / (loss) before income taxes	$ 132,287	$ 133,137	$ 25,798	$ (73,278)	$ 217,944

The following tables summarize select information on the Company's consolidated balance sheets by reportable segments:

	As at December 31, 2018				
	Canada	**California**	**Central and Eastern U.S.**	**Corporate and Other**	**Total**
Land held for development	$ 409,568	$ 423,728	$ 584,076	$ —	$ 1,417,372
Land under development	246,612	259,956	396,747	—	903,315
Housing inventory	125,319	246,170	182,651	—	554,140
Model homes	22,143	53,008	24,271	—	99,422
Total land and housing inventory	803,642	982,862	1,187,745	—	2,974,249
Commercial properties	51,503	—	218,326	—	269,829
Investments in unconsolidated entities	49,714	207,317	90,294	—	347,325
Held-to-maturity investment	—	—	—	300,000	300,000
Goodwill	—	—	—	16,479	16,479
Other assets [(1)]	151,812	62,847	169,658	229,594	613,911
Total assets	$ 1,056,671	$ 1,253,026	$ 1,666,023	$ 546,073	$ 4,521,793

(all dollar amounts are in thousands of U.S. dollars)

	As at December 31, 2017				
	Canada	California	Central and Eastern U.S.	Corporate and Other	Total
Land held for development	$ 510,564	$ 403,416	$ 533,603	$ —	$ 1,447,583
Land under development	213,758	352,959	352,031	—	918,748
Housing inventory	171,113	200,076	157,438	—	528,627
Model homes	15,751	61,926	25,389	—	103,066
Total land and housing inventory	911,186	1,018,377	1,068,461	—	2,998,024
Commercial properties	33,390	—	4,568	—	37,958
Investments in unconsolidated entities	54,800	187,269	70,788	—	312,857
Held-to-maturity investment	—	—	—	300,000	300,000
Goodwill	—	—	—	—	—
Other assets (1)	178,135	48,836	107,823	254,652	589,446
Total assets	$ 1,177,511	$ 1,254,482	$ 1,251,640	$ 554,652	$ 4,238,285

(1) Other assets presented in above tables within the operating segments note includes receivables and others assets, cash, restricted cash, and deferred income tax assets.

Note 25. Related Party Transactions

Related parties include the directors, executive officers, director nominees or shareholders, and their respective immediate family members. There are agreements among the Company's affiliates to which it is a party or subject to, including a name license. The Company’s significant related party transactions as at and for the years ended December 31, 2018 and 2017 were as follows:

- During the year ended December 31, 2018, the Company received $21.1 million of dividends from the preferred shares of Brookfield BPY Holdings Inc. (2017 - $17.1 million). These transactions were recorded at the exchange amount.
- During the year ended December 31, 2018, the Company paid $0.2 million (2017 - $6.5 million) to Brookfield Asset Management Inc. for Canadian tax credits. These transactions were recorded at the exchange amount.

Note 26. Subsequent Events

The Company performed an evaluation of subsequent events through February 5, 2019, which is the date these consolidated financial statements were approved, and has determined that there are no subsequent events that require disclosure in these consolidated financial statements.

CORPORATE INFORMATION

CORPORATE PROFILE

Brookfield Residential Properties Inc. is a leading land developer and homebuilder in North America. We entitle and develop land to create master-planned communities, build and sell lots to third-party builders, and conduct our own homebuilding operations. We also participate in select, strategic real estate opportunities, including infill projects, mixed-use developments, and joint ventures. We are the flagship North American residential property company of Brookfield Asset Management Inc., a leading global alternative asset manager with approximately $330 billion of assets under management. Further information is available at BrookfieldResidential.com or Brookfield.com or contact:

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BONDHOLDER INQUIRIES

Brookfield Residential welcomes inquiries from bondholders, analysts, media representatives and other interested parties. Questions relating to bondholder relations or media inquiries can be directed to Thomas Lui, Executive Vice President & Chief Financial Officer, at (403) 231-8938 or via e-mail at thomas.lui@brookfieldrp.com.