



Interim Consolidated Financial Statements

Third Quarter
September 30, 2019



CANADA'S PREMIER NON-BANK LENDER™

INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(UNAUDITED)
(in thousands of Canadian dollars)

	<u>Notes</u>	<u>September 30</u> <u>2019</u>	<u>December 31</u> <u>2018</u>
Assets			
Mortgages receivable	5	\$ 737,192	\$ 682,721
Foreclosed properties	6	17,007	17,007
Prepaid expenses		<u>102</u>	<u>22</u>
Total assets		<u>\$ 754,301</u>	<u>\$ 699,750</u>
Liabilities			
Borrowings under credit facility	7	\$ 164,785	\$ 147,846
Accounts payable and accrued liabilities	8	1,619	2,093
Accrued convertible debenture interest		1,236	1,011
Dividends payable		2,966	4,205
Convertible debentures	9	<u>156,137</u>	<u>157,289</u>
Total liabilities		<u>326,743</u>	<u>312,444</u>
Shareholders' equity			
Share capital		422,747	385,261
Deferred share incentive plan units		653	644
Equity component of convertible debentures		1,868	1,675
Contributed surplus		781	645
Retained earnings (deficit)		<u>1,509</u>	<u>(919)</u>
Total shareholders' equity		<u>427,558</u>	<u>387,306</u>
Total liabilities and shareholders' equity		<u>\$ 754,301</u>	<u>\$ 699,750</u>

Commitments 7, 13(d)

The accompanying notes are an integral part of these interim consolidated financial statements.

Approved on behalf of the board of directors:

"Robert Goodall"
Robert Goodall, Director

"Mark Silver"
Mark Silver, Director

INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**(UNAUDITED)****(in thousands of Canadian dollars, except for number of common shares)**

	Notes	Share capital		Deferred share incentive plan units	Equity component of convertible debentures	Contributed surplus	Retained earnings (deficit)	Total
		Number	Amount					
Balance, December 31, 2017		33,252,139	\$ 345,325	\$ 802	\$ 1,322	\$ 645	\$ 970	\$ 349,064
Impact of adoption of IFRS 9	2(b)	–	–	–	–	–	(2,000)	(2,000)
Balance, restated at January 1, 2018		33,252,139	345,325	802	1,322	645	(1,030)	347,064
Shares issued by prospectus		2,760,000	34,500	–	–	–	–	34,500
Shares issued under dividend reinvestment plan	10	236,678	2,970	–	–	–	–	2,970
Shares issued under employee share purchase plan		9,078	118	–	–	–	–	118
Shares issued under deferred share incentive plan	11	38,020	450	(450)	–	–	–	–
Shares issued on debenture conversion	9	74,058	983	–	(5)	–	–	978
Issue costs		–	(1,614)	–	–	–	–	(1,614)
Share-based payments	11	–	–	214	–	–	–	214
Equity component of convertible debentures issued	9	–	–	–	383	–	–	383
Issue costs attributable to equity component of convertible debentures issued	9	–	–	–	(18)	–	–	(18)
Net income and comprehensive income		–	–	–	–	–	25,232	25,232
Dividends declared		–	–	–	–	–	(23,980)	(23,980)
Balance, September 30, 2018		36,369,973	382,732	566	1,682	645	222	385,847
Shares issued under dividend reinvestment plan	10	74,661	984	–	–	–	–	984
Shares issued under employee share purchase plan		3,031	37	–	–	–	–	37
Shares issued on debenture conversion	9	113,533	1,508	–	(7)	–	–	1,501
Share-based payments	11	–	–	78	–	–	–	78
Net income and comprehensive income		–	–	–	–	–	8,537	8,537
Dividends declared		–	–	–	–	–	(9,678)	(9,678)
Balance, December 31, 2018		36,561,198	\$ 385,261	\$ 644	\$ 1,675	\$ 645	\$ (919)	\$ 387,306
Shares issued by prospectus	10	2,645,000	34,517	–	–	–	–	34,517
Shares issued under dividend reinvestment plan	10	245,338	3,225	–	–	–	–	3,225
Shares issued under employee share purchase plan		8,031	109	–	–	–	–	109
Shares issued under deferred share incentive plan	11	18,169	229	(229)	–	–	–	–
Shares issued on debenture conversion	9	74,659	995	–	(5)	–	–	990
Maturity of convertible debentures	9	–	–	–	(136)	136	–	–
Issue costs		–	(1,589)	–	–	–	–	(1,589)
Share-based payments	11	–	–	238	–	–	–	238
Equity component of convertible debentures issued	9	–	–	–	351	–	–	351
Issue costs attributable to equity component of convertible debentures issued	9	–	–	–	(17)	–	–	(17)
Net income and comprehensive income		–	–	–	–	–	28,837	28,837
Dividends declared		–	–	–	–	–	(26,409)	(26,409)
Balance, September 30, 2019		<u>39,552,395</u>	<u>\$ 422,747</u>	<u>\$ 653</u>	<u>\$ 1,868</u>	<u>\$ 781</u>	<u>\$ 1,509</u>	<u>\$ 427,558</u>

Dividends amounted to \$0.675 per share for the nine months ended September 30, 2019 (nine months ended September 30, 2018 – \$0.675, year ended December 31, 2018 – \$0.94).

The accompanying notes are an integral part of these interim consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(in thousands of Canadian dollars, except for per share amounts)

	Notes	Three months ended September 30		Nine months ended September 30	
		2019	2018	2019	2018
Revenues					
Mortgage interest and fees	8	\$ 16,716	\$ 15,476	\$ 49,179	\$ 43,466
Operating expenses					
Mortgage servicing and management fees	8	1,743	1,661	5,180	4,725
Transfer agent, regulatory fees and investor relations		90	70	220	249
Share-based payments	8, 11	80	72	238	214
Professional fees		48	60	138	142
Directors' expense	8	45	49	146	149
Administration and general		22	28	77	94
Rental loss	6	4	–	124	–
Provision for mortgage losses	5(b)	390	563	1,190	1,263
Total operating expenses		<u>2,422</u>	<u>2,503</u>	<u>7,313</u>	<u>6,836</u>
Income before financing costs		<u>14,294</u>	<u>12,973</u>	<u>41,866</u>	<u>36,630</u>
Financing costs					
Interest on convertible debentures		2,544	2,551	7,717	6,773
Interest and other bank charges		<u>1,815</u>	<u>1,722</u>	<u>5,312</u>	<u>4,625</u>
Total financing costs		<u>4,359</u>	<u>4,273</u>	<u>13,029</u>	<u>11,398</u>
Net income and comprehensive income for the period		<u>\$ 9,935</u>	<u>\$ 8,700</u>	<u>\$ 28,837</u>	<u>\$ 25,232</u>
Earnings per common share					
Basic	12	<u>\$ 0.25</u>	<u>\$ 0.24</u>	<u>\$ 0.74</u>	<u>\$ 0.72</u>
Diluted	12	<u>\$ 0.25</u>	<u>\$ 0.24</u>	<u>\$ 0.73</u>	<u>\$ 0.71</u>

The accompanying notes are an integral part of these interim consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**(UNAUDITED)****(in thousands of Canadian dollars)**

	Three months ended		Nine months ended	
	September 30		September 30	
	2019	2018	2019	2018
Cash provided by (used in):				
Operating activities				
Net income and comprehensive income for the period	\$ 9,935	\$ 8,700	\$ 28,837	\$ 25,232
Adjustments to determine net cash flows provided by (used in) operating activities				
Share-based payments	80	72	238	214
Mortgage interest and fees earned	(16,716)	(15,476)	(49,179)	(43,466)
Mortgage interest and fees received	11,358	12,776	35,300	33,960
Interest on convertible debentures expensed	2,544	2,551	7,717	6,773
Interest and other bank charges expensed	1,815	1,722	5,312	4,625
Provision for mortgage losses	390	563	1,190	1,263
Changes in operating assets and liabilities				
Prepaid expenses	99	(178)	(80)	(217)
Accounts payable and accrued liabilities	225	(52)	(387)	(157)
Additions to mortgage discount	–	–	46	–
Additions to unamortized origination fees	133	125	556	384
Cash provided by operating activities	<u>9,863</u>	<u>10,803</u>	<u>29,550</u>	<u>28,611</u>
Investing activities				
Cash advances of mortgages receivable	(21,703)	(56,538)	(152,038)	(197,618)
Cash repayments of mortgages receivable	23,198	105,870	109,653	175,985
Cash provided by (used in) investing activities	<u>1,495</u>	<u>49,332</u>	<u>(42,385)</u>	<u>(21,633)</u>
Financing activities				
Advances under credit facility	37,700	166,799	245,125	373,683
Repayments under credit facility	(35,156)	(249,710)	(228,151)	(414,902)
Interest on convertible debentures paid	(4,406)	(1,556)	(6,422)	(5,252)
Interest and other bank charges paid	(1,740)	(1,374)	(5,434)	(4,333)
Issuance of common shares	35	37	34,626	34,618
Share capital issue costs	–	–	(1,589)	(1,614)
Issuance of convertible debentures	–	34,500	28,750	34,500
Convertible debenture issue costs	–	(1,627)	(1,369)	(1,627)
Repayment of convertible debentures	–	–	(28,278)	–
Cash dividends paid	(7,791)	(7,204)	(24,423)	(22,051)
Cash provided by (used in) financing activities	<u>(11,358)</u>	<u>(60,135)</u>	<u>12,835</u>	<u>(6,978)</u>
Increase (decrease) in cash	–	–	–	–
Cash, beginning of period	–	–	–	–
Cash, end of period	<u>\$ –</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ –</u>

The accompanying notes are an integral part of these interim consolidated financial statements.

NOTE 1 – NATURE OF OPERATIONS

Atrium Mortgage Investment Corporation (the “company”) is a corporation domiciled in Canada, incorporated under the *Ontario Business Corporations Act*. The address of the company’s registered head office and principal place of business is Suite 900, 20 Adelaide Street East, Toronto, Ontario M5C 2T6.

The company is a Mortgage Investment Corporation (MIC) as defined in Section 130.1(6) of the Canada *Income Tax Act* (ITA). Accordingly, the company is not taxed on income provided that its taxable income is paid to its shareholders in the form of dividends within 90 days after December 31 each year. Such dividends are generally treated by shareholders as interest income, so that each shareholder is in the same position as if the mortgage investments made by the company had been made directly by the shareholder.

The company’s common shares are listed on the Toronto Stock Exchange (TSX) under the symbol AI and its convertible debentures are listed under the symbols AI.DB, AI.DB.B, AI.DB.C, AI.DB.D and AI.DB.E.

NOTE 2 – BASIS OF PRESENTATION**(a) Statement of compliance**

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and follow International Accounting Standard 34 *Interim Financial Reporting* (IAS 34) as issued by the International Accounting Standards Board (IASB) as set out in Part I of the *CPA Canada Handbook – Accounting*. These interim consolidated financial statements should be read in conjunction with the company’s audited financial statements for the year ended December 31, 2018. Significant accounting policies have been consistently applied in the preparation of these interim consolidated financial statements, which were authorized for issuance by the board of directors on October 31, 2019.

(b) New and amended standards and interpretations

Effective January 1, 2018, the company adopted IFRS 9 *Financial Instruments* (IFRS 9), which replaced IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). IFRS 9 was adopted retrospectively without restatement, as allowed under the standard’s transitional provisions. IFRS 9 addresses the measurement of financial assets and financial liabilities, including the impairment of financial assets and other commitments.

As a result of the application of IFRS 9, the company changed its accounting policies for financial assets and mortgages receivable effective January 1, 2018, as described in Notes 3(a), (b), (c), (d) and (e).

Adoption of IFRS 9 had no effect on the measurement of the company’s financial assets and financial liabilities, which continue to be measured at amortized cost subsequent to their initial recognition.

The effect on the allowance for credit losses on January 1, 2018 has been recognized as an adjustment to opening retained earnings (deficit) in the interim consolidated statements of changes in shareholders’ equity.

(c) Basis of measurement

These interim consolidated financial statements are prepared on the historical cost basis.

(d) Functional and presentation currency

These interim consolidated financial statements are presented in Canadian dollars, which is also the company’s functional currency. Dollars are expressed in thousands except for per share amounts or where the context requires otherwise.

NOTE 2 – BASIS OF PRESENTATION (continued)**(e) Principles of consolidation**

These interim consolidated financial statements include the accounts of the company and Canadian Properties LP, which is considered to be a subsidiary for financial reporting purposes. Consolidation commenced the date the company obtained control and continues until control ceases. Atrium has consolidated the subsidiary from August 5, 2016, the date of its formation. All transactions and balances between the company and the subsidiary have been eliminated, including unrealized gains and losses, if any.

(f) Use of estimates and judgements

The preparation of interim consolidated financial statements in accordance with IFRS requires management to make estimates, assumptions and judgements that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the reporting date and the reported amounts of revenue and expenses during the reporting period.

The most subjective of these estimates relate to:

- (a) determining whether the cash flows from the mortgages receivable represent solely payments of principal and interest (SPPI);
- (b) the measurement of impairment losses for mortgages receivable, in particular: measurement of credit risk to determine whether there has been a significant increase in credit risk since initial recognition; the assessment of when mortgages receivable become impaired and the incorporation of forward-looking information to determine expected credit losses; and
- (c) the measurement of the liability and equity components of the convertible debentures which depend upon the estimated market interest rates for a comparable debenture without the convertibility feature.

Management believes that its estimates are appropriate; however, actual results could differ from the amounts estimated. Estimates and underlying assumptions are reviewed each quarter. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES**(a) Financial instrument assets – initial recognition and measurement**

Financial instrument assets are initially recognized when the company becomes a party to a contract. On initial recognition, the measurement category is determined, based on: (i) the business model under which the asset is held, and (ii) the contractual cash flow characteristics of the instrument.

Upon initial recognition, financial assets are measured as either:

- Fair value through profit and loss (FVTPL) – which is the required measurement classification for instruments that are held for trading and derivative assets;
- Amortized cost – if the instrument is held within a business model whose objective is to collect contractual cash flows and the cash flows represent SPPI;
- Fair value through other comprehensive income (FVOCI) – which is required for debt instruments held in a dual-purpose business model, to collect contractual cash flows and to sell the instruments and can be irrevocably elected at initial recognition provided they have not been designated as FVTPL and are not held for trading; or
- Designated as FVTPL – available on initial recognition provided certain criteria are met.

All of the company's mortgages receivable are held in a single business model. The company has concluded that its business model is to hold mortgages receivable to collect contractual cash flows for the following reasons:

- The performance of the mortgage portfolio is assessed on the basis of effective yield, and not on a fair value basis, whether realized or unrealized.
- Neither key management compensation nor remuneration paid to the company's manager is based on the fair values of mortgages receivable.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (continued)**(a) Financial instrument assets – initial recognition and measurement (continued)**

- Historically the company has not sold, and in future has no expectations to sell, any of its mortgages receivable. While the company may decrease its interest in a syndicated mortgage receivable by transferring its interest, at its amortized cost carrying amount, to another lender in the syndicate, such transfers are consistent with the business model of holding mortgages receivable to collect contractual cash flows.

The returns earned by the company on its mortgages receivable are interest rates that are set at levels to provide an acceptable profit margin based on the time value of money and credit risk, although other basic lending risks (for example, the location and quality of the underlying collateral) may also be built-in. There are no factors that give rise to variation in the return on the company's mortgages receivable other than the time value of money, credit risk and other basic lending risks. Interest rates, or the credit spread for variable rate mortgages, are set for the full term of the loan, which is considered SPPI because the rate is still based on the time value of money and credit risk. The majority of the mortgages receivable can be prepaid after an initial closed period with no penalty, subject to the borrower providing advance written notice according to the terms of their mortgage so the return therefore represents SPPI.

Mortgages receivable are initially recognized at fair value and are subsequently carried at amortized cost using the effective interest method. See Note 3(d) Financial instruments – revenue recognition.

(b) Financial instrument liabilities – initial recognition and measurement

Financial liabilities are measured as either:

- FVTPL – which is required for any financial instrument liabilities that are held for trading and for derivative liabilities;
- Designated as FVTPL – available on initial recognition if either: the instrument includes one or more embedded derivatives and the host contract is not a financial asset; or if the designation meets certain criteria;
- Designated as at fair value – if the instrument does not meet the criteria and is designated as at FVTPL and is not otherwise required to be measured as FVTPL, it can still be irrevocably designated at initial recognition as at fair value, meaning that changes in fair value related to changes in own credit risk are presented in other comprehensive income and other changes in fair value are presented in net income; or
- Amortized cost – which is the default category and is also used for any host contract that is a financial instrument liability.

The company's borrowings under credit facility, accounts payable and accrued liabilities, dividends payable, accrued convertible debenture interest and the liability component of convertible debentures are measured at amortized cost. These financial instrument liabilities are initially recognized at fair value and are subsequently measured at amortized cost using the effective interest method.

(c) Financial instruments – impairment of assets

Loan commitments and letters of credit (collectively commitments) and mortgages receivable are assessed for impairment at the end of each reporting period using an expected credit loss (ECL) model. The ECL model uses a three-stage impairment approach based on changes in the credit risk of the commitment or mortgage receivable since initial recognition. The three stages are as follows:

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (continued)**(c) Financial instruments – impairment of assets (continued)**

Credit stage and financial assets included	Impairment loss recognized
Stage 1 – commitments and mortgages receivable on initial recognition and existing assets that have not shown a significant increase in credit risk since initial recognition	12-month ECL – portion of lifetime ECLs that represent the ECL from possible default events within the next 12 months
Stage 2 – commitments and mortgages receivable that have experienced a significant increase in credit risk since initial recognition and up to the date of approval of the interim consolidated financial statements	Lifetime ECL – expected losses from possible default events over the expected life of the instrument, weighted by the likelihood of loss
Stage 3 – impaired commitments and mortgages receivable for which there is objective evidence of impairment at the date of approval of the interim consolidated financial statements	Lifetime ECL – expected losses from possible default events over the expected life of the instrument, weighted by the likelihood of loss

Credit quality is assessed at each reporting period and results in commitments and mortgages receivable being moved between stages, as necessary. Significant judgement is required when assessing evidence of credit impairment and estimating expected credit losses.

For commitments and mortgages receivable, the company considers a number of past events, current conditions and forward-looking information when assessing if there has been a significant increase or subsequent decrease in credit risk. There is a presumption in IFRS 9 that credit risk has increased significantly once payments are 30 days past due. However, for single-family residential mortgages receivable, the company's historical experience is that mortgages receivable can become 30 days past due, but be brought up to date by the borrower, therefore another additional risk factor also needs to be identified for the mortgage receivable to move to Stage 2. For single-family residential mortgages receivable that are not 30 days past due, a significant increase in credit risk may still be evidenced by the presence of one or more additional risk factors. For all other mortgages receivable, a significant increase in credit risk is considered to have occurred if payments are 30 days past due or if one or more additional risk factors is present.

The additional risk factors used in assessing credit risk include:

- changes in the financial condition of the borrower;
- responsiveness of the borrower;
- other borrower specific information that may be available, without consideration of collateral;
- current economic conditions: interest rates, housing prices, real estate market statistics and employment statistics; and
- supportable forward-looking information: macro-economic factors, such as forecast real estate values and interest rate forecasts.

Determining whether there has been a significant increase in credit risk since initial recognition, or a subsequent reduction in credit risk back to the level at initial recognition, requires the exercise of significant judgement.

The company considers a commitment or mortgage receivable to be impaired when there is objective evidence that one or more events have occurred that have an unfavourable impact on estimated future cash flows such that there is no longer reasonable assurance as to the timely collection of the full amount of principal and interest.

The company considers a commitment or mortgage receivable to be in default if payments are greater than 90 days past due for single-family residential mortgages receivable or 30 days past due for all other mortgages receivable, or if an event of default has occurred under the terms of the mortgage commitment, including: non-payment of property taxes, a material adverse change in the financial position of the borrower and/or guarantors or a material adverse change in the property given as security. These definitions are consistent with industry practice.

An ECL represents the difference between the present value of all contractual cash flows that are due under the original terms of the contract and the present value of all cash flows expected to be received. The company's application of the concept uses three inputs to measure ECLs for commitments and mortgages receivable classified as Stage 1: probability of default (PD), loss given default (LGD) and exposure at default (EAD). These inputs are determined at each reporting period using historical data and current conditions.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (continued)**(c) Financial instruments – impairment of assets (continued)**

Adjustments may be made to the probability of default if the effects of, for example, forecasts of housing prices, employment and interest rates, are expected to be significantly different over the term of the mortgage. The inputs for Stage 1 mortgages receivable are calculated separately for (i) single-family residential mortgages receivable and (ii) mortgages receivable on all other properties on the basis of differences in the credit risk of each. The ECL is assessed individually for each commitment and mortgage receivable classified as either Stage 2 or Stage 3. For mortgages receivable in these stages, forecast future information specific to the loan (for example, forecasts of real estate prices) is incorporated when assessing the cash flows expected to be received.

Mortgages receivable are presented on the interim consolidated statements of financial position net of the provision for mortgage losses. A loss on a mortgage receivable is written off against the related provision for mortgage losses when there is no reasonable expectation of further recovery, which is the point at which the underlying real property has been liquidated and claims against guarantors, if any, are unlikely to recover any further losses. For any mortgages receivable that have been written off but where guarantors are still being pursued for collection, no recovery is recognized until virtually certain of collection.

(d) Financial instruments - revenue recognition

Mortgage interest and fees revenues are recognized in the interim consolidated statements of income and comprehensive income using the effective interest method. Mortgage interest and fees revenues include the company's share of any fees received, as well as the effect of any discount or premium on the mortgage. Interest revenue is calculated on the gross carrying amount for mortgages receivable in Stages 1 and 2 and on the net carrying amount for mortgages receivable in Stage 3 (see Note 3(c) Financial instruments – impairment of assets).

The effective interest method derives the interest rate that discounts the estimated future cash receipts during the expected life of the mortgage receivable (which is the contractual life, if a shorter period is not expected) to its carrying amount. When calculating the effective interest rate, future cash flows are estimated considering all contractual terms of the financial instrument, but not future credit losses (see Note 3(c) Financial instruments – impairment of assets). The calculation of the effective interest rate includes all fees and transaction costs paid or received. Fees and transaction costs include incremental revenues and costs that are directly attributable to the acquisition or issuance of the mortgage.

(e) Financial instruments – derecognition

Financial assets are derecognized when the contractual rights to receive cash flows from the asset expire. When the company exercises its security and takes title to the underlying real estate, a mortgage receivable is derecognized on the date of foreclosure.

Financial liabilities are derecognized when the obligation under the liability is discharged, cancelled, or expires.

(f) Foreclosed properties

Foreclosed properties are properties over which the company has taken title through exercise of its security interest. Such properties are accounted for under IAS 40 *Investment Property*. A foreclosed property is recognized on the date of foreclosure and is measured initially at cost, which is the book value of the respective mortgage receivable net of any related provision for mortgage loss, plus any directly attributable expenditures and transaction costs. Any costs subsequently incurred to complete the construction or development of a foreclosed property are capitalized. After initial recognition, foreclosed properties are measured using the cost model. Depreciation commences from the date the property is substantially complete and is recognized when the property's carrying amount exceeds its residual value. If the higher of the fair value and the value in use of a foreclosed property (its recoverable amount) is less than its carrying amount, then an impairment loss is recognized for the excess. Any impairment loss, or gain or loss realized on disposal is recognized in the interim consolidated statements of income and comprehensive income.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (continued)**(g) Convertible debentures**

Convertible debentures can be converted into common shares of the company at the option of the investor. They are compound financial instruments with two components: a financial liability, and a call option which is an equity instrument. The fair value of the liability component is measured as of the date that the convertible debentures were issued, and the equity instrument is valued on that date based upon the difference between the fair value of the convertible debenture and the fair value of the liability component. The measurement of the fair value of the liability component is based upon market rates of interest on similar debt instruments without the conversion feature. Expenses of issue are allocated between the two components on a pro-rata basis. The book value of the debt is accreted up to its face value over the life of the financial liability using the effective interest method, which applies a constant interest rate over the term of the debt. The value of the equity component is not remeasured subsequent to its initial measurement date.

(h) Income taxes

The company qualifies as a MIC under the ITA, and as such is not taxed on income provided that its taxable income is distributed to its shareholders in the form of dividends within 90 days after December 31 each year. It is the company's policy to pay such dividends to remain non-taxable. Accordingly, no provision for current or deferred income taxes is required.

(i) Earnings per common share

Basic earnings per common share is calculated by dividing earnings during the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting the income and comprehensive income attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive items such as convertible debentures and deferred share incentive plans.

(j) Share-based payments

The company has an equity-settled share-based compensation plan for grants to eligible directors, officers, and senior management under its deferred share incentive plan. Grants are measured based upon the fair value of the awards granted, using the volume-weighted average trading share price for the five trading days prior to the date of the grant.

NOTE 4 – RECENT ACCOUNTING PRONOUNCEMENTS

Various pronouncements have been issued by the IASB or IFRS Interpretations Committee (IFRIC) that will be effective for future accounting periods. The company closely monitors new accounting standards as well as amendments to existing standards and assesses what impact, if any, they will have on the interim consolidated financial statements. None of the standards issued to date are expected to have a material effect on the interim consolidated financial statements.

NOTE 5 – MORTGAGES RECEIVABLE**(a) Mortgage portfolio**

Property type	September 30, 2019			December 31, 2018		
	Number	Outstanding amount	% of Portfolio	Number	Outstanding amount	% of Portfolio
Low-rise residential	34	\$ 221,973	30.0%	38	\$ 232,713	34.0%
High-rise residential	16	180,343	24.4%	15	146,027	21.3%
Mid-rise residential	19	145,812	19.7%	20	139,708	20.4%
House and apartment	87	60,328	8.2%	101	64,230	9.4%
Condominium corporation	14	2,755	0.4%	14	2,533	0.4%
Residential portfolio	170	611,211	82.7%	188	585,211	85.5%
Commercial	19	128,255	17.3%	20	99,193	14.5%
Mortgage portfolio	<u>189</u>	<u>739,466</u>	<u>100.0%</u>	<u>208</u>	<u>684,404</u>	<u>100.0%</u>
Accrued interest receivable		3,701			3,122	
Mortgage discount		(235)			(221)	
Unamortized origination fees		(650)			(684)	
Provision for mortgage losses		(5,090)			(3,900)	
Mortgages receivable		<u>\$ 737,192</u>			<u>\$ 682,721</u>	

The mortgage portfolio has maturity dates between 2019 and 2030 with a weighted average remaining term of 8.1 months at September 30, 2019 (December 31, 2018 – 11.3 months). The portfolio has a weighted average interest rate (which excludes lender fees earned by the company) of 8.80% as at September 30, 2019 (8.85% as at December 31, 2018, 8.83% as at September 30, 2018).

Within the mortgage portfolio, at September 30, 2019 there were 22 loans aggregating \$107,337 (14.5% of the mortgage portfolio) in which the company has a subordinate position in a syndicated mortgage receivable (December 31, 2018 – 21 mortgages receivable aggregating \$74,399, 10.9% of the mortgage portfolio). Additional analysis of the mortgage portfolio, including by location of underlying property and type of mortgage, is set out in the “Investment Portfolio” section of the Management’s Discussion and Analysis for the quarter ended September 30, 2019.

A majority of the mortgages receivable have an initial closed period, after which the borrower may repay the principal at any time prior to maturity, without penalty, subject to providing advance written notice according to the terms of their mortgage.

Principal repayments based on contractual maturity dates are as follows:

Three months ended December 31, 2019	\$ 231,757	31.3%
Years ended December 31, 2020	356,181	48.2%
2021	122,708	16.6%
2022	23,219	3.1%
2023	3,307	0.5%
Thereafter	<u>2,294</u>	<u>0.3%</u>
	<u>\$ 739,466</u>	<u>100.0%</u>

NOTE 5 – MORTGAGES RECEIVABLE (continued)**(b) Provision for mortgage losses**

The gross carrying amounts of mortgages receivable and provision for mortgage losses by property type are as follows:

As at September 30, 2019

Gross carrying amount	Stage 1	Stage 2	Stage 3	Total
Low-rise residential	\$ 206,622	\$ 15,351	\$ –	\$ 221,973
High-rise residential	180,343	–	–	180,343
Mid-rise residential	145,812	–	–	145,812
House and apartment	59,750	578	–	60,328
Condominium corporation	2,755	–	–	2,755
Commercial	124,043	4,212	–	128,255
Mortgage portfolio	<u>\$ 719,325</u>	<u>\$ 20,141</u>	<u>\$ –</u>	<u>\$ 739,466</u>

Provision for mortgage losses

Low-rise residential	\$ 1,468	\$ 180	\$ –	\$ 1,648
High-rise residential	1,282	–	–	1,282
Mid-rise residential	1,036	–	–	1,036
House and apartment	223	–	–	223
Condominium corporation	20	–	–	20
Commercial	881	–	–	881
Mortgage portfolio	<u>\$ 4,910</u>	<u>\$ 180</u>	<u>\$ –</u>	<u>\$ 5,090</u>

As at December 31, 2018

Gross carrying amount	Stage 1	Stage 2	Stage 3	Total
Low-rise residential	\$ 232,713	\$ –	\$ –	\$ 232,713
High-rise residential	146,027	–	–	146,027
Mid-rise residential	139,708	–	–	139,708
House and apartment	61,007	3,223	–	64,230
Condominium corporation	2,533	–	–	2,533
Commercial	95,244	3,949	–	99,193
Mortgage portfolio	<u>\$ 677,232</u>	<u>\$ 7,172</u>	<u>\$ –</u>	<u>\$ 684,404</u>

Provision for mortgage losses

Low-rise residential	\$ 1,395	\$ –	\$ –	\$ 1,395
High-rise residential	875	–	–	875
Mid-rise residential	837	–	–	837
House and apartment	207	–	–	207
Condominium corporation	15	–	–	15
Commercial	571	–	–	571
Mortgage portfolio	<u>\$ 3,900</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 3,900</u>

The provision for mortgage losses at September 30, 2019 is \$5,090. Of this provision, \$4,910 represents management's estimate of the ECLs on mortgages receivable in the company's portfolio that have not experienced a significant increase in credit risk since initial recognition (Stage 1). The ECL was assessed individually for each mortgage receivable and commitment classified as Stage 2 and management estimated the ECL as \$180.

NOTE 5 – MORTGAGES RECEIVABLE (continued)**(b) Provision for mortgage losses (continued)**

The changes in the provision for mortgage losses are shown in the following table.

	Nine months ended September 30, 2019			
	Stage 1	Stage 2	Stage 3	Total
Opening balance, January 1, 2019	\$ 3,900	\$ –	\$ –	\$ 3,900
Provision for mortgage losses				
Transfers to Stage 1 ⁽¹⁾	–	–	–	–
Transfers to Stage 2 ⁽¹⁾	(96)	96	–	–
Transfers to Stage 3 ⁽¹⁾	–	–	–	–
Net remeasurement ⁽²⁾	720	84	–	804
Mortgage advances	1,039	–	–	1,039
Mortgage repayments	(653)	–	–	(653)
Balance, September 30, 2019	<u>\$ 4,910</u>	<u>\$ 180</u>	<u>\$ –</u>	<u>\$ 5,090</u>

(1) Transfers between stages which are presumed to occur before any corresponding remeasurement of the provision.

(2) Net remeasurement represents the change in the expected credit loss related to changes in model inputs or assumptions, including changes in macroeconomic conditions, and changes in measurement following a transfer between stages.

During the nine month period ended September 30, 2019, the provision for mortgage losses for mortgages classified as Stage 1 increased primarily as a result of the overall increase in the mortgage portfolio. The provision for mortgage losses for mortgages classified as Stage 2 increased as a result of the transfer of mortgages receivable from Stage 1 to Stage 2 due to a significant increase in credit risk since initial recognition. The ECL is assessed individually for Stage 2 mortgages.

	Nine months ended September 30, 2018			
	Stage 1	Stage 2	Stage 3	Total
Opening balance, January 1, 2018	\$ 3,300	\$ –	\$ 5,900	\$ 9,200
Provision for mortgage losses				
Transfers to Stage 1 ⁽¹⁾	(12)	–	–	(12)
Transfers to Stage 2 ⁽¹⁾	–	12	–	12
Transfers to Stage 3 ⁽¹⁾	–	–	–	–
Net remeasurement ⁽²⁾	(125)	(12)	1,149	1,012
Mortgage advances	1,109	–	–	1,109
Mortgage repayments	(862)	–	–	(862)
Write-offs ⁽³⁾	–	–	(359)	(359)
Balance, September 30, 2018	<u>\$ 3,410</u>	<u>\$ –</u>	<u>\$ 6,690</u>	<u>\$ 10,100</u>

(1) Transfers between stages which are presumed to occur before any corresponding remeasurement of the provision.

(2) Net remeasurement represents the change in the expected credit loss related to changes in model inputs or assumptions, including changes in macroeconomic conditions, and changes in measurement following a transfer between stages.

(3) Represents write-offs against prior period provision for mortgage losses. Actual loss incurred was \$363.

During the nine month period ended September 30, 2018, the provision for mortgage losses for mortgages receivable classified as Stage 1 increased as a result of the overall increase in the mortgage portfolio. The increase in the provision for mortgage losses for mortgages receivable classified as Stage 3 was a result of a combination of an increase in the outstanding balance of the mortgages receivable and an increase in the expected credit loss for these mortgages receivable.

NOTE 6 – FORECLOSED PROPERTIES

During the year ended December 31, 2018, the company acquired through a credit bid one property on which it held a mortgage.

	Nine months ended September 30 2019	Year ended December 31 2018
	Balance, beginning of period	\$ 17,007
Property acquired through a credit bid during the period	–	15,208
Capital improvements and expenditures	–	735
Balance, end of period	<u>\$ 17,007</u>	<u>\$ 17,007</u>

NOTE 6 – FORECLOSED PROPERTIES (continued)

Rental loss	Three months ended		Nine months ended	
	September 30		September 30	
	2019	2018	2019	2018
Revenue from foreclosed properties	\$ 260	\$ –	\$ 529	\$ –
Property operating costs	(264)	–	(653)	–
Rental loss	<u>\$ (4)</u>	<u>\$ –</u>	<u>\$ (124)</u>	<u>\$ –</u>

NOTE 7 – CREDIT FACILITY

At September 30, 2019, the company had a credit facility from a syndicate of four Canadian financial institutions of \$210,000 (December 31, 2018 – \$210,000) at a formula rate that varies with bank prime and the market bankers' acceptance rate. At any time during the term of the credit facility, the company has the one-time right to increase the credit facility by up to \$30,000 (such that the total maximum availability would be up to \$240,000). The annualized weighted average rate for the nine month period ended September 30, 2019 was 4.09% (3.81% for the year ended December 31, 2018). Drawings under the credit facility may be by way of a bank loan (including an overdraft facility of up to \$500), bankers' acceptances or letters of credit (LCs). LCs represent irrevocable assurances that the company's banks will make payments in the event that a borrower of the company cannot meet its obligations to third parties. LCs carry the same credit risk, recourse and collateral security requirements as mortgages extended to customers. The committed credit facility was effective January 2, 2019, has a term to January 11, 2021, and is subject to certain conditions of drawdown and other covenants.

The credit facility is secured by a lien over all of the company's assets by means of a general security agreement. The amount that may be drawn down under the credit facility is determined by the aggregate value of mortgages receivable that are acceptable to the lender. Under the terms of the credit facility, covenants must be met in respect of shareholders' equity, debt to total assets and interest coverage. At September 30, 2019 and December 31, 2018, the company was in compliance with these covenants.

Credit facility	September 30	December 31
	2019	2018
Bankers' acceptances	\$ 155,500	\$ 136,000
Bank loan	9,804	12,490
Overdraft facility	–	(160)
Unamortized finance costs	(519)	(484)
Borrowings under credit facility	164,785	147,846
Letters of credit	6,150	7,908
Total credit facility utilization	<u>\$ 170,935</u>	<u>\$ 155,754</u>

NOTE 8 – RELATED PARTY TRANSACTIONS

The company pays management and mortgage servicing fees to Canadian Mortgage Capital Corporation (CMCC), which is the manager of the company, and responsible for its day-to-day management. The majority beneficial owner and Chief Executive Officer (CEO) of the manager is also CEO of the company. The company incurred management and mortgage servicing fees of \$5,180 for the nine month period ended September 30, 2019 (nine month period ended September 30, 2018 – \$4,725). The management agreement between the company and CMCC contains provisions for the payment of termination fees to the manager in the event that the management agreement is terminated in certain circumstances. Amounts due to related party of \$563 (December 31, 2018 – \$529) are included in accounts payable and accrued liabilities and are due to CMCC, are in the normal course of business, are non-interest bearing, due on demand and are paid within 30 days of each period end.

Under an employee share purchase plan (ESPP) for the company's common shares, participants, including employees of CMCC, may contribute up to an annual maximum to the ESPP and CMCC matches 50% of the participants' contributions. The total amount matched by CMCC for the nine month period ended September 30, 2019 was \$36 (nine month period ended September 30, 2018 – \$39).

NOTE 8 – RELATED PARTY TRANSACTIONS (continued)

Certain of the company's mortgages receivable are shared with other investors. As at September 30, 2019, companies owned by a director and officer of the company had co-invested in one syndicated secured mortgage receivable. The total amount of the mortgage receivable is \$54,703 (December 31, 2018 – one syndicated mortgage receivable of \$50,484) of which the company's share is \$27,351 (December 31, 2018 – \$25,242).

As at September 30, 2019, the company had three mortgages receivable from borrowers over which a director and officer of the company has joint control (December 31, 2018 – two).

- A secured mortgage receivable loan with a total gross commitment of \$3,490 (December 31, 2018 – \$3,490), of which \$3,490 had been funded at September 30, 2019 (December 31, 2018 – \$3,394). During the nine month period ended September 30, 2019, the company recognized net mortgage interest and fees of \$241 (nine month period ended September 30, 2018 – \$214) from this mortgage receivable.
- A secured mortgage receivable loan with a total gross commitment of \$8,738 (December 31, 2018 – \$8,738). The company's share of the commitment is \$2,330 (December 31, 2018 – \$2,330), of which \$2,330 had been funded at September 30, 2019 (December 31, 2018 – \$2,330). During the nine month period ended September 30, 2019, the company recognized net mortgage interest and fees of \$176 (nine month period ended September 30, 2018 – \$169) from this mortgage receivable.
- A secured mortgage receivable loan with a total gross commitment of \$7,875 (December 31, 2018 – \$nil). The company's share of the commitment is \$1,500 (December 31, 2018 – \$nil), of which \$1,500 had been funded at September 30, 2019 (December 31, 2018 – \$nil). During the nine month period ended September 30, 2019, the company recognized net mortgage interest and fees of \$87 (nine month period ended September 30, 2018 – \$nil) from this mortgage receivable.

Key management includes directors and officers of the company. Compensation expenses for key management personnel include:

	Three months ended		Nine months ended	
	September 30		September 30	
	2019	2018	2019	2018
Directors' fees	\$ 45	\$ 45	\$ 135	\$ 134
Share-based payments to directors (Note 11)	30	29	88	107
Share-based payments to officers (Note 11)	17	15	51	44
	<u>\$ 92</u>	<u>\$ 89</u>	<u>\$ 274</u>	<u>\$ 285</u>

Related party transactions are in the normal course of business and are recorded at the amount of consideration established and agreed to by the related parties.

NOTE 9 – CONVERTIBLE DEBENTURES

	Convertible debenture						Total
	5.60% ALDB.E	5.50% ALDB.D	5.30% ALDB.C	5.50% ALDB.B	6.25% ALDB.A	5.25% ALDB	
Nine months ended September 30, 2019							
Issued and outstanding							
face value	\$ 28,750	\$ 34,500	\$ 25,300	\$ 40,250	\$ —	\$ 32,500	\$ 161,300
Book value –							
Convertible debentures,							
beginning of period	\$ —	\$ 32,627	\$ 24,124	\$ 39,299	\$ 29,186	\$ 32,053	\$ 157,289
Conversion to shares	—	—	—	—	(990)	—	(990)
Issued	28,750	—	—	—	—	—	28,750
Equity component	(351)	—	—	—	—	—	(351)
Issue costs	(1,369)	—	—	—	—	—	(1,369)
Issue costs attributed to							
equity component	17	—	—	—	—	—	17
Repayment of							
convertible debenture	—	—	—	—	(28,278)	—	(28,278)
Accretion for the period	158	195	157	255	82	222	1,069
Convertible debentures,							
end of period	\$ 27,205	\$ 32,822	\$ 24,281	\$ 39,554	\$ —	\$ 32,275	\$ 156,137

On March 29, 2019, the company completed a public offering of 5.60% convertible debentures for gross proceeds of \$25,000. On April 16, 2019, the company received gross proceeds of \$3,750 from the exercise in full of the over-allotment option on the 5.60% convertible debentures.

	Convertible debenture						Total
	5.60% ALDB.E	5.50% ALDB.D	5.30% ALDB.C	5.50% ALDB.B	6.25% ALDB.A	5.25% ALDB	
Year ended December 31, 2018							
Issued and outstanding							
face value	\$ —	\$ 34,500	\$ 25,300	\$ 40,250	\$ 29,271	\$ 32,500	\$ 161,821
Book value –							
Convertible debentures,							
beginning of year	\$ —	\$ —	\$ 23,916	\$ 38,961	\$ 31,340	\$ 31,759	\$ 125,976
Conversion to shares	—	—	—	—	(2,479)	—	(2,479)
Issued	—	34,500	—	—	—	—	34,500
Equity component	—	(383)	—	—	—	—	(383)
Issue costs	—	(1,626)	—	—	—	—	(1,626)
Issue costs attributed to							
equity component	—	18	—	—	—	—	18
Accretion for the period	—	118	208	338	325	294	1,283
Convertible debentures,							
end of year	\$ —	\$ 32,627	\$ 24,124	\$ 39,299	\$ 29,186	\$ 32,053	\$ 157,289

	Convertible debenture					
	5.60% ALDB.E	5.50% ALDB.D	5.30% ALDB.C	5.50% ALDB.B	6.25% ALDB.A	5.25% ALDB
Maturity date	March 31, 2025	Dec. 31, 2025	June 30, 2024	Sept. 30, 2021	March 31, 2019	June 30, 2020
Initial term	6 years	7 years	7 years	7 years	5 years	7 years
Conversion at option of shareholder at:	\$14.75/share	\$15.60/share	\$14.94/share	\$14.65/share	\$13.30/share	\$13.50/share
Interest payment dates	March 31, Sept. 30	June 30, Dec. 31	June 30, Dec. 31	March 31, Sept. 30	March 31, Sept. 30	June 30, Dec. 31
Redeemable at the company's option at par plus accrued interest, provided the weighted average trading price of common shares is not less than 125% of the conversion price from to	March 31, 2022 March 31, 2024	Dec. 31, 2021 Dec. 31, 2023	June 30, 2020 June 30, 2022	Sept. 30, 2017 Sept. 30, 2019	March 31, 2017 March 31, 2018	June 30, 2016 June 30, 2018
Redeemable at the company's option at par plus accrued interest and unpaid interest after	March 31, 2024	Dec. 31, 2023	June 30, 2022	Sept. 30, 2019	March 31, 2018	June 30, 2018

NOTE 10 – SHARE CAPITAL

The company is authorized to issue an unlimited number of common shares without par value. Common shares rank equally with each other and have no preference, conversion, exchange or redemption rights. Common shares participate pro rata with respect to any dividends paid, including distributions upon termination and dissolution.

In February 2019, the company completed an equity offering of 2,645,000 common shares, including the exercise in full of the over-allotment option, at a price of \$13.05 per share for gross proceeds of \$34,517.

The company has an optional dividend reinvestment plan (DRIP) for shareholders, whereby participants may reinvest cash dividends in additional common shares of the company at the volume weighted average price for five days prior to distribution, less a 2% discount. During the three and nine month period ended September 30, 2019, 81,457 and 245,338 common shares were issued under the Company's DRIP (three and nine month period ended September 30, 2018 – 72,521 and 236,678), using reinvested dividends of \$1,092 and \$3,225 (three and nine month period ended September 30, 2018 – \$947 and \$2,970). Shares issued under the DRIP are issued by the company from treasury (See Note 15 – Subsequent events).

Under the employee share purchase plan (ESPP), each participant may contribute up to an annual maximum to the ESPP, and CMCC matches 50% of the participant's contribution. Thus, the company does not bear any of the cost of the ESPP, as it is reimbursed by CMCC and the participants.

NOTE 11 – SHARE-BASED PAYMENTS

	Nine months ended September 30, 2019			Year ended December 31, 2018		
	Deferred share units	Income deferred share units	Total	Deferred share units	Income deferred share units	Total
Balance, beginning of period	68,667	9,056	77,723	81,667	11,502	93,169
Units granted	22,000	–	22,000	22,000	–	22,000
Units cancelled	–	–	–	(3,000)	(331)	(3,331)
Units earned	–	2,253	2,253	–	3,905	3,905
Common shares issued	(16,167)	(2,002)	(18,169)	(32,000)	(6,020)	(38,020)
Balance, end of period	<u>74,500</u>	<u>9,307</u>	<u>83,807</u>	<u>68,667</u>	<u>9,056</u>	<u>77,723</u>

Share compensation expense:

	Three months ended September 30		Nine months ended September 30	
	2019	2018	2019	2018
September 1, 2019 grant	\$ 15	\$ –	\$ 15	\$ –
September 1, 2018 grant	38	15	130	15
September 1, 2017 grant	13	30	47	115
September 1, 2016 grant	8	16	27	50
September 1, 2015 grant	3	7	9	21
September 1, 2014 grant	2	3	7	9
August 30, 2013 grant	1	1	3	4
	<u>\$ 80</u>	<u>\$ 72</u>	<u>\$ 238</u>	<u>\$ 214</u>

Grants are provided to directors and certain employees of the manager under the company's deferred share incentive plan ("DSIP"). The deferred share units vest annually over three years. Common shares are issued to participants on the vesting date of each tranche of deferred share units, unless a participant elects to defer the issuance. In addition, income deferred share units ("IDSU") are credited to holders of deferred share units granted before 2017 based upon dividends paid on common shares. The fair value of share-based compensation was based upon the volume weighted average market price of the common shares five days prior to the grant date of September 3, 2019 (\$13.72) and September 1, 2018 (\$13.71).

NOTE 12 – EARNINGS PER SHARE

	Three months ended		Nine months ended	
	September 30		September 30	
	2019	2018	2019	2018
Basic earnings per share –				
Numerator				
Net income and comprehensive income for the period	\$ 9,935	\$ 8,700	\$ 28,837	\$ 25,232
Denominator				
Weighted average common shares outstanding	<u>39,497,651</u>	<u>36,257,306</u>	<u>39,028,480</u>	<u>35,273,120</u>
Basic earnings per share	<u>\$ 0.25</u>	<u>\$ 0.24</u>	<u>\$ 0.74</u>	<u>\$ 0.72</u>
Diluted earnings per share –				
Numerator				
Net income and comprehensive income for the period	\$ 9,935	\$ 8,700	\$ 28,837	\$ 25,232
Interest on convertible debentures	<u>2,544</u>	<u>2,551</u>	<u>7,717</u>	<u>6,773</u>
Net income and comprehensive income for diluted earnings per share	<u>12,479</u>	<u>11,251</u>	<u>36,554</u>	<u>32,005</u>
Denominator				
Weighted average common shares outstanding	39,497,651	36,257,306	39,028,480	35,273,120
Convertible debentures	11,006,349	11,022,011	11,061,065	9,833,999
Deferred share incentive plan	74,174	62,019	71,841	69,983
Income deferred share units	<u>8,398</u>	<u>8,244</u>	<u>7,919</u>	<u>8,618</u>
Weighted average common shares outstanding – diluted basis	<u>50,586,572</u>	<u>47,349,580</u>	<u>50,169,305</u>	<u>45,185,720</u>
Diluted earnings per share	<u>\$ 0.25</u>	<u>\$ 0.24</u>	<u>\$ 0.73</u>	<u>\$ 0.71</u>

NOTE 13 – FINANCIAL INSTRUMENTS**(a) Classification of financial instruments**

Financial assets comprise mortgages receivable and are classified and measured at amortized cost. Financial liabilities comprise borrowings under credit facility, accounts payable and accrued liabilities, dividends payable, accrued convertible debenture interest and the liability component of convertible debentures. All financial liabilities are measured as other financial liabilities at amortized cost.

(b) Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between arm's length market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data or other means.
- Level 3 inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. All financial assets are classified and measured at amortized cost. Their carrying values approximate their fair values due to their relatively short-term maturities and because market interest rates have not fluctuated significantly since the date at which the loans were entered into. The fair value of borrowings under credit facility approximates book value since it bears interest at floating rates. The accounts payable and accrued liabilities, dividends payable and accrued convertible debenture interest carrying values approximate their fair values due to the short term nature of the items.

NOTE 13 – FINANCIAL INSTRUMENTS (continued)**(b) Fair value (continued)**

The fair value of convertible debentures at the time of issue is established using Level 2 inputs. The fair value of convertible debentures has been determined based on the closing prices of the convertible debentures on the TSX on the respective dates.

	September 30	December 31
	2019	2018
Convertible debentures		
Fair value	\$ 164,129	\$ 158,036
Less book value of equity component	<u>(1,868)</u>	<u>(1,675)</u>
	<u>\$ 162,261</u>	<u>\$ 156,361</u>
Book value of financial liability component	<u>\$ 156,137</u>	<u>\$ 157,289</u>

(c) Credit risk

Mortgages receivable and issued letters of credit are exposed to credit risk. Credit risk is the risk that a counterparty to a financial instrument will fail to discharge its obligation or commitment, resulting in a financial loss to the company. The maximum exposure to credit risk related to mortgages receivable, including letters of credit outstanding, at September 30, 2019 is \$744,227 (December 31, 2018 – \$691,534).

The company mitigates the credit risk by maintaining strict credit policies including due diligence processes, credit limits, documentation requirements, review and approval of new and renewed mortgages receivable by the board of directors or a subgroup thereof, quarterly review of the entire portfolio by the board of directors, and other credit policies approved by the board of directors. Credit risk is approved by the board of directors. These credit policies and processes have been consistently applied throughout the two year period ended September 30, 2019.

All mortgages receivable are secured by the underlying real estate, plus other credit enhancements, which may include guarantees from the borrowers, personal guarantees from the borrower's shareholders and/or cross guarantees from related entities. The quality of the mortgage collateral is primarily driven by the location and type of underlying property and type of mortgage receivable. For further information, refer to Note 5(a) and to the "Investment Portfolio" section of the Management's Discussion and Analysis for the quarter ended September 30, 2019. The company foreclosed on one property during the 2018 year (See Note 6 – Foreclosed properties). Management continuously monitors real estate values and considers there to have been no significant changes in the quality of the collateral underlying the remaining mortgage portfolio.

At September 30, 2019, the largest borrower group accounted for 11.1% of mortgages receivable (December 31, 2018 – 11.7%). See Note 5(a) and Note 5(b) for a breakdown of mortgages receivable and provision for mortgage losses by property type.

(d) Liquidity risk

Liquidity risk is the risk that the company will not be able to meet its obligations when due. The primary sources of liquidity risk are the requirements to fund commitments for new mortgages, advances on existing mortgages receivable, as well as obligations under the company's credit facility. The company's liquidity risk is managed on an ongoing basis in accordance with the policies and procedures in place that reduce the risk to an acceptable level. Policies and procedures include continuous monitoring of expected cash flows, reviewing credit requirements with the company's bankers, issuing convertible debentures or common shares in the public markets from time to time as required, and staggering the maturities of convertible debentures when they are issued. From time to time the company has arranged temporary increases in its credit facility with its banks in order to manage liquidity requirements, and expects to be able to continue to do so in the future if required. The company's significant financial liabilities include borrowings under credit facility, accounts payable and accrued liabilities, dividends payable, accrued convertible debenture interest and the liability component of convertible debentures. The borrowings under credit facility are drawn upon as required to discharge accounts payable and accrued liabilities as well as to pay out dividends on a monthly basis. The company's agreement with the lender is that the operating line will not be called provided that all covenants are met and that any significant excess cash is used to pay down the borrowings under credit facility.

NOTE 13 – FINANCIAL INSTRUMENTS (continued)**(d) Liquidity risk (continued)**

September 30, 2019	Carrying value	Contractual cash flow	Within 1 year	1 to 3 years	3 to 5 years	More than 5 years
Borrowings under credit facility ¹	\$165,304	\$174,169	\$ 6,940	\$167,229	\$ –	\$ –
Accounts payable and accrued liabilities	1,619	1,619	1,619	–	–	–
Accrued convertible debenture interest	1,236	1,236	1,236	–	–	–
Dividends payable	2,966	2,966	2,966	–	–	–
Convertible debentures ²	156,137	180,298	77,599	34,662	68,037	–
Total	327,262	360,288	90,360	201,891	68,037	–
Unadvanced mortgage commitments ³	–	79,172	79,172	–	–	–
Total contractual liabilities	\$327,262	\$439,460	\$169,532	\$201,891	\$ 68,037	\$ –

Notes:

(1) Includes interest assuming the outstanding balance is not repaid until maturity on January 11, 2021.

(2) The 5.25% debentures are assumed to be repaid in the fourth quarter of 2019; 5.50% 2021 debentures are assumed to be repaid in the fourth quarter of 2019; 5.30% debentures are assumed to be repaid June 30, 2022; 5.50% 2025 debentures are assumed to be repaid December 31, 2023 and 5.60% debentures are assumed to be repaid March 31, 2024.

(3) Unadvanced mortgage commitments include additional funds on existing mortgages receivable and new mortgage commitments. The experience of the company has been that a portion of the unadvanced amounts on existing mortgages receivable will never be drawn.

As at September 30, 2019, management considers that it has adequate procedures in place to manage liquidity risk.

(e) Interest rate risk

The company is exposed to interest rate risk in that an increase in interest rates will result in increased interest expense due to its borrowings under credit facility being set at a variable rate and mortgages receivable are set at a combination of fixed and variable rates. The financial structure of the company results in relatively moderate interest rate risk because a majority of the company's financing is through common shares and convertible debentures, with a moderate amount of borrowings under the credit facility that bear floating interest rates.

If interest rates on debt had been one percentage point higher (lower) during the nine month period ended September 30, 2019, income and comprehensive income would have been reduced (increased) by approximately \$408 during the period, assuming that no changes had been made to the interest rates at which new mortgage loans were entered into. However, if new mortgage loans had been entered into at higher (lower) interest rates, the resulting reduction of income and comprehensive income would have been less than (greater than) \$408.

(f) Currency risk

Currency risk is the risk that the value of financial assets and financial liabilities will fluctuate due to changes in foreign exchange rates. The company is not exposed to currency risk as all assets and liabilities are denominated in Canadian funds.

NOTE 14 – CAPITAL MANAGEMENT

The company defines capital as total debt plus shareholders' equity, as shown below:

	September 30	December 31
	2019	2018
Borrowings under credit facility	\$ 164,785	\$ 147,846
Convertible debentures	156,137	157,289
Total debt	320,922	305,135
Shareholders' equity	427,558	387,306
Capital employed	<u>\$ 748,480</u>	<u>\$ 692,441</u>

The company's objectives for managing capital are to preserve shareholders' equity, provide shareholders with stable dividends, and to use leverage in a conservative manner to improve return to shareholders. The company finances growth of its portfolio by issuing common shares and debt. In addition, a small amount of equity is raised every month through a dividend reinvestment plan for shareholders and the employee share purchase plan.

As bank borrowings increase, the company could expect to raise further funds through public offerings of convertible debentures or common shares, and through private placements of debt. The borrowings under credit facility are subject to external covenants as set out in Note 7 – Credit facility. There has been no change in the company's capital management objectives since the prior period.

NOTE 15 – SUBSEQUENT EVENTS

On October 8, 2019, the company announced it had entered into an underwriting agreement with a syndicate of underwriters pursuant to which the underwriters would purchase 1,120,000 common shares of the company at a price of \$13.40 per share for gross proceeds of \$15,008. The company also granted to the underwriters an over-allotment option to purchase up to an additional 168,000 common shares at the issue price, exercisable in whole or in part at any time for a period of up to 30 days following the closing of the offering. Gross proceeds of \$17,259 were received by the company on October 18, 2019 which included exercise of the over-allotment option in full.

On October 8, 2019, the company also announced it had agreed to sell 746,300 common shares to an entity jointly controlled by two existing shareholders on a non-brokered private placement basis at a price of \$13.40 per share for gross proceeds of \$10,000. Gross proceeds of \$10,000 were received by the company on October 18, 2019.

On October 12, 2019, the company issued 26,989 common shares (\$362) to shareholders under its dividend reinvestment plan.