Condensed Interim Financial Statements

# TREZ CAPITAL MORTGAGE INVESTMENT CORPORATION

For the three months ended March 31, 2018 and 2017
(Unaudited)

The accompanying unaudited condensed interim financial statements of the Company as at March 31, 2018 have been prepared in accordance with the International Accounting Standard 34 – Interim Financial Reporting as issued by the International Accounting Standards Board and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements. The Company's auditor will perform an audit of the December 31, 2018 Financial Statements

# TREZ CAPITAL MORTGAGE INVESTMENT CORPORATION

Condensed Interim Statements of Financial Position
(Unaudited)

| | Notes | | As at March 31, 2018 | | As at December 31, 2017 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Investments in mortgages | 4 | $ | 35,555,801 | $ | 48,133,697 |
| Cash | | | 17,701,666 | | 7,219,217 |
| Cash held in trust | | | 266,620 | | - |
| Amounts receivable | | | 100,000 | | 100,000 |
| Total assets | | $ | 53,624,087 | $ | 55,452,914 |
| **Liabilities and Shareholders' Equity** | | | | | |
| Dividends payable | 5 | $ | 18,554,247 | $ | 691,726 |
| Accounts payable and accrued liabilities | | | 105,517 | | 89,725 |
| Management fee payable | 6, 8 | | 245,010 | | 68,206 |
| Incentive fee provision | 7, 8 | | 486,415 | | 486,416 |
| Total liabilities | | | 19,391,189 | | 1,336,073 |
| Shareholders' equity | 5 | | 34,232,898 | | 54,116,841 |
| Total liabilities and shareholders' equity | | $ | 53,624,087 | $ | 55,452,914 |

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

# TREZ CAPITAL MORTGAGE INVESTMENT CORPORATION

Condensed Interim Statements of Income and Comprehensive Income
(Unaudited)

| | Notes | For the three months ended March 31, 2018 | For the three months ended March 31, 2017 |
|---|---|---|---|
| Revenue: | | | |
| Interest and fee income | | $ 447,747 | $ 1,595,112 |
| | | 447,747 | 1,595,112 |
| Expenses: | | | |
| Management fees | 6,8 | 176,804 | 394,786 |
| Incentive fees | 7 | - | 7,135 |
| General and administrative expenses | | 133,961 | 163,795 |
| Realized mortgage investment loss | 4 | - | 1,921,749 |
| Fair value adjustment on investment in mortgages | 4 | - | (1,774,863) |
| | | 310,765 | 712,602 |
| Income from operations | | 136,982 | 882,510 |
| Income tax: | | | |
| Deferred income tax recovery | | - | 134,700 |
| Net income and comprehensive income for the period | | $ 136,982 | $ 1,017,210 |
| Earnings per share: | 9 | | |
| Basic and diluted | | $ 0.01 | $ 0.07 |

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

# TREZ CAPITAL MORTGAGE INVESTMENT CORPORATION

Condensed Interim Statements of Changes in Shareholders' Equity
(Unaudited)

**Three months ended March 31, 2018**

| | Notes | Common shares | Deficit | Total |
|---|---|---|---|---|
| Shareholders' equity at December 31, 2017 | | $ 122,789,548 | $ (68,672,707) | $ 54,116,841 |
| Net income and comprehensive income for the period | | - | 136,982 | 136,982 |
| Dividends to shareholders | 5 | - | (19,936,419) | (19,936,419) |
| Repurchase of shares | 5 | (84,506) | - | (84,506) |
| Shareholders' equity at March 31, 2018 | | $ 122,705,042 | $ (88,472,144) | $ 34,232,898 |

**Three months ended March 31, 2017**

| | Notes | Common shares | Deficit | Total |
|---|---|---|---|---|
| Shareholders' equity at December 31, 2016 | | $ 160,345,187 | $ (21,781,183) | $ 138,564,004 |
| Net income and comprehensive income for the period | | - | 1,017,210 | 1,017,210 |
| Dividends to shareholders | 5 | - | (2,394,205) | (2,394,205) |
| Repurchase of shares | 5 | (35,000,000) | - | (35,000,000) |
| Shareholders' equity at March 31, 2017 | | $ 125,345,187 | $ (23,158,178) | $ 102,187,009 |

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

# TREZ CAPITAL MORTGAGE INVESTMENT CORPORATION

Condensed Interim Statements of Cash Flows
(Unaudited)

| | For the three months ended March 31, 2018 | For the three months ended March 31, 2017 |
|---|---|---|
| Cash provided by (used in): | | |
| Operations: | | |
| Net income and comprehensive income for the period | $ 136,982 | $ 1,017,210 |
| Non-cash adjustments: | | |
| Interest income earned | (447,747) | (1,595,106) |
| Incentive fees | - | 7,135 |
| Realized mortgage investment loss | - | 1,921,749 |
| Fair value adjustment on investments in mortgages | - | (1,774,863) |
| Deferred Income Tax Recovery | - | (134,700) |
| Incentive fee paid | - | (30,849) |
| Interest received | 511,215 | 1,402,507 |
| | 200,450 | 813,083 |
| Changes in non-cash operating items: | | |
| Management fees payable | 176,804 | (44,071) |
| Accounts payable and accrued liabilities | 15,792 | (87,228) |
| Cash flows from operating activities before undernoted | 393,046 | 681,784 |
| Funding of investments in mortgage | (31,707) | (370,146) |
| Principal repayments on investments in mortgages | 12,546,134 | 4,631,645 |
| | 12,907,473 | 4,943,283 |
| Financing: | | |
| Cash held in trust | (266,620) | - |
| Repurchase of shares | (84,506) | (35,000,000) |
| Dividends to shareholders | (2,073,898) | (2,640,048) |
| | (2,425,024) | (37,640,048) |
| Increase (decrease) in cash during the period | 10,482,449 | (32,696,765) |
| Cash and cash equivalents, beginning of period | 7,219,217 | 45,543,146 |
| Cash and cash equivalents, end of period | $ 17,701,666 | $ 12,846,381 |

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

## 1. Operations:

Trez Capital Mortgage Investment Corporation (the "Company") is a non-bank lender providing residential and commercial short-term bridge and conventional real estate financing, including construction and mezzanine mortgages. Trez Capital Mortgage Investment Corporation was incorporated on April 18, 2012 under the Canada Business Corporations Act. The Company is managed by Trez Capital Fund Management Limited Partnership (the "Manager"). The Mortgage Broker for the Company is Trez Capital Limited Partnership.

The shares of the Company are publicly listed on the Toronto Stock Exchange under the symbol TZZ. The Company is a Canadian mortgage investment corporation and the registered office of the Company is 1700-745 Thurlow Street, Vancouver, BC, V6E 0C5.

On May 9, 2016, the Special Committee of the Board of Directors announced the completion of its strategic review process and a plan for the orderly wind-up of the Company's assets and the return of capital to shareholders (the "Orderly Wind-Up Plan"). The Orderly Wind-Up Plan in its entirety was approved by shareholders at the Company's annual and special meeting of shareholders held on June 16, 2016.

Under the Orderly Wind-Up Plan, the Company has ceased originating new loans and all mortgage renewal activity, subject to contractual rights, and its assets are being monetized over time. Management has estimated the value of its mortgage portfolio based on its best judgment as to the eventual cash flows that it expects to receive in the normal course of business. Eventual cash flows could vary by a material amount as outlined in note 5. The Orderly Wind-Up Plan has been implemented and capital is being returned to shareholders under the supervision of the Board of Directors with the assistance of the Manager. The fees to the Manager have been restructured as outlined in notes 6 and 7.

In addition, an Investment & Capital Management Committee was formed and its mandate is: (i) the management of the normal course issuer bid ("NCIB"); and (ii) the management and oversight of the Orderly Wind-Up Plan.

In the first quarter of 2017, as a result of a cash outlay in relation to cancellation of shares and monetization of residential mortgages related to the Orderly Wind–Up Plan, the Company ceased to maintain its status as a Mortgage Investment Corporation pursuant to the Income Tax Act (Canada) and consequently is no longer able to deduct dividends paid to shareholders from its taxable income. However, the Company expects its non-capital losses carried forward from prior years are sufficient to offset any future taxable income.

## 2. Basis of presentation:

(a) Statement of compliance:

The condensed interim financial statements have been prepared in compliance with International Accounting Standard 34, *Interim Financial Statements*. The accompanying condensed interim financial statements should be read in conjunction with the notes to the Company's audited financial statements for the year ended December 31, 2017 which have

**2. Basis of presentation (continued):**

(a) Statement of compliance (continued):

been prepared in accordance with International Financial Reporting Standards ("IFRS"), since they do not contain all disclosures required by IFRS for annual financial statements. These condensed interim financial statements reflect all normal and recurring adjustments which are, in the opinion of the Manager, necessary for a fair presentation of the respective interim periods presented.

These condensed interim financial statements were approved by the Board of Directors on May 9, 2018.

(b) Functional and presentation currency:

These financial statements are presented in Canadian dollars, which is the functional currency of the Company.

(c) Basis of measurement:

These condensed interim financial statements have been presented on a historical cost basis, except for investments in mortgages which are measured at fair value.

(d) Use of estimates and judgments:

In preparing these interim financial statements, management has made judgements and estimates that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those described in the last annual financial statements, except for new judgements and estimation uncertainty related to the application of IFRS 9, which is described in Note 3.

The most significant estimates that the Manager is required to make relate to the fair value of the investments in mortgages.

**3. Changes in significant accounting policies:**

Except as described below, the accounting policies applied in these interim financial statements are the same as those applied in the Company's audited financial statements as at and for the year ended December 31, 2017.

The changes in accounting policies are also expected to be reflected in the Company's financial statements for the year ended December 31, 2018.

The Company has adopted IFRS 9 *Financial Instruments* from January 1, 2018. A number of other new standards are effective from January 1, 2018 but they do not have a material effect on the Company's financial statements.

**3. Changes in significant accounting policies (continued):**

(a) IFRS 9 Financial Instruments:

IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement.*

There was no impact of transition to IFRS 9 on the opening fair value of loss provisions and retained earnings of the Company.

(i) Classification and measurement of financial assets and liabilities:

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans and receivables and available for sale.

The adoption of IFRS 9 has not had a significant effect on the Company's accounting policies related to financial liabilities. The impact of IFRS 9 on the classification and measurement of financial assets is set out below.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost; Fair value through other comprehensive income (FVOCI)-debt investment; FVOCI-equity investment; or fair value through profit or loss (FVPTL). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL.

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Though investments in mortgages meet the above requirements, the Company has designated these as FVTPL. The implementation of the new measurement categories has had no significant effect on the value of the instruments. The following table summarizes the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company's financial assets as at January 1, 2018.

**3. Changes in significant accounting policies (continued):**

(i) Classification and measurement of financial assets and liabilities (continued):

| Classification | Old (IAS 39) | New (IFRS 9) |
|---|---|---|
| **Financial assets:** | | |
| Investments in mortgages | FVTPL | FVTPL |
| Cash | Loans and receivables | Amortized cost |
| Accounts receivable | Loans and receivables | Amortized cost |

ii) Impairment of financial assets:

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ (ECL) model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IFRS 39.

The Company’s financial assets at amortized cost consist of accounts receivable and cash. Investments in mortgages are classified as FVTPL. As part of the assessment of fair value, the Manager routinely reviews each mortgage for changes in credit risk to determine whether or not the fair value of a mortgage should be adjusted for the change in credit risk; therefore IFRS 9 does not impact investments in mortgages as they are already assessed as at fair value.

Under IFRS 9, loss allowances are measured on either of the following bases:

- 12 month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date
- Lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

The Company has elected to measure loss allowances for accounts receivables at an amount equal to lifetime ECLs. When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information analysis, based on the Company’s historical experience and informed assessment of forward looking information.

There was no impact on the assets of the Company measured at amortized cost and no impairments were recorded.

## 4. Investments in mortgages:

(a) Mortgages:

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Property type | Number | Amount | Number | Amount |
| Residential | 4 | $ 18,709,905 | 7 | $ 27,256,040 |
| Office | 1 | 20,454,036 | 2 | 24,422,329 |
| | 5 | 39,163,941 | 9 | 51,678,369 |
| Accrued interest and fees receivable | | 228,360 | | 291,828 |
| Fair value adjustments on investments in mortgages | | (3,836,500) | | (3,836,500) |
| | | $ 35,555,801 | | $ 48,133,697 |

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Property location | Number | Amount | Number | Amount |
| Alberta | - | $ - | 1 | $ 4,000,000 |
| Ontario | 3 | 26,800,450 | 3 | 26,768,743 |
| Nova Scotia | 2 | 12,363,491 | 5 | 20,909,626 |
| | 5 | $ 39,163,941 | 9 | $ 51,678,369 |

**4. Investments in mortgages (continued):**

(a) Mortgages (continued):

The mortgages are secured by the real property to which they relate, bear interest at a weighted average interest rate of 2.3% (December 31, 2017 – 3.4%) and mature prior to end of 2019. The mortgage agreements stipulate a minimum interest rate and a variable interest rate based on the Prime Rate for Canadian Dollar Loans established by HSBC ("Prime Rate"). Current premium to the Prime Rate ranges from plus 3.6% to plus 3.8% (in 2017 between 1.8% to 6.5%), with the current minimum rates ranging from 7.0% to 7.3% (in 2017 between 5.0% to 9.7%), excluding mortgages in default.

Principal repayments based on contractual maturity dates are as follows:

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Number | Amount | Number | Amount |
| Past due | 2 | $ 6,362,007 | 2 | $ 6,362,007 |
| 2018 | - | - | 4 | 12,247,822 |
| 2019 and beyond | 3 | 32,801,934 | 3 | 33,068,540 |
| | 5 | $ 39,163,941 | 9 | $ 51,678,369 |

All mortgages are conventional uninsured mortgages which contain a prepayment option, whereby the borrower may repay the principal at any time prior to maturity without penalty or yield maintenance, subject to minimum interest provisions.

As part of the assessment of fair value, the Manager routinely reviews each mortgage for changes in credit risk to determine whether or not fair value of a mortgage should be adjusted for the change in credit risk.

As at March 31, 2018, the Manager estimated the changes in credit risk for its mortgages, including mortgages in default as explained below, and have recognized unrealized losses on its investment in fair value of mortgages totaling $3,836,500 (December 31, 2017 - $3,836,500).

(b) Default or past due mortgages:

A mortgage is considered in default when a payment has not been received by the contractual due date, or a term in the mortgage agreement has been breached.

The following mortgages were in default or past due as at March 31, 2018:

(*i*) Two mortgages with the same borrower with an aggregate carrying amount of $6,362,007 (December 31, 2017 - $6,362,007) were not performing and were past due on their maturity dates. Subsequent to the year end, the borrower made an offer which the Manager accepted where the borrower made a $600,000 loan repayment in January 2018, and agreed to repay the loan in full with interest by the end of March. The borrower asked for an extension of the March date to allow additional time to arrange alternative financing, an expected repayment date of May has been set. Currently there is a fair value provision on the properties totaling $441,500 (December 31, 2017 - $441,500).

## 4. Investments in mortgages (continued):

(b) Default or past due mortgages (continued):

(*ii*) In the second quarter of 2017, a mortgage went into default when a borrower breached the terms of a forbearance agreement. The Manager took legal action and a receiver was appointed. The property was marketed for sale and bids were accepted in Q1 of 2018. Management reviewed the offers and is currently pursuing and negotiating the most attractive offer. The total fair value adjustment recorded on the property is $3,395,000 (December 31, 2017 - $3,395,000).

## 5. Class A shares:

As at March 31, 2018 and December 31, 2017, there were an unlimited number of Class A common shares and an unlimited number of Class B common shares authorized. As at March 31, 2018, there were 11,843,491 Class A shares outstanding (December 31, 2017 – 11,864,941 Class A Shares).

The holders of the Class A shares are entitled to receive dividends as and when declared by the Board of Directors of the Company.

(a) Dividends:

On March 23, 2018, the Company announced that its board of directors suspended regular monthly distribution commencing with the April 2018 distribution which would otherwise be paid on May 15, 2018. The decision to suspend distribution was premised on a review of the last remaining mortgages and cash requirements. Also at this time the Company announced that its board of directors had declared a special distribution of $1.52 per Class A share. Pursuant to the Orderly Wind-up Plan, the distribution will constitute a return of capital and will be paid on April 20, 2018 to holders of Class A shares of record at the close of business on April 9, 2018. The distribution is estimated to total $17,863,771.

All dividends have constituted a return of capital since and including the distribution paid on August 15, 2016.

For the three months ended March 31, 2018, the Company had declared regular monthly dividends totaling $2,072,648 or $0.175 per share and special distributions of 17,863,771 or $1.52 per share (December 31, 2017 - $8,744,490 or $0.70 per share) of which $18,554,227 is payable at March 31, 2018 (December 31, 2017 - $691,726).

**5. Class A shares (continued):**

(a) Dividends (continued):

The board anticipates making further special distribution as the mortgage portfolio matures or mortgages are sold, subject to reasonable expected operating expenditures.

(b) Normal course issuer bid:

On May 17, 2017 the Company announced it received approval from the Toronto Stock Exchange ("TSX") for the renewal of its normal course issuer bid ("NCIB"), which enables it to purchase, from time to time over a period of 12 months up to an aggregate maximum of 1,210,345 Class A Shares, representing approximately 10% of its issued and outstanding Class A shares. In aggregate, under the current NCIB, the Company purchased 439,880 Class A shares at a weighted average price of $6.00 per share of which 21,450 Class A share were purchased during the three months ended March 31, 2018 at a weighted average price of $3.94 per share.

Under the previous NCIB that commenced on May 19, 2016 and expired on May 18, 2017, the Company purchased 736,116 Class A Shares at a weighted average price of $8.25 per share.

Prior to that, pursuant to a bid that expired on January 11, 2016, the Company acquired a total of 314,900 shares at a weighted average price of $6.65 per share.

All purchases under the NCIB were made through the facilities of the TSX at market prices and in accordance with the rules of the TSX.

(c) Substantial issuer bids ("SIB"):

On July 21, 2016, the Company announced that its Board of Directors had authorized a SIB to purchase for cancellation Class A shares ("Shares") for an aggregate purchase price not to exceed $20 million (the "Offer"). On August 15, 2016, the Company announced the commencement of the Offer with revised terms. Specifically, the Company announced that pursuant to the Offer, the Company would offer to purchase up to $17 million of its Shares by way of a modified "Dutch auction" whereby shareholders were able to tender all or a portion of their Shares (i) at a price not more than $8.70 and not less than $8.50 per Share, in increments of $0.05 per Share; or (ii) without specifying a purchase price, in which case the Shares were to be purchased at the purchase price to be determined by the Board of Directors in accordance with the terms of the Offer.

On September 20, 2016, the Company repurchased 2,000,000 shares at a price of $8.50 per share under SIB for a total consideration of $17,000,000. The shares purchased under the bid represented 10.7% of the shares outstanding as at August 15, 2016.

On December 5, 2016, the Company announced that its Board of Directors had authorized a second substantial issuer bid ("SIB") to purchase for cancellation of Shares for an aggregate purchase price not to exceed $35 million (the "Second Offer"). Pursuant to the second Offer, the Company would offer to purchase up to $35 million of its Shares by way of a modified "Dutch auction" whereby shareholders may tender all or a portion of their Shares (i) at a price not more than $8.30 and not less than $8.00 per Share, in increments of $0.05 per Share; or

## 5. Class A shares (continued):

(c) Substantial issuer bids ("SIB") (continued):

(ii) without specifying a purchase price, in which case their Shares will be purchased at the purchase price to be determined by the Board in accordance with the terms of the Offer.

On January 10, 2017, the Company issued a circular offering to purchase for cancellation Class A shares for an aggregate purchase price not to exceed $35 million. Pursuant to the Second Offer, the Company purchased 4,216,867 Shares at $8.30 per Share for total consideration of $35,000,000 on February 14, 2017. As a result of the purchase, the Company ceased to maintain its status as a mortgage investment corporation pursuant to the Income Tax Act (Canada).

## 6. Management fees:

The Manager is responsible for the day-to-day operations, including administration of the Company's mortgage portfolio. Pursuant to the Management Agreement dated May 25, 2012, (amended November 30, 2013) the Manager is entitled to a fee of 1.25% per annum of the gross assets of the Company (the "Management Fee"), plus applicable taxes, calculated monthly and paid monthly in arrears.

Prior to approval on June 16, 2016 of the Orderly Wind-Up Plan by the shareholders, the Manager was also entitled to a performance fee. In any calendar year where the Company had a net return in excess of the Hurdle Rate (Hurdle Rate is defined as the average two-year Government of Canada Bond Yield for the 12 month period then ended plus 450 basis points), the Manager was entitled to receive from the Company a performance fee equal to 20% of the net return of the Company over the Hurdle Rate (the "Performance Fee"). The Manager calculated the final Performance Fee in respect of a completed calendar year based on the audited financial statements for that year. The Performance Fee in respect of a calendar year was payable to the Manager within 15 days of the issuance of the Company's audited financial statements for that year.

As part of the Orderly Wind-Up Plan, the Manager had agreed to waive the performance fee beginning May 1, 2016. For the three months ended March 31, 2018 the fees related to the performance fee were nil (2017 - nil) and payable of nil (December 31, 2017 - nil).

## 7. Incentive fees:

The Manager has agreed to assist in the Orderly Wind-Up Plan and to certain amendments to the Company's management agreement to facilitate the Orderly Wind-Up Plan. Pursuant to those amendments, the Manager has agreed to provide the full asset management services necessary to support the Orderly Wind-Up Plan. In addition to waiving the Performance Fee, the Manager will also waive its rights, if any, to early termination fees in exchange for an incentive fee calculated as the greater of the following:

## 7. Incentive fees (continued):

(i) 20% of the amount by which the sum of:

(A) The aggregate realized proceeds: and

(B) The Company's unrestricted cash as at April 30, 2016 Exceeds $163,509,009; and

(ii) $1,000,000.

Aggregate realized proceeds are defined as the amount of proceeds on the sale, repayment or maturity of mortgages or any other transaction resulting in the monetization of the mortgages under the Orderly Wind-Up Plan.

Unrestricted cash is defined as the amount of Company's cash derived from the proceeds on the sale, repayment or maturity of mortgages or any other transaction resulting in the monetization of the mortgages on or prior to April 30, 2016.

At March 31, 2018, the estimated total amount of the incentive fee is $1,233,732 (December 31, 2017 - $1,233,732) of which $747,317 (2017 - $747,317) has been paid with the future incentive fee obligation totaling $486,415. This amount is a percentage of the lower threshold level, determined by adding the sum of total realized proceeds received to the period end, plus the unrestricted cash as at April 30, 2016, divided by the upper threshold. As at March 31, 2018, cumulative realized proceeds totaled $129,853,641 (December 31, 2017 - $117,307,507).

A reconciliation of incentive fee provision for the three months ended March 31, 2018 is as follows:

| | | |
|---|---|---|
| Opening balance, December 31, 2017 | $ | 486,416 |
| Increase in provision | | - |
| Incentive fees realized & paid | | - |
| Incentive fee provision, March 31, 2018 | $ | 486,416 |

## 8. Related party transactions and balances:

The following are related party transactions not disclosed elsewhere in these financial statements:

(a) The Company is managed by the Manager, a related party by virtue of common management. Pursuant to the Management Agreement referred to in note 6, during the three months ended March 31, 2018 the Company incurred management fees in the amount of $176,804 (March 31, 2017 - $394,786). At March 31, 2018, $245,010 (December 31, 2017 - $68,206) in management fees and $76,731 of incentive fees were outstanding.

(b) As at March 31, 2018, the Company has co-invested in three mortgage investments (December 31, 2017 – four mortgage investments) with other funds managed by the Manager. The total amount of the mortgage investment is $37,656,448 of which the Company's share is $32,801,934 (December 31, 2017 - $42,963,687 of which the Company's share was $32,961,499). During the three months ended March 31, 2018, the Company purchased investments in mortgages from entities under common management of $nil (2017 - nil) and sold investments in mortgages of $4,000,000 (2017 - $7,822,416) to entities under common management.

**8. Related party transactions and balances (continued):**

(c) The Company had one mortgage, where property securing the mortgage was acquired by a related entity after the previous owner defaulted on the mortgage in October 2015. The loan was sold to a third party in the fourth quarter of 2017 (December 31, 2016 - $5,942,846). For the three months ended March 31, 2018, the Company recognized nil (March 31, 2017 - $147,996) in interest income from the affiliate of the Manager and has accrued interest receivable of nil as at March 31, 2018 (December 31, 2017 - nil).

(d) The Company had one mortgage with an entity affiliated with the Manager which was repaid in the fourth quarter of 2017 (December 31, 2016 - $1,357,277). The mortgage, which was previously in default, was initially assigned to an affiliate of the Manager of the Company on October 1, 2015. Subsequently, another affiliate of the Manager obtained legal ownership title to the remaining properties on April 3, 2017. For the three months ended March 31, 2018, the Company recognized nil (2017 - $29,013) in interest income from the affiliate of the Manager and had accrued interest receivable of nil (December 31, 2017 - nil).

All related party transactions are measured at the amount of consideration established and agreed to by the related parties. The Company invests in mortgages on a participation basis with parties related to the Manager. Title to mortgages are held by Computershare Canada, (the “Custodian”), on behalf of the beneficial owners of the mortgages. In addition, certain Mortgage Broker duties are performed by the Mortgage Broker. The Manager and the Mortgage Broker are related to the Company through common management.

**9. Earnings per share:**

(a) Basic and diluted earnings per share:

Basic and diluted earnings per share are calculated by dividing net income attributable to common shares by the weighted average number of common shares during the three month period ended March 31, 2018 and 2017:

**Three months ended March 31, 2018:**

| | | |
|---|---|---|
| Total income and comprehensive income for the period | $ | 136,982 |
| Earnings attributable to common shares | $ | 136,982 |
| Weighted average number of common shares (basic and diluted) | | 11,857,458 |
| Earnings per share (basic and diluted) | $ | 0.01 |

## 9. Earnings per share (continued):

(a) Basic and diluted earnings per share (continued):

**Three months ended March 31, 2017:**

| | | |
|---|---|---|
| Total income and comprehensive income for the period | $ | 1,017,210 |
| Earnings attributable to common shares | $ | 1,017,210 |
| Weighted average number of common shares (basic and diluted) | | 13,688,993 |
| Earnings per share (basic and diluted) | $ | 0.07 |

## 10. Fair value of financial instruments and risk management:

(a) Fair value of financial instruments:

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. The Company's investments in mortgages are carried at fair value in the financial statements.

The following table shows a hierarchy for disclosing fair value based on inputs used to value the Company's investments. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy are as follows:

- Quoted prices (unadjusted) in active markets for identical assets and liabilities (Level 1);
- Inputs other than quoted prices in active markets included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The Company's assets recorded at fair value have been categorised as follows:

| March 31, 2018 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Investments in mortgages | $ - | $ - | $ 35,555,801 | $ 35,555,801 |

**10. Fair value of financial instruments and risk management (continued):**

(a) Fair value of financial instruments (continued):

| December 31, 2017 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Investments in mortgages | $ - | $ - | $ 48,133,697 | $ 48,133,697 |

There were no transfers between Level 1 and Level 2 during the period.

A reconciliation of Level 3 assets at March 31, 2018 is as follows:

| | |
|---|---|
| Opening balance | $ 48,133,697 |
| Funding of investment in mortgages | 31,707 |
| Accrued interest and fees receivable | (63,469) |
| Principal repayments or sold investments in mortgages | (12,546,134) |
| Investment in mortgages, March 31, 2018 | $ 35,555,801 |

A reconciliation of Level 3 assets at December 31, 2017 is as follows:

| | |
|---|---|
| Opening balance | $ 94,868,684 |
| Funding of investment in mortgages | 5,956,742 |
| Interest capitalized to investment in mortgages | 642,806 |
| Change in accrued interest and fees receivable | (517,680) |
| Principal repayments on investment in mortgages | (51,553,324) |
| Fair value adjustments on investments in mortgages | 7,599,749 |
| Realized mortgage investment loss | (8,622,490) |
| Reclassification to amounts receivable | (240,790) |
| Investment in mortgages, December 31, 2017 | $ 48,133,697 |

**10. Fair value of financial instruments and risk management (continued):**

(a) Fair value of financial instruments (continued):

The key valuation techniques used in measuring the fair values of default mortgages include:

| Valuation technique | Significant unobservable inputs | Inter-relationship between significant unobservable inputs and fair value measurement |
|---|---|---|
| Discounted cash flow model | The adjusted credit risk premium based on the change in the borrower's credit risk utilizing the knowledge gained since the loan was originated | The estimate of fair value would increase (decrease) if:<br>- The term of the mortgage was shortened (or extended)<br>- The adjusted risk premium rate was lower (higher) |
| | Assessment of fair value of collateral of mortgages in default where payments expected from sale of property. | - Estimated fair value of collateral was (lower) higher |
| | The projected length of time the mortgage will remain in default without the underlying property being liquidated or foreclosed upon. | |