MCAN MORTGAGE CORPORATION

MANAGEMENT'S DISCUSSION AND

ANALYSIS OF OPERATIONS

DECEMBER 31, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

This Management's Discussion and Analysis of Operations ("MD&A") should be read in conjunction with the consolidated balance sheets and accompanying notes as at December 31, 2016 and December 31, 2015 and the consolidated statements of income, changes in shareholders' equity, comprehensive income and cash flows for the years then ended, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") and presented in Canadian currency. This MD&A has been presented as at February 23, 2017.

Additional information regarding MCAN Mortgage Corporation ("MCAN", the "Company" or "we"), including copies of our continuous disclosure materials such as the Annual Information Form, are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com and our website at www.mcanmortgage.com.

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A CAUTION ABOUT FORWARD-LOOKING INFORMATION AND STATEMENTS

This MD&A contains "forward-looking statements" within the meaning of applicable Canadian securities laws. The words "may," "believe," "will," "anticipate," "expect," "planned," "estimate," "project," "future," and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters identify forward-looking statements. Such statements reflect management's current beliefs and are based on information currently available to management. The forward-looking statements in this MD&A include, among others, statements and assumptions with respect to:

- the current business environment and outlook;
- possible or assumed future results;
- ability to create shareholder value;
- business goals and strategy;
- the stability of home prices;
- effect of challenging conditions on us;
- factors affecting our competitive position within the housing markets;
- the price of oil and its impact on housing markets in Western Canada;
- sufficiency of our access to capital resources; and
- the timing of the effect of interest rate changes on our cash flows.

The material factors or assumptions that were identified and applied by us in drawing conclusions or making forecasts or projections set out in the forward-looking statements include, but are not limited to:

- the Company's ability to successfully implement and realize on its business goals and strategy;
- factors and assumptions regarding interest rates;
- housing sales and residential mortgage borrowing activities;
- the effect of competition;
- government regulation of the Company's business;
- computer failure or security breaches;
- future capital and funding requirements;
- the value of mortgage originations;
- the expected margin between interest earned on mortgage portfolios and interest paid on deposits;
- the relative continued health of real estate markets;
- acceptance of the Company's products in the marketplace;
- availability of key personnel;
- the Company's operating cost structure; and
- the current tax regime.

Reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause the actual results to differ materially from the anticipated future results expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially from those set forth in the forward-looking statements include, but are not limited to:

- global market activity;
- worldwide demand for and related impact on oil and other commodity prices;
- changes in government and economic policy;
- changes in general economic, real estate and other conditions;
- changes in interest rates;
- changes in Canada Mortgage Bonds ("CMB") and mortgage-backed securities ("MBS") spreads and swap rates;
- MBS and mortgage prepayment rates;
- mortgage rate and availability changes;
- adverse legislation or regulation;
- availability of CMB and MBS issuer allocation;
- technology changes;
- confidence levels of consumers;
- ability to raise capital and term deposits on favourable terms;
- our debt and leverage;
- competitive conditions in the homebuilding industry, including product and pricing pressures;
- ability to retain our executive officers and other employees;
- litigation risk;
- relationships with our mortgage originators;
- additional risks and uncertainties, many of which are beyond our control, referred to in this MD&A and our other public filings with the applicable Canadian regulatory authorities.

Subject to applicable securities law requirements, we undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in subsequent reports should be consulted.

ACRONYMS

ALCO	*Asset and Liability Committee*	***HELOC***	*Home Equity Line of Credit*	***MD&A***	*Management's Discussion & Analysis*
BCBS	*Basel Committee on Banking Supervision*	***IAS***	*International Accounting Standard*	***MIC***	*Mortgage Investment Corporation*
CAR	*Capital Adequacy Requirements*	***IASB***	*International Accounting Standards Board*	***NHA***	*National Housing Act*
CDIC	*Canada Deposit Insurance Corporation*	***IFRIC***	*IFRS Interpretations Committee*	***NSFR***	*Net Stable Funding Ratio*
CET 1	*Common Equity Tier 1*	***IFRS***	*International Financial Reporting Standards*	***OSFI***	*Office of the Superintendent of Financial Institutions*
CHT	*Canada Housing Trust*	***LAR***	*Liquidity Adequacy Requirements*	***RAF***	*Risk Appetite Framework*
CMB	*Canada Mortgage Bonds*	***LCR***	*Liquidity Coverage Ratio*	***RCB***	*Risk Committee of the Board*
CMHC	*Canada Mortgage and Housing Corporation*	***LP ARA***	*Limited Partner's At-Risk Amount*	***RMBS***	*Residential Mortgage Backed Securities*
DRIP	*Dividend Reinvestment Plan*	***LTV***	*Loan to Value (ratio)*	***SEDAR***	*System for Electronic Document Analysis and Retrieval*
EIM	*Effective Interest Rate Method*	***MBS***	*Mortgage Backed Securities*	***TSX***	*Toronto Stock Exchange*

SELECTED FINANCIAL INFORMATION

Table 1: Income Statement Highlights

(in thousands except for per share amounts and %)	2016	2015	2014	Change from 2015 ($)	Change from 2015 (%)
Income Statement Highlights					
Net investment income - corporate assets	$ 51,701	$ 42,741	$ 39,151	$ 8,960	21.0%
Net investment income - securitization assets	5,778	4,467	(94)	1,311	29.3%
	57,479	47,208	39,057	10,271	21.8%
Other income	-	68	782	(68)	(100.0%)
Operating expenses	17,963	14,508	13,383	3,455	23.8%
Net income before income taxes	39,516	32,768	26,456	6,748	20.6%
Provision for (recovery of) income taxes	(666)	(89)	1,010	(577)	648.3%
Net income	$ 40,182	$ 32,857	$ 25,446	$ 7,325	22.3%
Basic and diluted earnings per share	$ 1.75	$ 1.51	$ 1.23	$ 0.24	15.9%
Dividends per share	$ 1.17	$ 1.13	$ 1.12	$ 0.04	3.5%
Taxable income per share [1]	$ 1.24	$ 0.90	$ 0.86	$ 0.34	37.8%
Return on average shareholders' equity [1]	14.74%	13.45%	11.50%		1.29%
Yields					
Average mortgage portfolio yield - corporate [2]	5.15%	5.35%	5.62%		(0.20%)
Term deposit average interest rate [2]	2.23%	2.34%	2.46%		(0.11%)
Spread of mortgages over term deposits	2.92%	3.01%	3.16%		(0.09%)
Average mortgage portfolio yield - securitized [2]	2.73%	2.71%	2.90%		0.02%
Financial liabilities from securitization - average interest rate [2]	2.02%	2.07%	2.37%		(0.05%)
Spread of mortgages over liabilities	0.71%	0.64%	0.53%		0.07%

[1] *Refer to the “Non-IFRS Measures” section of this MD&A for a definition of these measures.*
[2] *Refer to “Average Interest Rate” in the “Non-IFRS Measures” section of this MD&A for a definition of this measure.*

Table 2: Balance Sheet Highlights

(in thousands except for per share amounts and %) As at December 31	2016	2015	2014	Change from 2015 ($)	Change from 2015 (%)
Balance Sheet Highlights					
Assets					
Corporate	$ 1,188,480	$ 1,155,046	$ 1,045,352	$ 33,434	2.9%
Securitization	1,092,375	1,091,912	760,366	463	0.0%
Total assets	$ 2,280,855	$ 2,246,958	$ 1,805,718	$ 33,897	1.5%
Mortgages - corporate	$ 904,112	$ 944,109	$ 895,467	$ (39,997)	(4.2%)
Mortgages - securitized	$ 1,071,849	$ 1,075,947	$ 741,184	$ (4,098)	(0.4%)
Liabilities					
Corporate	$ 927,293	$ 917,852	$ 834,310	$ 9,441	1.0%
Securitization	1,071,786	1,070,304	746,105	1,482	0.1%
Total liabilities	$ 1,999,079	$ 1,988,156	$ 1,580,415	$ 10,923	0.5%
Shareholders' equity	$ 281,776	$ 258,802	$ 225,303	$ 22,974	8.9%
Capital Ratios [1]					
Income Tax Assets to Capital Ratio	4.87	5.11	5.05		(4.7%)
Common Equity Tier 1 Capital Ratio (transitional)	22.98%	23.58%	23.37%		(0.60%)
Common Equity Tier 1 Capital Ratio (all-in)	22.55%	23.02%	22.62%		(0.47%)
Tier 1 Capital Ratio (transitional)	22.98%	23.58%	23.37%		(0.60%)
Tier 1 Capital Ratio (all-in)	22.55%	23.02%	22.62%		(0.47%)
Total Capital Ratio (transitional)	22.98%	23.58%	23.37%		(0.60%)
Total Capital Ratio (all-in)	22.55%	23.02%	22.62%		(0.47%)
Leverage ratio [2]	10.46%	9.96%	n/a		0.50%
Assets to Capital Multiple [2]	n/a	n/a	8.14		n/a
Credit Quality					
Impaired mortgage ratio (total) [1]	0.14%	0.11%	0.50%		0.03%
Impaired mortgage ratio (corporate) [1]	0.31%	0.23%	0.92%		0.08%
Mortgage Arrears					
Corporate	$ 13,041	$ 19,889	$ 29,859	$ (6,848)	(34.4%)
Securitized	13,609	14,361	8,546	(752)	(5.2%)
Total	$ 26,650	$ 34,250	$ 38,405	$ (7,600)	(22.2%)
Common Share Information (end of period)					
Number of common shares outstanding	23,075	22,782	20,808		1.3%
Book value per common share [1]	$ 12.21	$ 11.36	$ 10.83	$ 0.85	7.5%
Common share price - close	$ 14.32	$ 12.14	$ 14.40	$ 2.18	18.0%
Market capitalization [1]	$ 330,434	$ 276,573	$ 299,635	$ 53,861	19.5%

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*

[2] *Mortgages securitized through the market MBS program and CMB program for which derecognition has not been achieved are included in regulatory assets in the leverage ratio and assets to capital multiple. The leverage ratio replaced the assets to capital multiple effective January 1, 2015 such that the leverage ratio is n/a for 2014 and the assets to capital multiple is n/a for 2015 and 2016. For further information, refer to the "Capital Management" section of this MD&A.*

HIGHLIGHTS

Income Statement

- We earned record net income of $40.2 million in 2016, an increase of $7.3 million (22%) from $32.9 million in 2015.
- Earnings per share increased by $0.24 (16%) to $1.75 in 2016 from $1.51 in 2015.
- Return on average shareholders' equity[1] increased to 14.74% in 2016 from 13.45% in 2015.
- Our equity investment in MCAP Commercial LP ("MCAP") continued to provide strong equity income of $13.5 million in 2016, an increase of 34% from $10.1 million in 2015.
- Increase of 29% in securitization income from our continued participation in the market MBS program and re-entry into the CMB program in 2016.

Corporate Activity

- Corporate assets, which totalled $1.19 billion at December 31, 2016, increased by $33 million from December 31, 2015.
- The corporate mortgage portfolio decreased by $40 million during 2016 to $904 million from $944 million, which included increases of $32 million in construction, $28 million in commercial and $25 million in insured single family, and decreases of $111 million in uninsured single family and $13 million in completed inventory loans.
- Increase of $36 million during 2016 in our higher-yielding corporate non-mortgage investments, consisting of marketable securities, our equity investment in MCAP and financial investments. Increases in the fair value of marketable securities and financial investments led to a $5.8 million increase in accumulated other comprehensive income during 2016, up from a $2.9 million increase in 2015.
- Consistent with the prior quarter dividend increase, the Board of Directors (the "Board") declared a 2017 first quarter dividend of $0.30 per share to be paid on March 30, 2017 to shareholders of record as of March 15, 2017.

Securitization Activity

- We recommenced our participation in the CMB program in 2016 by securitizing $100 million of insured single family mortgages and $86 million of insured multi family loans. We recognized upfront gains of $394,000 on securitization of the multi family loans, while the single family mortgages remained on our balance sheet after securitization.
- We securitized $42 million of new MBS to third parties through the market MBS program.

Credit Quality

- The impaired total mortgage ratio[1] increased to 0.14% at December 31, 2016 from 0.11% at December 31, 2015.
- The impaired corporate mortgage ratio[1] increased to 0.31% at December 31, 2016 from 0.23% at December 31, 2015.
- Total mortgage arrears[1] were $27 million at December 31, 2016, down $7 million (22%) from $34 million at December 31, 2015.
- Net write-offs were 2.4 basis points of the average corporate portfolio in 2016, improved from 4.2 basis points in 2015.
- The average loan to value ratio ("LTV") of our uninsured single family portfolio was 56.5% at December 31, 2016, improved from 63.4% at December 31, 2015.

Capital

- Our Common Equity Tier 1, Tier 1 and Total Capital to risk-weighted assets ratios[1] were 22.98% on the transitional basis and 22.55% on the "all-in" basis at December 31, 2016 compared to 23.58% and 23.02%, respectively, at December 31, 2015.
- Our leverage ratio[1] was 10.46% at December 31, 2016 compared to 9.96% at December 31, 2015.
- Income tax asset capacity[1] was $209 million at December 31, 2016 compared to $141 million at December 31, 2015.

[1] *Considered to be a "Non-IFRS Measure". For further details, refer to the "Non-IFRS Measures" section of this MD&A.*

OUTLOOK

Market conditions

The Bank of Canada has forecasted 2017 Canadian GDP growth of 2.1%, a slight increase over the 1.9% rate for Q4 2016. With the relatively low levels of expected economic growth, the probability of increased interest rates is again low for 2017. However, one of the effects of the recent U.S. election has been an increase in U.S. bond yields, which has also impacted the interest rate market in Canada. We expect housing markets to continue to benefit from historically low interest rates, but we also expect a slowdown in housing as a result of the impact of regulatory changes announced last quarter to mortgage underwriting and insurance.

Canadian residential real estate markets continue to have mixed performances as regional economies adjust with local economic conditions. Western Canada continues to experience the negative impact of weak oil prices on employment, while other regional economies benefit from the lower Canadian dollar and employment strength in the manufacturing sector. The Canadian dollar has strengthened marginally since the U.S. election, but has continued to trade at a discount to the U.S. dollar due to weak world-wide commodity prices, a stronger U.S. economy, higher U.S. interest rates and the potential for further U.S. rate increases.

We expect financial markets to experience increased volatility following the U.S. election result, with increased uncertainty around U.S. policy, particularly trade. Fluctuations in stock markets upon reaction to announced changes will impact expectations for global growth and volatility in international currencies as they impact corporate earnings and valuations. In Canada, the impact of a weak oil sector and soft commodity prices continues to affect a significant portion of the stock market. Concerns over low or regionally negative economic growth and increases in unemployment rates are expected to have a spillover effect on consumer confidence.

Ontario and British Columbia have continued to exhibit strong fundamentals and growth, with GDP growth driven by exports and immigration. In Alberta, housing markets have continued to slow as a result of lower oil prices and weakening employment. We continue to focus our origination in Ontario and British Columbia and monitor our exposure to Alberta. We are selective in our origination of new residential construction projects.

Real estate conditions

Canadian housing market conditions continue to be mixed. The Toronto housing market continues to experience significant price inflation with forecasts for continued strength in 2017. Price inflation in Toronto continues to be well in excess of levels supported by employment and income growth.

Vancouver has recently experienced a slowing of sales and price inflation. This has arisen after recent changes in mortgage underwriting rules and the 15% tax on non-resident real estate purchases enacted in mid-2016. This tax was intended to help restore housing affordability for residents in the Metro Vancouver Area by raising non-residents' cost of purchasing and, on the margin, discouraging foreign speculation. The greatest impact of this foreign buyer tax has been on homes selling above $5 million.

While some of the price inflation in both Toronto and Vancouver is driven by low mortgage rates and lot supply shortages, we believe that price inflation at these high levels increases the risk of a price correction. We are operating with tightened underwriting policies for uninsured mortgages, specifically for self-employed applicants.

In late 2016, the Department of Finance announced new mortgage regulations. The most significant regulations expected to impact the market are as follows:

- Expanding the stress tests to all insured mortgages, to be qualified using the Bank of Canada's posted rate (currently at 4.64%).
- All portfolio-insured mortgages will be required to conform to the same lending guidelines as insured mortgages.
- Principal residence capital gains will be limited to Canadian residents.

We expect the impact of these new regulations to be as follows:

- No change to overall market CMB issuance levels.
- Expected decrease to MBS issuance levels and tighter MBS spreads in the market as less mortgages are eligible for portfolio insurance.
- Redirection of uninsurable mortgages to balance sheet investors such as MCAN, chartered bank covered bonds, asset-backed commercial paper and potentially the private residential mortgage-backed securities ("RMBS") market.
- Higher market uninsured mortgage rates as lenders price in higher capital requirements and increased funding costs.
- Stable short-term market insured mortgage rates due to increased competition amongst lenders.

The Department of Finance also launched a consultation in late 2016 on lender risk sharing for government backed insured mortgages. We expect the impact of potential risk sharing to be as follows:

- Increased lender costs; the Department of Finance expects an increase of 20-30 basis points in lender costs over a five-year period. To date, we have noted market increases in excess of this amount.
- Increased risk-weighting and capital requirements for these assets due to higher risk of loss, which may require increased collective and individual mortgage allowances.

We have observed the early impacts of the changes noted above on housing markets, specifically the slowing of first time buyers in the market. However, Q4 2016 market activity is not a good indicator of market momentum, given the relatively small portion of annual sales that it represents. We are continuing to evaluate the impact of these regulatory changes to the market and MCAN. We believe that the effect of these changes will likely require a minimum of 6-12 months to begin providing clarity on the direction of the mortgage market in Canada.

Effective January 1, 2017, the Office of the Superintendent of Financial Institutions Canada ("OSFI") introduced new minimum capital adequacy requirements for mortgage insurers. These changes are expected to increase premiums on mortgage portfolio insurance paid by lenders which may impact rates charged to borrowers.

Impact on MCAN

We will continue to monitor housing market developments as they evolve and will continue to ensure that our mortgage portfolio remains well positioned. MCAN has a stated annual corporate asset growth target of 10%. In 2016, we experienced below-target growth of 3%. In 2017, we expect to continue to make adjustments to the composition of our balance sheet so as to evaluate the risks and rewards of each of our product lines.

We believe that MCAN is well positioned to adapt to changes in mortgage and housing markets given that we, as a regulated financial institution, have access to both the insured securitization market as well as the term deposit funding market.

RESULTS OF OPERATIONS

Table 3: Net Income - For the Years Ended December 31

(in thousands except for per share amounts and %)	2016	2015	Change from 2015 ($)	Change from 2015 (%)
Net Investment Income - Corporate Assets				
Mortgage interest	$ 50,670	$ 50,997	$ (327)	(1%)
Equity income from MCAP Commercial LP	13,509	10,096	3,413	34%
Fees	2,547	3,231	(684)	(21%)
Marketable securities	3,622	2,076	1,546	74%
Financial investments and other loans	6,487	3,506	2,981	85%
Interest on cash and cash equivalents	604	730	(126)	(17%)
Whole loan gain on sale income	324	626	(302)	(48%)
Realized loss on derivatives	-	(2,914)	2,914	(100%)
	77,763	**68,348**	**9,415**	**14%**
Term deposit interest and expenses	22,035	20,671	1,364	7%
Mortgage expenses	3,993	3,823	170	4%
Interest on loans payable	244	838	(594)	(71%)
Provision for (recovery of) credit losses	(210)	275	(485)	(176%)
	26,062	**25,607**	**455**	**2%**
	51,701	**42,741**	**8,960**	**21%**
Other Income - Corporate Assets				
Gain on dilution of investment in MCAP Commercial LP	-	68	(68)	(100%)
	-	**68**	**(68)**	**(100%)**
Net Investment Income - Securitization Assets				
Mortgage interest	28,298	25,564	2,734	11%
Other securitization income	461	198	263	133%
	28,759	25,762	2,997	12%
Interest on financial liabilities from securitization	21,176	19,763	1,413	7%
Mortgage expenses	1,805	1,461	344	24%
Fair value adjustment - derivative financial instruments	-	71	(71)	(100%)
	22,981	21,295	1,686	8%
	5,778	**4,467**	**1,311**	**29%**
Operating Expenses				
Salaries and benefits	9,406	8,515	891	10%
General and administrative	8,557	5,993	2,564	43%
	17,963	14,508	3,455	24%
Net Income Before Income Taxes	39,516	32,768	6,748	21%
Provision for (recovery of) income taxes	(666)	(89)	(577)	648%
Net Income	**$ 40,182**	**$ 32,857**	**$ 7,325**	**22%**
Basic and diluted earnings per share	$ 1.75	$ 1.51	$ 0.24	16%
Dividends per share	$ 1.17	$ 1.13	$ 0.04	4%

Net Income

The $7.3 million increase in net income from 2015 was primarily due to increases in equity income from MCAP, income from financial investments and other loans and securitization income. Additionally, we incurred a significant hedge loss in 2015 that did not recur in 2016. These items were offset by higher operating expenses in 2016.

Net Investment Income - Corporate Assets

Mortgage interest income

Table 4: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

For the Years Ended December 31	2016			2015		
(in thousands except %)	Average Balance	Interest Income	Average Rate [1]	Average Balance	Interest Income	Average Rate [1]
Single family						
- Uninsured	$ 318,503	$ 14,611	4.59%	$ 318,892	$ 15,171	4.74%
- Insured	110,694	3,562	3.40%	143,685	5,154	3.58%
- Uninsured - completed inventory	19,099	1,038	5.44%	14,534	799	5.48%
Construction loans						
- Residential	407,246	22,286	5.47%	336,762	20,262	5.57%
- Non residential	6,957	390	5.61%	1,186	65	5.52%
Commercial loans						
- Uninsured	124,625	8,783	7.05%	94,567	9,546	9.28%
Mortgages - corporate portfolio	$ 987,124	$ 50,670	5.15%	$ 909,626	$ 50,997	5.35%
Term deposits	940,926	22,035	2.23%	844,309	20,671	2.34%
Spread of mortgages over term deposits			2.92%			3.01%
Mortgages - securitized portfolio	$ 1,035,457	$ 28,298	2.73%	$ 950,480	$ 25,564	2.71%
Financial liabilities from securitization	1,046,154	21,176	2.02%	962,263	19,763	2.07%
Spread of mortgages over liabilities			0.71%			0.64%

[1] *Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income on impaired loans, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Excluding discount income on impaired loans and deferred interest, non-recurring items were immaterial for the years ended December 31, 2016 and December 31, 2015. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure*.

We experienced a significant increase in our construction portfolio balance during 2016 amidst lower single family origination volumes. The construction growth was a result of lending to experienced builders in market segments where the cost to build has not followed real estate appreciation. Lending in this segment is based on specific conditions required prior to funding, which act as a risk mitigant given other concerns in the real estate market. The average portfolio balance experienced a seasonal increase in the middle of the year, but levelled off later in the year. The decrease in the average yield was a result of lower funding rates for new loans in the residential construction portfolio in 2016.

The higher income from the construction portfolio provided a balance against the decrease in uninsured single family income, as that portfolio declined significantly during 2016.

New uninsured single family originations were low in 2016 due to reduced spreads from a competitive market, the tightening of our underwriting standards (specifically for self-employed borrowers) and increased processing times as we worked on a transition of our systems and processes. As a result of these factors, we experienced an increase in mortgage applications in 2016 that did not meet our underwriting standards or had unsupported or difficult to substantiate income verification. We took a more defensive approach to origination in 2016 given the accelerated valuations in this market segment. We believe that this conservative approach to uninsured single family mortgage origination was an appropriate course of action given the risk environment in 2016.

The average uninsured single family portfolio balance was comparable to 2015, however the portfolio balance trended downwards throughout 2016 given the lower origination volumes and tightened underwriting standards noted above. Market rates for the funding of new single family mortgages decreased for most of 2016, which led to the decreases in the portfolio average yield for both uninsured single family and insured single family.

In general, the majority of our insured single family originations from the Xceed platform are destined for securitization such that the majority of the portfolio is held on a short-term basis. Given our lower securitization volumes in 2016 compared to 2015, the average insured single family portfolio balance decreased in 2016.

The 2016 growth in the commercial portfolio was primarily in commercial term mortgages. In 2016, we targeted growth in this higher-yielding portfolio and were able to identify investment opportunities. The decrease in the yield from 2015 was due to a lower average rate on the high ratio component of the portfolio, which consists of loans such as second mortgages on residential construction projects. The yield on this component of the commercial portfolio can be volatile.

In 2015, we earned discount income of $1.5 million on the payout of previously impaired construction loans and $529,000 of deferred interest on a commercial loan, both of which are excluded from the average yield as they were non-recurring items.

Average mortgage portfolio yield is considered to be a non-IFRS measure. For a definition of this measure, refer to the “Non-IFRS Measures” section of this MD&A.

Equity income from MCAP

The increase in equity income from MCAP in 2016 was a result of higher securitized mortgage interest income from a larger average portfolio, and higher servicing and administration income due to an increase in assets under administration.

Other net investment income

The decrease in fees in 2016 is primarily due to a non-recurring $742,000 deferred profit participation fee received on a commercial loan in 2015.

The increase in marketable securities income in 2016 is a result of a significantly higher average portfolio balance.

Income from financial investments and other loans includes $4.1 million of income recognized from our investment in the Crown Realty II Limited Partnership (“Crown LP”), compared to $2.5 million in 2015. The receipt of partnership distributions from Crown LP generates a transfer from accumulated other comprehensive income to net income. We also recognized $2.1 million of income from our investment in the KingSett High Yield Fund, up from $0.9 million in 2015 as a result of a higher average investment balance.

The realized loss on derivatives incurred in 2015 was related to the hedging of mortgage funding commitments at that time. In late 2015, we closed out these hedges and adjusted the structure of our term deposit portfolio to provide a closer term match such that we did not have any gains or losses from derivatives in 2016.

The change in the average term deposit balance is generally similar to that of the average corporate mortgage portfolio in that we use term deposits to fund our corporate assets. Similar to single family mortgages, market rates for new term deposits, all of which are fixed-rate, decreased from 2015.

Mortgage expenses, consisting primarily of mortgage servicing fees, were comparable to 2015. Although we had a larger average mortgage portfolio, the average servicing rate decreased slightly from 2015.

Details of the provision for (recovery of) credit losses are discussed in the “Credit Quality” sub-section below.

For further information on corporate and securitization net investment income, refer to the “Net Interest Income” sub-section below.

Net Investment Income - Securitization Assets

Net investment income from securitization assets relates to our participation in the market MBS program and CMB program, which involve the securitization of insured mortgages through the Canada Mortgage and Housing Corporation (“CMHC”) National Housing Act (“NHA”) MBS program. For further details on these programs, refer to the “Securitization Programs” section of this MD&A.

In 2016, our total securitization volumes were $228 million (2015 - $589 million), consisting of $42 million of insured single family mortgages (2015 - $589 million) through the market MBS program and $100 million of insured single family mortgages (2015 - $nil) and $86 million of insured multi family loans (2015 - $nil) through the CMB program. Securitization volumes in 2016 were lower than the past two years due to the reduced origination volumes noted above.

Market MBS Program

Although our 2016 market MBS program securitization volumes were lower than 2015, the average portfolio balance increased over 2015 as new securitizations were adequate to offset mortgage repayments. Additionally, the average yield increased slightly due to the fact that the 2016 average portfolio contained a higher proportion of mortgages originated through our internal Xceed platform than 2015. Our internally originated mortgages are significantly more profitable than externally purchased mortgages, which contributed to the increase in spread income.

CMB Program

Spread income from insured single family mortgages securitized through the CMB program was minimal in 2016 given the small average portfolio size. These mortgages remained on our consolidated balance sheet since we retained significant continuing involvement with the mortgages. Although our average portfolio balance was low in 2016 given our recent re-entry into the program and low origination volumes, the net spread of 1.08% earned on the CMB program mortgages is significantly higher than the market MBS spread given the much lower CMB program funding cost.

On securitization, the multi family loans were derecognized from our balance sheet as we transferred control of the assets at that time. Accordingly, we recognized upfront gains of $394,000 on the securitization of these mortgages, which are included in other securitization income.

Net Interest Income

Presented in the following tables is an analysis of average rates and net interest income. Net interest income is the difference between interest earned on certain assets and the interest paid on liabilities to fund those assets. For further details, refer to the "Non-IFRS Measures" section of this MD&A.

Table 5: Net Interest Income

For the Years Ended December 31	2016			2015		
(in thousands except %)	Average Balance [1]	Income / Expense	Average Rate[3]	Average Balance [1]	Income / Expense	Average Rate[3]
Assets						
Cash and cash equivalents	$ 77,790	$ 604	0.78%	$ 86,138	$ 730	0.85%
Marketable securities	50,078	3,622	7.23%	30,250	2,076	6.86%
Mortgages - corporate	987,124	50,670	5.15%	909,626	50,997	5.35%
Financial investments	19,117	2,135	11.17%	7,851	913	11.63%
Other loans	3,878	204	5.26%	1,774	84	4.74%
Corporate interest earning assets	1,137,987	57,235	5.03%	1,035,639	54,800	5.29%
Cash held in trust	15,158	40	0.26%	17,511	76	0.87%
Mortgages - securitized	1,035,457	28,298	2.73%	950,480	25,564	2.71%
Financial investments	-	-	-	95	1	2.11%
Securitization interest earning assets	1,050,615	28,338	2.70%	968,086	25,641	2.68%
Total interest earning assets	2,188,602	85,573	3.91%	2,003,725	80,441	4.01%
Non interest earning assets	85,404	4,148	-	75,161	2,509	-
Total assets	$ 2,274,006	$ 89,721	3.95%	$ 2,078,886	$ 82,950	3.99%
Liabilities and shareholders' equity						
Term deposits	$ 940,926	$ 22,035	2.23%	$ 844,309	$ 20,671	2.34%
Loans payable	6,749	244	3.32%	21,595	838	3.12%
Corporate liabilities	947,675	22,279	2.24%	865,904	21,509	2.37%
Securitization liabilities	1,046,154	21,176	2.02%	962,263	19,763	2.07%
Total interest bearing liabilities	1,993,829	43,455	2.13%	1,828,167	41,272	2.23%
Non interest bearing liabilities	7,541	-	-	6,480	-	-
Shareholders' equity	272,636	-	-	244,239	-	-
Total liabilities and shareholders' equity	$ 2,274,006	$ 43,455	1.91%	$ 2,078,886	$ 41,272	1.99%
Net Interest Income [2]		$ 46,266			$ 41,678	

[1] *The average balances (excluding cash and cash equivalents, mortgages and term deposits) are calculated with reference to opening and closing monthly balances and as such may not be as precise as if daily balances were used. The average cash and cash equivalents, mortgage and term deposit balances are calculated using daily balances.*

[2] *Net interest income is equal to net investment income less equity income from MCAP, fees, whole loan gain on sale income, realized gain (loss) on derivatives, other securitization income, mortgage expenses, provision for credit losses and fair value adjustment - derivative financial instruments. Net interest income is a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.*

[3] *Average rate is equal to income/expense divided by the average balance on an annualized basis. The average rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items consisting of one-time gains/losses, asset write-downs and fees not associated with the asset/liability yield are excluded from the calculation of the average rate. Excluding discount income on impaired loans and deferred interest, non-recurring items were immaterial for the years ended December 31, 2016 and December 31, 2015. Average rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.*

Credit Quality

Table 6: Provisions for Credit Losses and Write-offs

(in thousands except basis points)				
			Change from 2015	
For the Years Ended December 31	**2016**	**2015**	**($)**	**(%)**
Individual provision (recovery)				
Single family uninsured	$ 287	$ 78	$ 209	268%
Residential construction	-	(55)	55	(100%)
	287	23	264	1148%
Collective provision (recovery)				
Single family uninsured	(459)	363	(822)	(226%)
Single family uninsured - completed inventory	(56)	42	(98)	(233%)
Construction	200	(99)	299	(302%)
Commercial	257	341	(84)	(25%)
Corporate mortgages - total	(58)	647	(705)	(109%)
Other provisions (recoveries)	(439)	(395)	(44)	11%
	$ (497)	$ 252	$ (749)	(297%)
Total provision for (recovery of) credit losses	$ (210)	$ 275	$ (540)	(196%)
Corporate mortgage portfolio data:				
Provision for (recovery of) credit losses	$ 229	$ 670	$ (441)	(66%)
Net write offs	$ 239	$ 385	$ (146)	(38%)
Net write offs (basis points)	2.4	4.2	(1.8)	(43%)

Individual mortgage allowances are recorded to reduce a mortgage to its estimated realizable value. Collective mortgage allowances represent losses that we believe have been incurred in the mortgage portfolio but have not yet been specifically identified. The collective provisions (recoveries) recorded during both periods are consistent with the growth (reduction) in the size of the respective mortgage portfolios.

During 2016, we had recoveries of $387,000 as a result of mortgage settlements or litigations, included in other provisions (recoveries). These recoveries related to Xceed-originated insured single family mortgages that had previously been written off prior to the acquisition of Xceed in 2013.

Operating Expenses

Table 7: Operating Expenses

(in thousands)				
			Change from 2015	
For the Years Ended December 31	**2016**	**2015**	**($)**	**(%)**
Salaries and benefits	$ 9,406	$ 8,515	$ 891	10%
General and administrative	8,557	5,993	2,564	43%
	$ 17,963	**$ 14,508**	**$ 3,455**	**24%**

The increase in salaries and benefits in 2016 is partly due to an increase in the average number of employees from 2015. We have continued to grow the size of our staff in operations, risk management and credit to maintain a sound corporate governance environment and risk management framework. Additionally, certain long-term compensation expenses were higher in 2016 as a result of a more pronounced increase in the share price in 2016.

The increase in general and administrative expense in 2016 consists primarily of expenditures relating to the development of new systems and processes related to single family mortgage operations; during 2016 we undertook multiple projects to improve governance and mitigate risk as part of this overall development process. This increase was also due to internal audit, risk and related expenses related to the Company's procedures and controls.

Provision for Income Taxes

Table 8: Income Taxes

(in thousands) For the Years Ended December 31	2016	2015	Change from 2015 ($)	Change from 2015 (%)
Current tax provision	$ (100)	$ -	$ (100)	$ -
Deferred tax provision (recovery)	(566)	(89)	(477)	536%
	$ (666)	**$ (89)**	**$ (577)**	**$ 648%**

The deferred tax recoveries in both years were due to tax losses recognized at the subsidiary level.

As at December 31, 2016, we had $11 million of losses available for carry-forward in the MCAN mortgage investment corporation ("MIC") parent company on a non-consolidated basis (December 31, 2015 - $12 million), the benefit of which is not reflected in deferred taxes.

The March 31, 2016 dividend created a timing difference in the loss carry forward balance in that it was deducted from 2016 taxable income instead of 2015. This deduction will increase the loss carry forward by $6.6 million when we finalize our 2016 corporate tax position. For further information, refer to Note 4 to the consolidated financial statements.

Taxable Income

The table below provides a reconciliation between net income for accounting purposes and taxable income. The adjustments below represent the difference between the individual components of net income for accounting and tax purposes. Taxable income is presented on a non-consolidated basis and does not incorporate taxable income from Xceed and other subsidiaries as it does not directly impact MCAN's non-consolidated taxable income.

The key differences between taxable income and pre-tax net income for accounting purposes include differences between equity income from MCAP and Xceed for accounting and tax purposes and the treatment of securitization program origination costs, securitization gains or losses, capital gains income, collective provisions for credit losses and the amortization of upfront securitization program costs for tax purposes. As a MIC, we typically pay out all of our taxable income to shareholders through dividends. In addition, our MIC status allows us to deduct dividends paid within 90 days of year end from taxable income. Dividends that are deducted in the calculation of taxable income are not included in the table below.

We originate and purchase insured mortgages that are securitized through the market MBS program and CMB program and sold to third parties or retained on our balance sheet (for further details on these programs, refer to the "Securitization Programs" section of this MD&A). The purchase of mortgages involves the payment of an up-front origination fee that is deductible for income tax purposes in the period that the mortgages are securitized, while for accounting purposes this fee is capitalized and amortized over the term of the associated mortgages. In 2016, we incurred $3.8 million of origination costs on securitized mortgages, including market MBS held by MCAN (2015 - $13.8 million). As at December 31, 2016, the unamortized origination fee balance was $15.6 million (2015 - $17.1 million), which represents costs that are still to be expensed for non-consolidated accounting purposes but will be added back in the calculation of taxable income in future periods.

Taxable income is considered to be a non-IFRS measure. For further details, refer to the "Non-IFRS Measures" section of this MD&A.

Table 9: Taxable Income Reconciliation [1]

(in thousands) For the Periods Ended December 31	Q4 2016	Q4 2015	YTD 2016	YTD 2015
Net income for accounting purposes	$ 9,000	$ 9,450	$ 40,182	$ 32,857
Adjustments:				
Equity income from MCAP	(1,104)	(3,610)	(9,674)	(5,919)
Equity income from subsidiaries [2]	622	(2,522)	(601)	(440)
Provision for (recovery of) credit losses [2]	(255)	527	(56)	557
Amortization of upfront securitization program costs [3]	1,614	1,776	6,300	6,003
Securitization program mortgage origination costs [3]	(1,171)	(1,235)	(3,799)	(13,810)
CMB program multi family gain on sale adjustment [4]	(300)	-	(1,830)	-
Other securitization program cash outflows	(321)	(209)	(452)	(1,639)
Gain on sale of interest-only strips	-	3,073	-	3,073
Capital gains	-	(57)	(163)	(57)
Other items	(403)	(373)	(1,460)	(1,045)
Taxable Income	**$ 7,682**	**$ 6,820**	**$ 28,447**	**$ 19,580**

[1] Taxable income is presented above on a non-consolidated basis for the MIC entity. The current year amounts presented above represent estimates as they are not finalized until the completion of our corporate tax filings.
[2] Not deductible/recognizable in the calculation of taxable income. Individual mortgage allowances are 90% deductible for tax purposes.
[3] Deductible in full for tax purposes as mortgages securitized; capitalized and amortized for accounting purposes, however amortization is added back in calculation of taxable income.
[4] This adjustment reverses the recognition of the non-cash component of the upfront accounting gain and accounts for spread income collected for tax purposes.

Summary of Three Year Results of Operations

2014 represented the first full year of the integration of Xceed into MCAN operations. We re-launched the Xceed single family brand with mortgage brokers and originated over $200 million of new mortgages. Additionally, our securitization volumes through the market MBS program grew significantly to $561 million as the program provided incremental income to MCAN. Earnings per share were $1.23.

In 2015, we earned then-record net income of $32.9 million while earnings per share increased to $1.51. The Xceed origination platform increased significantly with $518 million in new mortgages originated. Our market MBS program securitization volumes were $589 million as the securitized mortgage portfolio continued to provide a reliable source of incremental income. Equity income from our investment in MCAP also increased by 63% to over $10 million. Corporate asset growth exceeded our 10% annual target as we finished the year with a $1.16 billion portfolio.

In 2016, we again posted record net income of $40.2 million with earnings per share of $1.75. Although we had lower single family originations and a reduction in the size of those portfolios, we experienced growth in certain higher-yielding asset classes such as construction and commercial mortgages, marketable securities and financial investments, and earned strong returns in these investments. Additionally, we had a record performance from our equity investment in MCAP, providing $13.5 million of income which represented a 34% increase over 2015. We also re-commenced our participation in the CMB program, and increased our net investment income from securitization assets.

Cash Flows

Operating activities provided cash flows of $52 million in 2016 and $22 million in 2015, primarily due to lower net corporate mortgage fundings in 2016.

Investing activities provided cash flows of $6 million in 2016 and $4 million in 2015. In 2016, we had higher distributions from the equity investment in MCAP.

Financing activities used cash flows of $23 million in 2016 and $1 million in 2015. In 2015, we had a substantially higher inflow from the issuance of common shares due to a rights issue.

FINANCIAL POSITION

Table 10: Assets

(in thousands) As at	December 31 2016	December 31 2015	Change from 2015 ($)	(%)
Corporate Assets				
Cash and cash equivalents	$ 111,732	$ 75,762	$ 35,970	47%
Marketable securities	55,126	40,735	14,391	35%
Mortgages	904,112	944,109	(39,997)	(4%)
Financial investments	57,264	41,793	15,471	37%
Other loans	3,584	4,176	(592)	(14%)
Equity investment in MCAP Commercial LP	50,805	44,191	6,614	15%
Foreclosed real estate	529	529	-	-
Deferred tax asset	1,782	1,125	657	58%
Other assets	3,546	2,626	920	35%
	1,188,480	**1,155,046**	**33,434**	**3%**
Securitization Assets				
Cash held in trust	15,724	13,112	2,612	20%
Mortgages	1,071,849	1,075,947	(4,098)	-
Other assets	4,802	2,853	1,949	68%
	1,092,375	**1,091,912**	**463**	**-**
	$ 2,280,855	**$ 2,246,958**	**$ 33,897**	**2%**

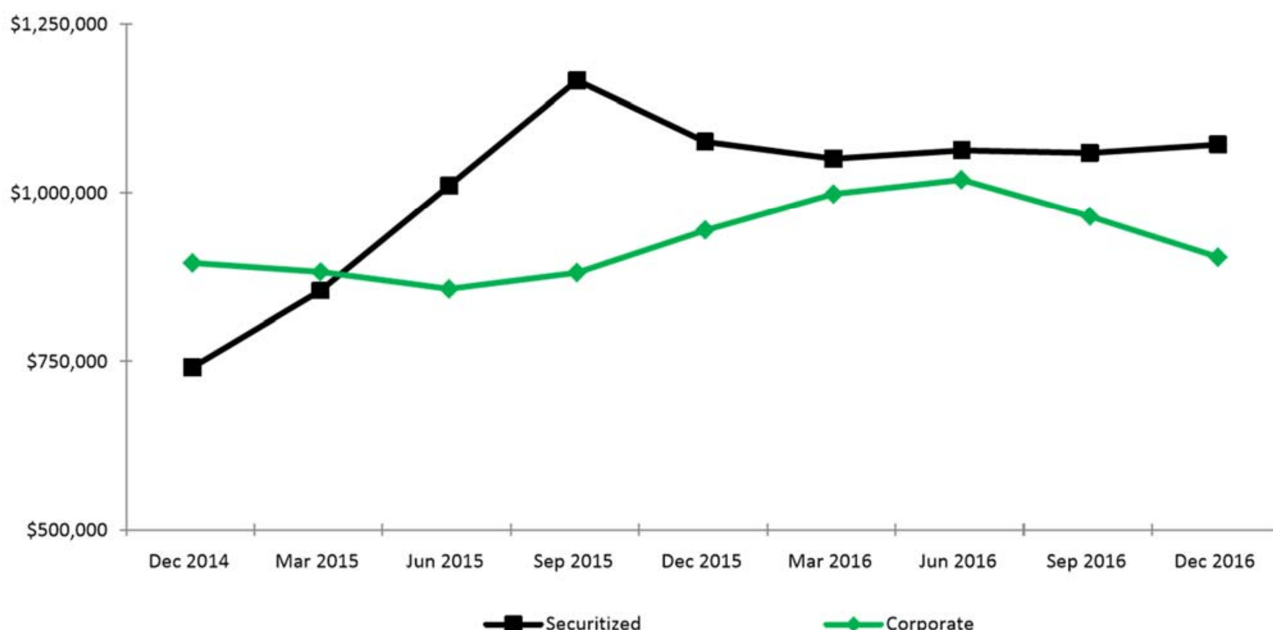
Mortgages - Corporate & Securitized

Table 11: Mortgage Summary

(in thousands) As at	December 31 2016	December 31 2015	Change from 2015 ($)	(%)
Corporate portfolio:				
Single family mortgages				
- Uninsured	$ 248,065	$ 359,465	$ (111,400)	(31%)
- Insured	108,334	83,619	24,715	30%
- Uninsured - completed inventory	18,162	31,280	(13,118)	(42%)
Construction loans			-	
- Residential	379,212	349,808	29,404	8%
- Non-residential	7,851	5,595	2,256	40%
Commercial loans			-	
- Uninsured	142,488	114,342	28,146	25%
	904,112	**944,109**	**(39,997)**	**(4%)**
Securitized portfolio:				
Single family insured - Market MBS program	971,548	1,075,947	(104,399)	(10%)
Single family insured - CMB program	100,301	-	100,301	-
	1,071,849	**1,075,947**	**(4,098)**	**-**
	$ 1,975,961	**$ 2,020,056**	**$ (44,095)**	**(2%)**

Corporate and Securitized Mortgage Portfolio Analysis

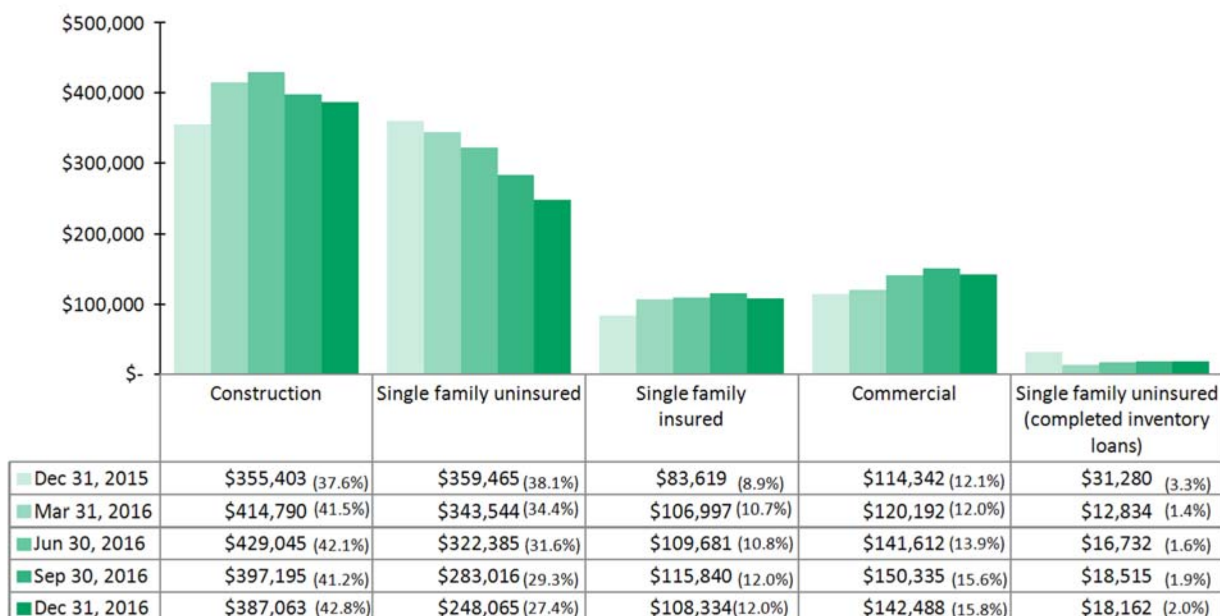
Figure 1: Total Corporate and Securitized Mortgage Portfolio (in thousands)



The corporate mortgage portfolio decreased in the first half of 2015 as we took a measured approach to new construction fundings and reduced our Alberta exposure. After completing this rebalancing, we experienced significant growth in late 2015 and the first half of 2016 before experiencing seasonal repayments in the second half of 2016. This intra-year increase caused the average 2016 construction portfolio balance to be significantly higher than 2015. The uninsured single family mortgage portfolio declined throughout 2016 as a result of low origination volumes, which drove the overall decline in the corporate portfolio.

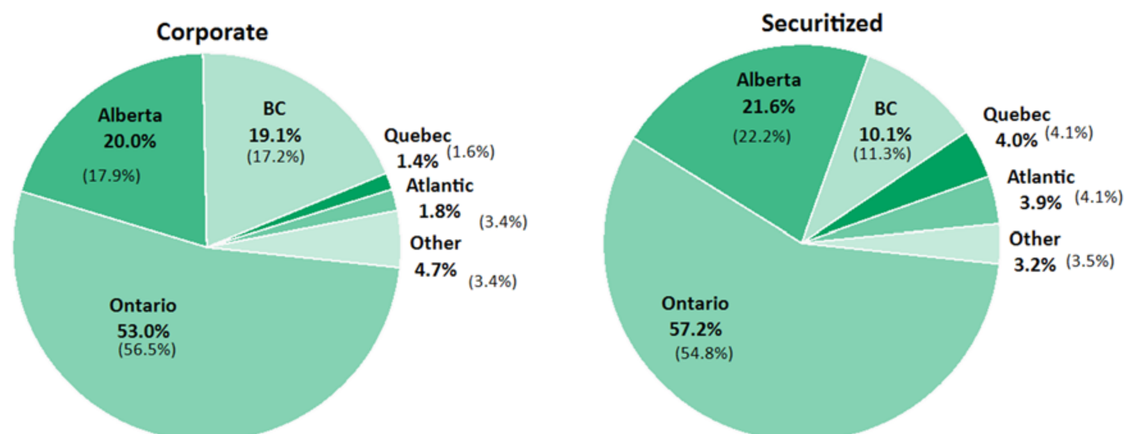
The securitized mortgage portfolio increased significantly throughout 2015 as a result of high securitization volumes, but decreased in Q4 2015 as a result of the sale of the interest-only strips associated with certain mortgages and a resulting derecognition from our balance sheet. Our 2016 securitization volumes were low such that new issuances and repayments of the existing portfolio offset each other.

Figure 2: Corporate Mortgage Portfolio Composition by Product Type (in thousands)



	Construction	Single family uninsured	Single family insured	Commercial	Single family uninsured (completed inventory loans)
Dec 31, 2015	$355,403 (37.6%)	$359,465 (38.1%)	$83,619 (8.9%)	$114,342 (12.1%)	$31,280 (3.3%)
Mar 31, 2016	$414,790 (41.5%)	$343,544 (34.4%)	$106,997 (10.7%)	$120,192 (12.0%)	$12,834 (1.4%)
Jun 30, 2016	$429,045 (42.1%)	$322,385 (31.6%)	$109,681 (10.8%)	$141,612 (13.9%)	$16,732 (1.6%)
Sep 30, 2016	$397,195 (41.2%)	$283,016 (29.3%)	$115,840 (12.0%)	$150,335 (15.6%)	$18,515 (1.9%)
Dec 31, 2016	$387,063 (42.8%)	$248,065 (27.4%)	$108,334 (12.0%)	$142,488 (15.8%)	$18,162 (2.0%)

Figure 3:Mortgage Portfolio Geographic Distribution as at December 31, 2016 (December 31, 2015)



Corporate Mortgages

2016 Summary

After $75 million of growth in the first two quarters of 2016, our corporate portfolio decreased by $115 million in the second half of the year for a net decrease of $40 million in 2016.

The construction portfolio was very strong in the first half of 2016 as a result of seasonal portfolio growth. This portfolio reduced to a more typical balance in the second half of the year as a result of seasonal repayments.

Single family mortgage origination volumes were lower in 2016 as a result of a tightening of our underwriting standards and increased processing times as we worked on a transition of systems and processes. Additionally, we took a more defensive approach to origination in 2016 given the accelerated valuations in this market segment. The uninsured portfolio decreased consistently throughout 2016, reducing by $111 million in the year. Despite the low origination volumes, the insured portfolio balance was relatively consistent in 2016 since the majority of originations are destined for securitization and therefore are held on a short-term basis.

Single family mortgages

We invest in insured and uninsured single family mortgages in Canada, primarily originated through Xceed for our own corporate portfolio and for securitization activities. Uninsured mortgages may not exceed 80% of the value of the real estate securing such loans at the time of funding. For the purposes of this ratio, value is the appraised value of the property as determined by a qualified appraiser at the time of funding. Residential mortgages insured by CMHC or other private insurers may exceed this ratio.

As we securitize mortgages that do not achieve derecognition, the assets are effectively transferred from corporate mortgages to securitized mortgages on the balance sheet. The change contributes to changes in asset levels when corporate mortgages are securitized in the following quarter.

For further information on MCAN-issued market MBS retained for liquidity purposes and included in corporate insured single family mortgages, refer to the “Securitization Programs” section of this MD&A.

Completed inventory loans

Completed inventory loans are credit facilities extended to developers to provide interim mortgage financing on residential units (condominium or freehold) where all construction has been completed and therefore no further construction risk exists. Satisfactory confirmation that all units are substantially complete is required prior to funding all completed inventory loans. Final occupancy permits, condominium corporation registration and/or written confirmation by the cost consultant as to the completion of the units are examples of verification measures.

Construction loans

Residential construction loans are made to homebuilders to finance residential construction projects. These loans generally have a floating interest rate and terms of one to two years. Non-residential construction loans provide construction financing for retail shopping developments, office buildings and industrial developments.

Commercial loans

Commercial loans include commercial term mortgages (e.g. loans secured by apartment buildings) and high ratio mortgage loans (e.g. second mortgages on residential construction projects). As at December 31, 2016, 50% of our commercial loan portfolio consisted of multi-family residential loans (December 31, 2015 - 46%).

Other items

While MCAN has exposure to real estate in the Fort McMurray area, we have no existing commercial lending or construction projects in the region. In regards to our single family mortgage exposure, we had $1.1 million and $8.9 million of outstanding corporate and securitized single family mortgages, respectively, and $7.4 million of off-balance sheet mortgages as at December 31, 2016. All of the aforementioned mortgages have mortgage insurance except for $117,000 of the corporate portfolio, for which no damage or loss was incurred. We are continuing to work with our borrowers and business partners to resolve any insurance claims. The fire in the Fort McMurray region has not had a material impact on net income to date and is not expected to have a future material impact on net income.

The Canadian mortgage industry has experienced an increase in the risk relating to the falsification of supporting documents provided to lenders in the mortgage underwriting process and we have observed this activity in our own underwriting processes. In response, we have added enhanced procedures to our underwriting process. We do not expect a material impact to our financial position or performance arising out of any such activity within the market or our own operations.

We continue to monitor our Alberta-based corporate mortgage portfolio. We are very diligent and selective in our mortgage funding opportunities and work with seasoned borrowers.

Mortgage renewal rights

Through Xceed, we retain the renewal rights to internally originated single family mortgages that are held as corporate or securitized mortgages or have been sold to third parties and derecognized from the balance sheet. At renewal, we may be able to renew these mortgages by offering clients attractive renewal options, thereby contributing to future revenues.

As at December 31, 2016, we had the renewal rights to $1.1 billion of single family mortgages (December 31, 2015 - $1.3 billion billion). The majority of these renewal rights relate to mortgages held on the consolidated balance sheet as corporate or securitized mortgages. The remaining balance of $130 million relates to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2015 - $219 million).

Table 12: Arrears and Impaired Mortgages

(in thousands except %) As at	December 31 2016	September 30 2016	December 31 2015
Corporate impaired mortgages			
Single family - uninsured	$ 2,759	$ 3,091	$ 2,196
Single family - insured	1,118	1,892	531
	3,877	4,983	2,727
Securitized impaired mortgages	587	-	-
Total impaired mortgages	$ 4,464	$ 4,983	$ 2,727
Impaired mortgage ratio (total) [1]	0.14%	0.15%	0.11%
Impaired mortgage ratio (corporate) [1]	0.31%	0.32%	0.23%
Total corporate mortgage arrears [1]			
Single family - uninsured	$ 8,878	$ 15,208	$ 14,826
Single family - insured	4,163	6,002	5,063
Commercial	-	3,000	-
	13,041	24,210	19,889
Total securitized mortgage arrears [1]	13,609	15,887	14,361
Total mortgage arrears [1]	$ 26,650	$ 40,097	$ 34,250
Collective allowance	$ 4,859	$ 5,115	$ 4,920
Individual allowance	390	377	339
Total allowance	$ 5,249	$ 5,492	$ 5,259

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.*

Economic volatility and continued weakness in commodity prices continue to affect housing markets in impacted provinces such as Alberta and Saskatchewan where job losses have impacted industry mortgage arrears. We continue to be diligent in monitoring the local housing markets in which we lend and will closely monitor our mortgage portfolio for early indicators of potential performance concerns.

Figure 4: Impaired Corporate Mortgage Ratio

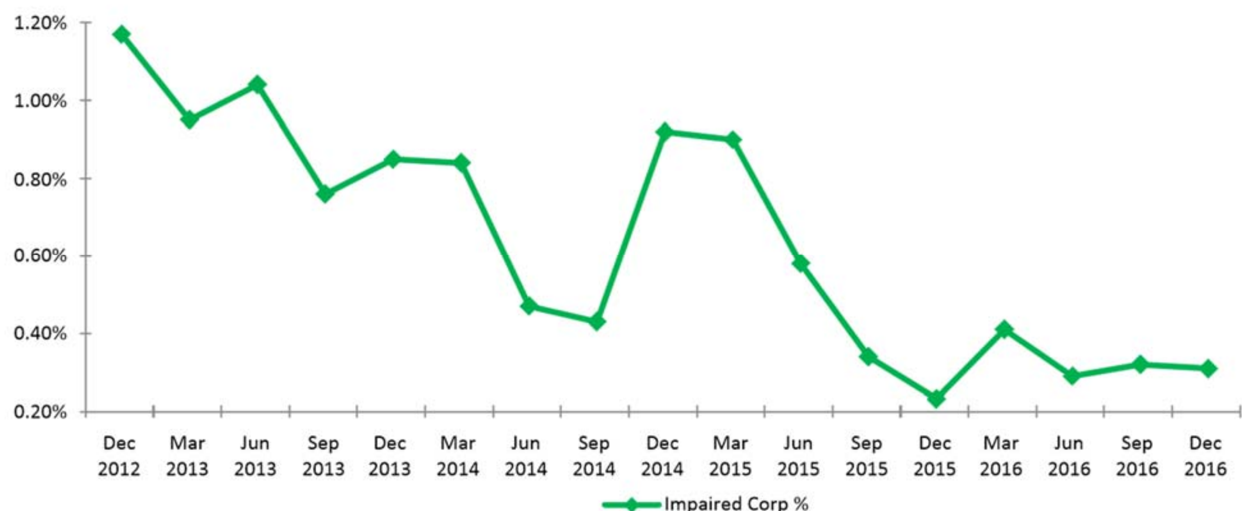


Table 13: Mortgage Originations

(in thousands) For the Periods Ended December 31	Q4 2016	Q4 2015	Annual 2016	Annual 2015
Single family - insured	$ 43,895	$ 51,099	$ 144,241	$ 356,594
Single family - uninsured	6,998	53,181	23,993	167,453
Single family - uninsured completed inventory	-	-	17,214	4,603
Residential construction (new loan fundings)	21,951	89,689	78,662	173,117
Non-residential construction (advances)	-	5,215	638	5,215
Commercial	15,725	10,754	79,294	58,674
	$ 88,569	**$ 209,938**	**$ 344,042**	**$ 765,656**

Uninsured single family originations were significantly lower in 2016 as a result of reduced spreads from a competitive market, the tightening of our underwriting standards (specifically for self-employed borrowers) and increased processing times as we transition our processes and legacy systems. Throughout 2016, we had an increase in mortgage applications that did not meet our underwriting standards and we therefore experienced a notable increase in the proportion of declined mortgage applications. The Toronto and Vancouver markets have experienced significant price inflation recently which is well in excess of supporting employment and income growth. Accordingly, we tightened our underwriting standards to mitigate these and other risks.

Insured single family originations also decreased in 2016, primarily due to increased processing times noted above.

Residential and non-residential construction volumes represent first advances on newly originated loans, i.e. they exclude additional fundings on existing loans in the portfolio. Although originations decreased from 2015, we still experienced growth in the portfolio during 2016 as a result of further draws on existing loans.

An increased focus on higher yielding commercial loans in 2016 led to higher origination volumes and an increase in the portfolio from December 31, 2015.

Table 14: Average Mortgage Loan to Value (LTV) Ratios

As at	December 31 2016	September 30 2016	December 31 2015
Corporate portfolio:			
Single family mortgages			
- Uninsured	72.2%	72.5%	72.7%
- Uninsured completed inventory	63.8%	51.0%	63.3%
- Insured	77.9%	81.1%	79.3%
Construction loans			
- Residential	58.8%	60.2%	66.1%
- Non-residential	58.4%	58.7%	59.4%
Commercial loans			
- Uninsured	67.3%	58.1%	68.7%
	66.2%	65.7%	63.5%
Securitized portfolio:			
Single family insured - Market MBS Program	86.2%	86.0%	85.9%
Single family insured - CMB Program	83.1%	83.7%	-
	85.9%	85.9%	85.9%
	76.8%	76.2%	75.4%

Additional Information on Residential Mortgages and Home Equity Lines of Credit ("HELOCs")

In accordance with OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures*, additional information is provided on the composition of MCAN's single family mortgage portfolio by insurance status and province, as well as amortization periods and LTV by province. LTV is calculated as the ratio of the outstanding loan balance on an amortized cost basis to the value of the underlying collateral at the time of origination.

Insured mortgages include mortgages insured by CMHC or other approved insurers at origination and mortgages that are portfolio insured after origination.

The HELOC balances displayed below relate to insured single family mortgages that have been acquired by MCAN. We do not originate HELOCs.

Table **15: Single Family Mortgages by Province as at December 31, 2016**

(in thousands except %)	Corporate						Securitized			
	Insured	%	Uninsured	%	HELOCs	%	Insured	%	Total	%
Ontario	$ 68,374	63.2%	$ 173,246	65.1%	$ 160	63.2%	$ 613,036	57.1%	$ 854,816	59.1%
Alberta	20,311	18.8%	47,312	17.8%	51	20.2%	231,027	21.6%	298,701	20.7%
British Columbia	2,953	2.7%	24,947	9.4%	42	16.6%	107,980	10.1%	135,922	9.4%
Quebec	5,495	5.1%	6,777	2.5%	-	-	42,715	4.0%	54,987	3.8%
Atlantic Provinces	8,616	8.0%	8,103	3.0%	-	-	41,407	3.9%	58,126	4.0%
Other	2,332	2.2%	5,842	2.2%	-	-	35,684	3.3%	43,858	3.0%
Total	**$ 108,081**	**100.0%**	**$ 266,227**	**100.0%**	**$ 253**	**100.0%**	**$ 1,071,849**	**100.0%**	**$ 1,446,410**	**100.0%**

Table 16: Single Family Mortgages by Province as at December 31, 2015

(in thousands except %)	Corporate						Securitized			
	Insured	%	Uninsured	%	HELOCs	%	Insured	%	Total	%
Ontario	$ 42,449	50.9%	$ 264,490	67.7%	$ 122	52.2%	$ 589,912	54.8%	$ 896,973	57.9%
Alberta	19,433	23.3%	54,815	14.0%	53	22.6%	239,192	22.2%	313,493	20.2%
British Columbia	3,646	4.4%	41,809	10.7%	59	25.2%	121,811	11.3%	167,325	10.8%
Quebec	6,887	8.3%	8,688	2.2%	-	-	43,960	4.1%	59,535	3.8%
Atlantic Provinces	8,848	10.6%	11,303	2.9%	-	-	43,712	4.1%	63,863	4.1%
Other	2,122	2.5%	9,640	2.5%	-	-	37,360	3.5%	49,122	3.2%
Total	**$ 83,385**	**100.0%**	**$ 390,745**	**100.0%**	**$ 234**	**100.0%**	**$ 1,075,947**	**100.0%**	**$ 1,550,311**	**100.0%**

Table 17: Single Family Mortgages by Amortization Period as at December 31, 2016

(in thousands except %)	Up to 20 Years	>20 to 25 Years	>25 to 30 Years	>30 to 35 Years	>35 to 40 Years	Total
Corporate	$ 67,175	$ 88,400	$ 211,956	$ 6,924	$ 106	$ 374,561
	17.9%	23.6%	56.6%	1.9%	0.0%	100.0%
Securitized	$ 164,923	$ 568,428	$ 247,246	$ 90,905	$ 347	$ 1,071,849
	15.4%	53.0%	23.1%	8.5%	0.0%	100.0%
Total	**$ 232,098**	**$ 656,828**	**$ 459,202**	**$ 97,829**	**$ 453**	**$ 1,446,410**
	16.1%	**45.4%**	**31.7%**	**6.8%**	**0.0%**	**100.0%**

Table 18: Single Family Mortgages by Amortization Period as at December 31, 2015

(in thousands except %)	Up to 20 Years	>20 to 25 Years	>25 to 30 Years	>30 to 35 Years	>35 to 40 Years	Total
Corporate	$ 76,636	$ 79,032	$ 301,874	$ 16,434	$ 388	$ 474,364
	16.2%	16.7%	63.6%	3.5%	0.0%	100.0%
Securitized	$ 119,194	$ 575,192	$ 277,016	$ 103,802	$ 743	$ 1,075,947
	11.1%	53.5%	25.7%	9.6%	0.1%	100.0%
Total	**$ 195,830**	**$ 654,224**	**$ 578,890**	**$ 120,236**	**$ 1,131**	**$ 1,550,311**
	12.6%	**42.2%**	**37.3%**	**7.8%**	**0.1%**	**100.0%**

Table 19: Average Loan to Value (LTV) Ratio for Uninsured Single Family Mortgage Originations

(in thousands except %) **For the Periods Ended December 31**	**Q4 2016**	**Average LTV**	**YTD 2016**	**Average LTV**	**Q4 2015**	**Average LTV**	**YTD 2015**	**Average LTV**
Ontario	$ 6,064	74.4%	$ 30,627	74.0%	$ 40,084	73.8%	$ 127,446	73.8%
Alberta	-	-	5,525	69.3%	6,401	73.2%	26,023	74.3%
British Columbia	750	57.7%	4,502	67.3%	4,733	73.0%	13,149	72.7%
Atlantic Provinces	-	-	-	-	-	-	1,336	62.7%
Other	184	80.0%	553	72.8%	1,963	76.4%	4,102	73.7%
	$ 6,998	**72.8%**	**$ 41,207**	**72.7%**	**$ 53,181**	**73.7%**	**$ 172,056**	**73.7%**

Based on past experience and relative to the specifics of the then prevailing economic conditions, we would expect to observe an increase in overall mortgage default and arrears rates in the event of an economic downturn as realization periods on collateral become longer and borrowers adjust to the new economic conditions and changing real estate values. This would also result in a corresponding increase in our allowance for credit losses. An economic downturn, for example, could include changes to employment and unemployment rates, income levels and consumer spending which would have the above noted impact on our single family mortgage portfolio. MCAN utilizes a number of risk assessment and mitigation strategies to lessen the potential impact for loss on single family mortgages. In addition, MCAN's corporate uninsured single family mortgage portfolio is also secured with an average LTV at origination of 71.6% as at December 31, 2016 (December 31, 2015 - 73.4%). Based on an industry index that incorporates current real estate values, the ratios would be 56.5% and 63.4%, respectively.

Other Corporate Assets

Cash and cash equivalents

Cash and cash equivalents, which include cash balances with banks and overnight term deposits, increased by $36 million in 2016. The December 31, 2016 balance was higher than usual as a result of certain early loan payouts. Cash and cash equivalents provide liquidity to meet maturing term deposit and new mortgage funding commitments and are considered to be Tier 1 liquid assets. For further information, refer to the "Liquidity Management" section of this MD&A.

Marketable securities

Marketable securities, consisting of corporate bonds and real estate investment trusts ("REITs"), increased by $14 million in 2016, which included a $3.6 million net increase in the unrealized gain on the portfolio that was reflected in accumulated other comprehensive income. The unrealized gain on the portfolio was volatile throughout 2016, primarily due to the impact of interest rate movements on REIT valuations. Marketable securities provide additional liquidity at yields in excess of cash and cash equivalents and are considered to be Tier 2 liquid assets. For further details, refer to the "Liquidity Management" section of this MD&A.

Financial investments

Corporate financial investments include a $33 million investment in Crown LP, in which we have a 14.1% equity interest (December 31, 2015 - $31 million). Crown LP invests primarily in commercial office buildings and classifies them into its core fund, which represents buildings expected to provide stable cash flows over a longer time horizon, and its opportunity fund, which represents buildings with medium term capital appreciation. Its fair value is driven primarily by independent appraisals of the buildings. As property acquisitions are made by Crown LP, we advance our proportionate share to finance the acquisitions.

During 2016, we recorded a $7.2 million gross increase in the unrealized gain on the investment (2015 - $8.5 million), which is recognized in the consolidated statements of comprehensive income net of deferred taxes. Additionally, we recognized $4.1 million of income from the Crown LP investment in 2016 (2015 - $2.5 million). The receipt of partnership distributions from Crown LP generates a transfer from accumulated other comprehensive income to net income, where it is reflected in income from financial investments and other loans.

We hold a $24 million investment in the KingSett High Yield Fund, in which we have a 9% equity interest (December 31, 2015 - $11 million). The fund invests in mortgages secured by real estate with a focus on mezzanine, subordinate and bridge mortgages and is carried at fair value. As mortgage advances are made by the fund, we advance our proportionate share. The fund pays a base distribution of 9% per annum, and distributes any additional income earned on a quarterly basis. Our 2016 return was 11.2%. Our total funding commitment is $63 million, which consists of $42 million of capital advances for the fund and $21 million that supports credit facilities.

Equity investment in MCAP

We hold a 14.74% equity interest in MCAP, which represents 4.3 million units held by MCAN of the 29.2 million total outstanding MCAP partnership units. The investment had a net book value of $51 million as at December 31, 2016 (December 31, 2015 - $44 million). The Limited Partner's At-Risk Amount ("LP ARA"), which represents the cost base of the equity investment in MCAP for income tax purposes, was $39 million as at December 31, 2016 (December 31, 2015 - $42 million). For further information on the LP ARA, refer to the "Non-IFRS Measures" section of this MD&A.

Our investment in MCAP creates a deduction from Total Capital under Basel III (refer to the "Capital Management" section of this MD&A), which is measured on an accounting basis and is phased in by 20% on an annual basis to 2018 such that the deduction was 60% in 2016. We have managed our investment in MCAP in line with our Risk Appetite Framework ("RAF") and regulatory requirements in order to minimize this deduction from Total Capital under Basel III while optimizing the economic benefits of the investment.

MCAP is an originator and servicer of mortgages for third party investors in Canada and securitizes mortgages on its own behalf. MCAP's origination volumes were $15.9 billion in 2016. MCAP had $60.6 billion of assets under administration as at November 30, 2016.

We currently use the equity basis of accounting for our investment in MCAP as per International Accounting Standard ("IAS") 28, *Investments in Associates and Joint Ventures*, as we have significant influence in MCAP through our entitlement to a position on MCAP's Board of Directors. If we experience further dilution we may no longer qualify for the equity basis of accounting. In that case, we would not recognize our pro-rata share of MCAP's net income as equity income, but would instead recognize distributions received from MCAP as income and would carry the investment as available for sale with changes in fair value recognized through accumulated other comprehensive income.

In mid-2016, MCAP filed a preliminary prospectus with respect to an initial public offering of common shares. Subsequently, MCAP withdrew the prospectus due to adverse market conditions. Since the events did not lead to a change in accounting, we continue to use the equity basis of accounting for our investment in MCAP.

Foreclosed real estate

Foreclosed real estate consists of a real estate investment which was previously an impaired construction loan. This investment is carried at the lower of the carrying amount and fair value less estimated costs to sell.

Securitization Assets

Securitization assets consist primarily of single family insured mortgages securitized through the market MBS program and CMB program. During 2016 we recognized $42 million of new securitized mortgages on our balance sheet from our participation in the market MBS program and $100 million from the CMB program.

For further information, refer to the "Securitization Programs" section of this MD&A.

Table 20: Liabilities and Shareholders' Equity

(in thousands) As at	December 31 2016	September 30 2016	December 31 2015	Change from 2015 ($)	(%)
Corporate Liabilities					
Term deposits	$ 911,866	$ 948,946	$ 903,041	$ 8,825	1%
Current tax liabilities	-	-	100	(100)	(100%)
Deferred tax liabilities	3,050	2,363	2,299	751	33%
Other liabilities	12,377	5,428	12,412	(35)	-
	927,293	**956,737**	**917,852**	**9,441**	**1%**
Securitization Liabilities					
Financial liabilities from securitization	1,071,786	1,058,402	1,070,304	1,482	-
	1,071,786	**1,058,402**	**1,070,304**	**1,482**	**-**
	1,999,079	**2,015,139**	**1,988,156**	**10,923**	**1%**
Shareholders' Equity					
Share capital	210,239	210,239	206,382	3,857	2%
Contributed surplus	510	510	510	-	-
Retained earnings	55,923	53,846	42,617	13,306	31%
Accumulated other comprehensive income	15,104	11,271	9,293	5,811	63%
	281,776	**275,866**	**258,802**	**22,974**	**9%**
	$ 2,280,855	**$ 2,291,005**	**$ 2,246,958**	**$ 33,897**	**2%**

We issue term deposits that are eligible for Canada Deposit Insurance Corporation ("CDIC") deposit insurance to fund our corporate operations. The role of term deposits in managing liquidity risk is discussed in the "Liquidity and Funding Risk" sub-section of the "Risk Governance and Management" section of this MD&A.

Financial liabilities from securitization relate to our participation in the market MBS program and CMB program, representing MBS that we have sold to third parties but have not been derecognized from our balance sheet. Activity in 2016 consists of the creation of $42 million of new liabilities from our participation in the market MBS program and $100 million from the CMB program less $141 million of net repayments. For further information on the market MBS program and CMB program, refer to the "Securitization Programs" section of this MD&A.

Share capital activity for 2016 reflects new common shares issued through the Dividend Reinvestment Plan ("DRIP") and the Executive Share Purchase Plan. For further information, refer to Note 21 to the consolidated financial statements.

Retained earnings activity for 2016 consists of net income of $40.2 million less dividends of $26.9 million.

Accumulated other comprehensive income represents unrealized gains or losses on available for sale marketable securities and financial investments. During 2016, we recorded a $3.6 million net increase in the unrealized gain on the marketable securities portfolio. In addition, we recorded a $2.2 million net increase in the unrealized gain on available for sale financial investments, which included a $7.0 million gross increase in the unrealized gain less a $4.1 million transfer to net income net of deferred taxes.

SELECTED QUARTERLY FINANCIAL DATA

Table 21: Selected Quarterly Financial Data

(in thousands except for per share amounts and %)	Q4/16	Q3/16	Q2/16	Q1/16	Q4/15	Q3/15	Q2/15	Q1/15
Net investment income - corporate assets	$ 11,684	$ 12,396	$ 16,996	$ 10,625	$ 12,602	$ 8,996	$ 13,745	7,398
Other income - corporate assets	-	-	-	-	-	-	68	-
Net investment income - securitization assets	1,519	1,594	1,421	1,244	1,469	1,246	1,058	694
	13,203	13,990	18,417	11,869	14,071	10,242	14,871	8,092
Operating expenses	4,471	4,323	4,650	4,519	4,224	3,577	3,136	3,571
Net income before income taxes	8,732	9,667	13,767	7,350	9,847	6,665	11,735	4,521
Provision for (recovery of) income taxes	(268)	(108)	131	(421)	397	(528)	(183)	225
Net income	$ 9,000	$ 9,775	$ 13,636	$ 7,771	$ 9,450	$ 7,193	$ 11,918	4,296
Average mortgage portfolio yield - corporate [1]	4.99%	5.14%	5.21%	5.27%	5.31%	5.25%	5.34%	5.48%
Average term deposit interest rate [1]	2.20%	2.22%	2.22%	2.25%	2.27%	2.32%	2.38%	2.40%
Basic and diluted earnings per share	$ 0.39	$ 0.43	$ 0.59	$ 0.34	$ 0.42	$ 0.32	$ 0.56	0.21
Return on average shareholders' equity [1]	12.94%	14.08%	20.10%	11.80%	14.66%	11.36%	20.16%	7.49%
Dividends per share								
Regular	$ 0.30	$ 0.29	$ 0.29	$ 0.29	$ 0.29	$ 0.28	$ 0.28	0.28
Total	$ 0.30	$ 0.29	$ 0.29	$ 0.29	$ 0.29	$ 0.28	$ 0.28	0.28

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*

Net investment income from corporate assets has been consistent since Q1 2015 with the exception of significant increases in Q4 2015 and Q2 2016 from income recognized upon the receipt of distributions from Crown LP. Q2 2015 and Q2 2016 also had substantial equity income from MCAP. Additionally, Q1 2015 was negatively impacted by significant realized and unrealized losses on derivatives. We have experienced a steady decrease in our corporate mortgage portfolio and term deposit yields due to decreases in market rates for new fundings. Realized and unrealized losses on derivatives were volatile in 2015.

Net investment income from securitization assets has increased steadily from growth in the market MBS program and our re-entry into the CMB program.

For an analysis of the increase in operating expenses in recent quarters, refer to the "Operating Expenses" sub-section of the "Results of Operations" section of this MD&A.

Table 22: Ten Year Financial Summary

(in thousands except per share amounts)

December 31	Net Income	Earnings Per Share	Dividends Per Share	Assets[1]	Shareholders' Equity	Market Capitalization
2016 (IFRS)	$ 40,182	$ 1.75	$ 1.17	$ 1,188,480	$ 281,776	$ 330,434
2015 (IFRS)	32,857	1.51	1.13	1,155,046	258,802	276,573
2014 (IFRS)	25,446	1.23	1.12	1,044,579	225,303	299,635
2013 (IFRS)	30,805	1.57	1.15	1,027,176	214,900	265,993
2012 (IFRS)	16,494	0.94	1.42	950,686	177,781	262,393
2011 (IFRS)	24,262	1.50	1.81	753,799	158,465	225,951
2010 (IFRS)	31,667	2.20	1.19	538,118	125,079	200,249
2009 (CGAAP)	24,742	1.73	1.44	506,683	122,879	194,766
2008 (CGAAP)	30,348	2.14	0.96	570,154	116,609	129,438
2007 (CGAAP)	14,843	1.12	1.00	557,425	103,007	140,416

[1] *2010-2016 consist of corporate assets only as reported under IFRS. 2007-2009 consist of total assets as reported under Canadian Generally Accepted Accounting Principles ("CGAAP").*

SUMMARY OF FOURTH QUARTER RESULTS

Table 23: Quarterly Net Income

(in thousands) For the Quarters Ended	December 31 2016	September 30 2016	December 31 2015
Net Investment Income - Corporate Assets			
Mortgage interest	$ 11,728	$ 12,987	$ 12,610
Equity income from MCAP Commercial LP	3,209	3,276	2,070
Fees	638	683	937
Marketable securities	889	1,205	802
Financial investments and other loans	933	614	2,920
Interest on cash and cash equivalents	206	145	149
Whole loan gain on sale income	-	-	113
Realized gain on derivatives	-	-	2
	17,603	**18,910**	**19,603**
Term deposit interest and expenses	5,492	5,685	5,189
Mortgage expenses	1,013	1,009	1,124
Interest on loans payable	-	64	163
Provision for (recovery of) credit losses	(586)	(244)	525
	5,919	**6,514**	**7,001**
	11,684	**12,396**	**12,602**
Net Investment Income - Securitization Assets			
Mortgage interest	7,122	7,187	7,556
Other securitization income	112	219	50
	7,234	7,406	7,606
Interest on financial liabilities from securitization	5,250	5,356	5,684
Mortgage expenses	465	456	453
	5,715	5,812	6,137
	1,519	**1,594**	**1,469**
Operating Expenses			
Salaries and benefits	2,129	2,191	2,586
General and administrative	2,342	2,132	1,638
	4,471	4,323	4,224
Net Income Before Income Taxes	8,732	9,667	9,847
Provision for (recovery of) income taxes	(268)	(108)	397
Net Income	**$ 9,000**	**$ 9,775**	**$ 9,450**
Basic and diluted earnings per share	$ 0.39	$ 0.43	$ 0.42
Dividends per share	$ 0.30	$ 0.29	$ 0.29

Q4 2016 vs. Q4 2015

Net Investment Income - Corporate Assets

Table 24: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

For the Quarters Ended December 31	2016			2015		
(in thousands except %)	Average Balance	Interest Income	Average Rate [1]	Average Balance	Interest Income	Average Rate [1]
Single family						
- Uninsured	$ 271,126	$ 3,104	4.56%	$ 354,792	$ 4,026	4.53%
- Insured	125,902	755	3.12%	102,650	938	3.65%
- Uninsured - completed inventory	17,888	244	5.42%	19,822	229	4.59%
Construction loans						
- Residential	387,536	5,152	5.29%	348,882	4,883	5.59%
- Non residential	7,852	108	5.45%	4,705	65	5.52%
Commercial loans						
- Uninsured	143,843	2,365	6.55%	101,567	2,469	8.88%
Mortgages - corporate portfolio	$ 954,147	$ 11,728	4.99%	$ 932,418	$ 12,610	5.31%
Term deposits	934,475	5,492	2.20%	864,518	5,189	2.27%
Spread of mortgages over term deposits			2.79%			3.04%
Mortgages - securitized portfolio	$ 1,032,208	$ 7,122	2.74%	$ 1,126,839	$ 7,556	2.66%
Financial liabilities from securitization	1,046,078	5,250	2.01%	1,135,196	5,684	2.01%
Spread of mortgages over liabilities			0.73%			0.65%

[1] Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income on impaired loans, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Excluding discount income on impaired loans and deferred interest, non-recurring items were immaterial for the quarters ended December 31, 2016 and December 31, 2015. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Changes in the average portfolio balance from Q4 2015 are generally consistent with the fiscal 2016 discussion in the "Net Investment Income - Corporate Assets" sub-section of the "Results of Operations" section of this MD&A.

The uninsured single family portfolio declined throughout 2016 as a result of low origination volumes for new mortgages in the year. Despite a general trend downwards in funding rates for new mortgages, the average portfolio yield increased over Q4 2015 as a result of higher penalty income.

The increase in the average construction portfolio balance from Q4 2015 was primarily due to strong funding volumes in the first half of 2016 that helped to maintain a high balance throughout the year amidst seasonal repayments.

We targeted growth in our commercial portfolio during 2016 and experienced a significant increase in the average portfolio balance over Q4 2015.

Market rates for new mortgage and term deposit fundings have generally decreased since 2015. Average mortgage portfolio yield is considered to be a non-IFRS measure. For a definition of this measure, refer to the "Non-IFRS Measures" section of this MD&A.

The increase in equity income from MCAP in Q4 2016 was a result of higher securitized mortgage interest income from a larger average portfolio, and higher servicing and administration income due to an increase in assets under administration.

The decrease in income from financial investments and other loans in Q4 2016 is primarily due to the recognition of $2.5 million of income from our investment in Crown LP in Q4 2015 upon the receipt of partnership distributions.

Net Investment Income - Securitization Assets

Despite a lower average portfolio balance, spread income from securitization assets was unchanged from Q4 2015. The slight increase in net investment income from securitization assets was due to a $78,000 upfront gain earned on the securitization of insured multi family loans through the CMB program.

In Q4 2016, our total securitization volumes were $74 million (Q4 2015 - $239 million), consisting of $8 million of insured single family mortgages (Q4 2015 - $239 million) through the market MBS program and $51 million of insured single family mortgages (Q4 2015 - $nil) and $15 million of insured multi family loans (Q4 2015 - $nil) through the CMB program.

For further information on corporate and securitization net investment income, refer to the "Net Interest Income" sub-section below.

Net Interest Income

Presented in the following tables is an analysis of average rates and net interest income. Net interest income is the difference between interest earned on certain assets and the interest paid on liabilities to fund those assets. For further details, refer to the "Non-IFRS Measures" section of this MD&A.

Table 25: Net Interest Income

For the Quarters Ended December 31	2016			2015		
(in thousands except %)	Average Balance [1]	Income / Expense	Average Rate [3]	Average Balance [1]	Income / Expense	Average Rate [3]
Assets						
Cash and cash equivalents	$ 98,044	$ 208	0.84%	$ 74,384	$ 149	0.79%
Marketable securities	51,682	889	6.84%	38,829	802	8.19%
Mortgages	954,147	11,728	4.99%	932,418	12,610	5.31%
Financial investments	21,195	494	9.27%	9,149	382	16.57%
Other loans	3,662	48	5.21%	2,027	29	5.68%
Corporate interest earning assets	1,128,730	13,367	4.71%	1,056,807	13,972	5.25%
Short term investments	18,405	11	0.24%	11,775	8	0.27%
Mortgages	1,032,208	7,122	2.74%	1,126,839	7,556	2.66%
Financial investments	-	-	-	-	-	-
Securitized interest earning assets	1,050,613	7,133	2.70%	1,138,614	7,564	2.64%
Total interest earning assets	2,179,343	20,500	3.74%	2,195,421	21,536	3.89%
Non interest earning assets	88,514	391	-	83,036	2,509	-
Total assets	$ 2,267,857	$ 20,891	3.66%	$ 2,278,457	$ 24,045	4.19%
Liabilities and shareholders' equity						
Term deposits	$ 934,475	$ 5,492	2.20%	$ 864,518	$ 5,189	2.27%
Loans payable	-	-	-	14,234	163	3.06%
Corporate liabilities	934,475	5,492	2.20%	878,752	5,352	2.29%
Securitization liabilities	1,046,078	5,250	2.01%	1,135,196	5,684	2.01%
Total interest bearing liabilities	1,980,553	10,742	2.11%	2,013,948	11,036	2.15%
Non interest bearing liabilities	9,044	-	-	6,728	-	-
Shareholders' equity	278,260	-	-	257,781	-	-
Total liabilities and shareholders' equity	$ 2,267,857	$ 10,742	1.88%	$ 2,278,457	$ 11,036	1.92%
Net Interest Income [2]		$ 10,149			$ 13,009	

[1] The average balances (excluding cash and cash equivalents, mortgages and term deposits) are calculated with reference to opening and closing monthly balances and as such may not be as precise as if daily balances were used. The average cash and cash equivalents, mortgage and term deposit balances are calculated using daily balances.

[2] Net interest income is equal to net investment income less equity income from MCAP, fees, whole loan gain on sale income, realized gain (loss) on derivatives, other securitization income, mortgage expenses and provision for credit losses. Net interest income is a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

[3] Average rate is equal to income/expense divided by the average balance on an annualized basis. The average rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items consisting of one-time gains/losses, asset write-downs and fees not associated with the asset/liability yield are excluded from the calculation of the average rate. Excluding discount income on impaired loans and deferred interest, non-recurring items were immaterial for the quarters ended December 31, 2016 and December 31, 2015. Average rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Credit Quality

Table 26: Provisions for Credit Losses and Write-offs

(in thousands except basis points) For the Quarters Ended	December 31 2016	September 30 2016	December 31 2015
Individual provision (recovery)			
Single family uninsured	$ 50	$ 51	$ 6
Collective provision (recovery)			
Single family uninsured	(148)	(167)	133
Single family uninsured - completed inventory	(1)	8	96
Construction	(67)	(218)	291
Commercial	(37)	105	38
Corporate mortgages - total	(253)	(272)	558
Other provisions (recoveries)	(383)	(23)	(39)
	$ (636)	$ (295)	$ 519
Total provision for (recovery of) credit losses	$ (586)	$ (244)	$ 525
Corporate mortgage portfolio data:			
Provision for (recovery of) credit losses	$ (203)	$ (221)	$ 564
Net write offs	$ 39	$ -	$ 45
Annualized net write offs (basis points)	1.6	-	1.9

The change in the corporate mortgage collective provision from Q4 2015 to Q4 2016 was largely driven by portfolio activity. Corporate mortgages that attract a collective allowance increased by $96 million in Q4 2015, compared to a $53 million decrease in Q4 2016. For a discussion of other provisions (recoveries), refer to the “Credit Quality” sub-section of the “Results of Operations” section of this MD&A.

Table 27: Operating Expenses

(in thousands) For the Quarters Ended	December 31 2016	September 30 2016	December 31 2015
Salaries and benefits	$ 2,129	$ 2,191	$ 2,586
General and administrative	2,342	2,132	1,638
	$ 4,471	**$ 4,323**	**$ 4,224**

Salaries and benefits were higher in Q4 2015 as a result of a higher variable compensation expense. For a discussion of general and administrative expenses, refer to the “Operating Expenses” sub-section of the “Results of Operations” section of this MD&A.

Table 28: Income Taxes

(in thousands) For the Quarters Ended	December 31 2016	September 30 2016	December 31 2015
Deferred tax provision	$ (268)	$ (108)	$ 397
	$ (268)	**$ (108)**	**$ 397**

The deferred tax provision (recovery) is driven by taxable income (losses) recognized in subsidiaries.

Q4 2016 vs. Q3 2016

Net Investment Income - Corporate Assets

Table 29: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

For the Quarters Ended	December 31, 2016			September 30, 2016		
(in thousands except %)	Average Balance	Interest Income	Average Rate [1]	Average Balance	Interest Income	Average Rate [1]
Single family						
- Uninsured	$ 271,126	$ 3,104	4.56%	$ 306,022	$ 3,621	4.72%
- Insured	125,902	755	3.12%	117,815	954	3.23%
- Uninsured - completed inventory	17,888	244	5.42%	22,098	374	6.75%
Construction loans						
- Residential	387,536	5,152	5.29%	421,242	5,729	5.42%
- Non residential	7,852	108	5.45%	7,408	104	5.57%
Commercial loans						
- Uninsured	143,843	2,365	6.55%	133,784	2,205	6.57%
Mortgages - corporate portfolio	$ 954,147	$ 11,728	4.99%	$ 1,008,369	$ 12,987	5.14%
Term deposits	934,475	5,492	2.20%	962,150	5,685	2.22%
Spread of mortgages over term deposits			2.79%			2.92%
Mortgages - securitized portfolio	$ 1,032,208	$ 7,122	2.74%	$ 1,032,280	$ 7,187	2.77%
Financial liabilities from securitization	1,046,078	5,250	2.01%	1,045,122	5,356	2.05%
Spread of mortgages over liabilities			0.73%			0.72%

[1] Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income on impaired loans, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Excluding discount income on impaired loans and deferred interest, non-recurring items were immaterial for the quarters ended December 31, 2016 and September 30, 2016. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Lower corporate mortgage interest was the main factor behind the small decrease in net income from Q3 2016 to Q4 2016. The decline in the average corporate portfolio balance in Q4 2016 was a result of continued low uninsured single family originations and seasonal repayments in the construction portfolio. All other key components of net income were comparable to Q3 2016.

Financial Position

Table 30: Quarterly Balance Sheet

(in thousands) As at	December 31 2016	September 30 2016	Change from Prior Quarter ($)	 (%)
Assets				
Corporate Assets				
Cash and cash equivalents	$ 111,732	$ 80,204	$ 31,528	39%
Marketable securities	55,126	52,901	2,225	4%
Mortgages	904,112	964,901	(60,789)	(6%)
Financial investments	57,264	49,716	7,548	15%
Other loans	3,584	3,729	(145)	(4%)
Equity investment in MCAP Commercial LP	50,805	49,073	1,732	4%
Foreclosed real estate	529	529	-	-
Deferred tax asset	1,782	1,501	281	19%
Other assets	3,546	7,017	(3,471)	(49%)
	1,188,480	**1,209,571**	**(21,091)**	**(2%)**
Securitization Assets				
Cash held in trust	15,724	17,669	(1,945)	(11%)
Mortgages	1,071,849	1,059,512	12,337	1%
Other assets	4,802	4,253	549	13%
	1,092,375	**1,081,434**	**10,941**	**1%**
	$ 2,280,855	**$ 2,291,005**	**$ (10,150)**	**-**
Liabilities and Shareholders' Equity				
Liabilities				
Corporate Liabilities				
Term deposits	$ 911,866	$ 948,946	$ (37,080)	(4%)
Deferred tax liabilities	3,050	2,363	687	29%
Other liabilities	12,377	5,428	6,949	128%
	927,293	**956,737**	**(29,444)**	**(3%)**
Securitization Liabilities				
Financial liabilities from securitization	1,071,786	1,058,402	13,384	1%
	1,071,786	**1,058,402**	**13,384**	**1%**
Shareholders' Equity				
Share capital	210,239	210,239	-	-
Contributed surplus	510	510	-	-
Retained earnings	55,923	53,846	2,077	4%
Accumulated other comprehensive income	15,104	11,271	3,833	34%
	281,776	**275,866**	**5,910**	**2%**
	$ 2,280,855	**$ 2,291,005**	**$ (10,150)**	**-**

Table 31: Quarterly Mortgage Summary

(in thousands) As at	December 31 2016	September 30 2016	Change from Prior Quarter ($)	(%)
Corporate portfolio:				
Single family mortgages				
- Uninsured	$ 248,065	$ 283,016	$ (34,951)	(12%)
- Insured	108,334	115,840	(7,506)	(6%)
- Uninsured - completed inventory	18,162	18,515	(353)	(2%)
Construction loans				
- Residential	379,212	389,679	(10,467)	(3%)
- Non-residential	7,851	7,516	335	4%
Commercial loans				
- Uninsured	142,488	150,335	(7,847)	(5%)
	904,112	**964,901**	**(60,789)**	**(6%)**
Securitized portfolio:				
Single family insured - Market MBS program	971,548	1,009,426	(37,878)	(4%)
Single family insured - CMB program	100,301	50,086	50,215	100%
	1,071,849	**1,059,512**	**12,337**	**1%**
	$ 1,975,961	**$ 2,024,413**	**$ (48,452)**	**(2%)**

The primary change in the corporate balance sheet during Q4 2016 was the decline in the corporate mortgage portfolio noted above. Our cash balances increased significantly during Q4 2016 due to certain early loan payouts. The increase in financial investments was driven by an increase in the fair value of the Crown LP investment, recorded to accumulated other comprehensive income. Securitization assets increased modestly as a result of new CMB program and market MBS program securitization issuances.

SECURITIZATION PROGRAMS

We are an NHA MBS issuer, which involves the securitization of insured mortgages to create MBS. We issue MBS through our internal market MBS program and the Canada Housing Trust ("CHT") CMB program. In both programs, we leverage our regulatory asset capacity by originating or purchasing insured single family mortgages for securitization and sale to third parties, thus providing us with a reliable source of incremental income.

Pursuant to the NHA MBS program, investors of MBS receive monthly cash flows consisting of interest and scheduled and unscheduled principal payments. CMHC makes principal and interest payments in the event of any MBS default by the issuer, thus fulfilling the Timely Payment obligation to investors. In instances where we have sold MBS, where applicable, these sales are executed for the purposes of transferring various economic exposures that result in accounting outcomes noted for each program below. Each of the programs noted below provide for many responsibilities that are linked to the issuer of these MBS instruments. We do not transfer program oversight or these specific responsibilities when selling MBS to other parties.

Market MBS Program

As part of the market MBS program, we may sell MBS to third parties and may also sell the interest-only strips to third parties. The MBS portion of the mortgage represents the core securitized mortgage principal and the right to receive coupon interest at a specified rate. The interest-only strips represent the right to receive excess cash flows after satisfying the MBS coupon interest payment and any other expenses such as mortgage servicing. As part of this program, we originate and purchase insured single family mortgages to sell as MBS.

During 2016, we pooled and sold $42 million of MBS to third parties (2015 - $589 million). The majority of our previous mortgage sales have not achieved derecognition as we retained significant continuing involvement with the assets such that the associated mortgages remained on the balance sheet while a corresponding liability was incurred. The mortgage interest income and interest on the financial liability from securitization associated with these mortgages are recognized on the accrual basis over the term of the mortgages.

During 2015, we sold the interest-only strips associated with $147 million of mortgages securitized through the market MBS program to third parties. Subsequent to sale, we derecognized the securitized mortgages and associated financial liabilities from securitization from the consolidated balance sheet as a result of the transfer of substantially all risks and rewards of ownership to the purchaser of the interest-only strip. We did not sell any interest-only strips in 2016.

We may issue market MBS through the NHA MBS program and retain the underlying MBS security instead of selling it to a third party. As at December 31, 2016, we held $37 million of retained MBS on our balance sheet (December 31, 2015 - $21 million), which is included in the insured single family classification within corporate mortgages.

CMB Program

We recommenced our participation in the CMB program in 2016 by securitizing both insured single family and insured multi family loans (e.g. loans secured by apartment buildings) through the CMB program. The CMB program involves the sale of MBS to CHT who in turn issues a non-amortizing bullet bond to external investors. The CMB program generally includes the reinvestment of mortgage principal repayments by the issuer into certain permitted assets, however we have transferred the benefits and obligations associated with the principal reinvestment function to a third party such that we only earn spread income on the amortizing mortgage balance. The third party is responsible for sourcing assets in which to reinvest and any associated obligations. This transfer has no net ongoing financial impact on MCAN.

We securitized $100 million of insured single family mortgages during 2016 (2015 - $nil). Similar to the market MBS program transaction, we did not derecognize the mortgages from the consolidated balance sheet as we retained significant continuing involvement with the assets such that the associated mortgages remained on the consolidated balance sheet while a corresponding liability was incurred. The mortgage interest income and interest on the financial liability from securitization associated with these mortgages is recognized on the accrual basis over the term of the mortgages.

We securitized $86 million of insured multi family loans during 2016 (2015 - $nil). We derecognized the mortgages from the consolidated balance sheet as control over the assets was transferred on securitization. In achieving derecognition, we recognized upfront gains of $394,000, which are included in other securitization income. Additionally, we recognized receivables in the amount of estimated discounted spread income to be earned over the term of the securitized mortgages.

Other Accounting Considerations

The primary risks associated with the market MBS program and CMB program are prepayment, liquidity and funding risk, including the obligation to fund 100% of any cash shortfall related to the Timely Payment (discussed below in the "Timely

Payment" sub-section). Prepayment risk includes the acceleration of the amortization of mortgage premiums as a result of early payouts.

Any mortgages securitized through the market MBS program or CMB program for which derecognition is not achieved remain on the consolidated balance sheet as securitized assets and are also included in total exposures in the calculation of the leverage ratio. A corresponding liability is also recognized on the balance sheet for mortgage securitizations that fail derecognition. However, for income tax purposes, all mortgages securitized by MCAN are considered to be true mortgage sales and therefore are not included in income tax assets. For further details on total exposures, regulatory capital and income tax assets and capital, refer to the "Capital Management" and "Non-IFRS Measures" sections of this MD&A.

MCAN has capitalized certain mortgage acquisition costs. These costs are amortized using the effective interest rate method ("EIM"), which incorporates mortgage prepayment assumptions.

Timely Payment

Consistent with all issuers of MBS, we are required to remit scheduled mortgage principal and interest payments to CMHC, even if these mortgage payments have not been collected from mortgagors, to ensure that the Timely Payment of principal and interest to MBS investors is effected. Similarly, at the maturity of the MBS pools that have been issued by MCAN, any outstanding principal must be paid to CMHC. We maintain the Timely Payment obligation in our role as MBS issuer until the maturity of the security. If we fail to make a scheduled principal and interest payment to CMHC, CMHC may enforce the assignment of the mortgages included in all MBS pools in addition to other assets backing the MBS issued.

If mortgage payments have not been collected from mortgagors or mortgagors are unable to renew their mortgages at their scheduled maturities, we will be required to use our own financial resources to fund our pro-rata share of these obligations until mortgage arrears are collected or proceeds are received from the mortgage insurers following the sale of the mortgaged properties.

As part of our participation in the market MBS program and CMB program, we are required to fund 100% of any cash shortfall unless we have sold the interest-only strip, in which case the purchaser of the interest-only strip is obligated to fund 100% of any cash shortfall. If the interest-only strip purchaser is not able to provide funds to cover any cash shortfalls, we will be required to use our own financial resources to fund our 100% share of this obligation until mortgage arrears are collected or proceeds are received from the mortgage insurers following the sale of the mortgaged properties.

In the case of mortgage defaults, we are required to make scheduled principal and interest payments to investors as part of the Timely Payment and then place the mortgage/property through the insurance claims process to recover any losses. These defaults may result in cash flow timing mismatches that may marginally increase funding and liquidity risks.

CAPITAL MANAGEMENT

Our primary capital management objectives are to maintain sufficient capital for regulatory purposes and to earn acceptable and sustainable risk-weighted returns for our shareholders. Through our risk management and corporate governance framework, we assess current and projected economic, housing market, interest rate and credit conditions to determine appropriate levels of capital. We typically pay out all taxable income by way of dividends. Capital growth is achieved through retained earnings, public share offerings, rights offerings and the DRIP. Our capital management is driven by the guidelines set out by the *Income Tax Act (Canada)* (the "Tax Act") and OSFI.

Income Tax Capital

As a MIC under the Tax Act, we are limited to an income tax liabilities to capital ratio of 5:1 (or an income tax assets to capital ratio of 6:1), based on our non-consolidated balance sheet in the MIC entity measured at its tax value. Securitization assets and liabilities (less accrued interest) are both excluded from the calculation of the income tax assets to capital ratio.

We manage our income tax assets to a level of 5.75 times income tax capital on a non-consolidated tax basis to provide a prudent cushion between the maximum permitted assets and total actual assets. Income tax asset capacity represents additional asset growth available to yield a 5.75 income tax assets to income tax capital ratio.

Table 32: Income Tax Capital [1]

(in thousands except ratios) As at	December 31 2016	September 30 2016	December 31 2015
Income tax assets [1]			
Consolidated assets	$ 2,280,855	$ 2,291,005	$ 2,246,958
Adjust for assets in subsidiaries	6,918	7,363	5,535
Non-consolidated assets in MIC entity	2,287,773	2,298,368	2,252,493
Add: mortgage allowances	4,897	5,152	4,953
Less: securitization assets [2]	(1,089,358)	(1,075,746)	(1,091,099)
Less: equity investments in MCAP and subsidiaries	(37,049)	(32,292)	(31,088)
Other adjustments	(5,605)	(5,483)	122
	$ 1,160,658	$ 1,189,999	$ 1,135,381
Income tax liabilities [1]			
Consolidated liabilities	$ 1,999,079	$ 2,015,139	$ 1,988,156
Adjust for liabilities in subsidiaries	(6,500)	(5,860)	(6,213)
Non-consolidated liabilities in MIC entity	1,992,579	2,009,279	1,981,943
Less: securitization liabilities [2]	(1,070,117)	(1,056,713)	(1,068,541)
	$ 922,462	$ 952,566	$ 913,402
Income tax capital [1]	$ 238,196	$ 237,433	$ 221,979
Income tax asset capacity [1]	$ 208,970	$ 175,243	$ 140,998
Income tax capital ratios [1]			
Income tax assets to capital ratio	4.87	5.01	5.11
Income tax liabilities to capital ratio	3.87	4.01	4.11

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*

[2] *The majority of securitization assets and liabilities per balance sheet are excluded from income tax assets, liabilities and capital to the extent that they are held in the MIC entity.*

Regulatory Capital

As a Loan Company under the *Trust and Loan Companies Act* (the "Trust Act"), OSFI oversees the adequacy of our capital. For this purpose, OSFI has imposed minimum capital-to-regulatory (or risk-weighted) assets ratios and a minimum leverage ratio which is calculated on a different basis from the income tax assets to capital ratio discussed in the "Income Tax Capital" sub-section.

Since the financial crisis, OSFI and the Basel Committee on Banking Supervision ("BCBS") have taken measures to promote a more resilient banking sector and strengthen global capital standards. Changes from Basel III that impact MCAN through the Capital Adequacy Requirements ("CAR") Guideline, Leverage Ratio and other items are listed below. We expect to be able to meet OSFI's requirements and expectations without materially adversely affecting the Company's business plan.

- OSFI requires all federally regulated financial institutions to meet the minimum Common Equity Tier 1 ("CET 1"), Total Tier 1 and Total Capital requirements set out therein. The minimum capital ratios are 4.5% for CET 1, 6% for Total Tier 1 and 8% for Total Capital (with the phase-in of certain regulatory adjustments and phase-out of non-qualifying capital instruments by 2022).

- The regulatory adjustments to be phased into the calculation of the capital ratios of a federally regulated financial institution include the deduction of certain significant investments in the capital of banking, financial and insurance entities above 10% of the institution's CET 1 Capital (after certain prescribed regulatory adjustments), which incorporates an adjustment for the equity investment in MCAP into CET 1 capital. For 2016, the "transitional" basis phases the adjustment in by a factor of 60%, while the "all-in" basis incorporates the entire adjustment. The adjustment factor will increase by 20% annually over the phase-in period until it is fully deductible by 2018.

- In 2016, OSFI implemented the requirement for all federally regulated financial institutions to maintain a capital conservation buffer. The buffer will be phased in over time and will reach its final level of 2.5% in 2019.

- In addition to the minimum capital requirements and capital conservation buffer to be maintained by all federally regulated institutions, OSFI expects all such institutions to attain target capital ratios equal to or greater than the 2019 minimum capital ratios and the 2019 capital conservation buffer well in advance of the phase-in period. Accordingly, OSFI expects all federally regulated institutions to have a CET 1 ratio of 7% and a Total Tier 1 ratio of 8.5% and a Total Capital ratio of 10.5% (in each case, calculated on an "all in" basis giving effect to all regulatory adjustments that will be required by 2019 and including the 2019 capital conservation buffer). Failure to achieve such targets will serve as triggers for supervisory intervention.

OSFI began the phase-in of the Credit Valuation Adjustment ("CVA") risk capital charge in 2014. The CVA risk capital charge applicable to CET 1 Capital is 64% in 2016. This will increase annually until it reaches 100% by 2019. The implementation of the CVA risk capital charge has had an insignificant impact on MCAN.

Our internal target minimum CET 1, Tier 1 and Total Capital ratios are 20%. We maintain prudent capital planning practices to ensure that we are adequately capitalized and continue to satisfy minimum standards and internal targets.

OSFI and the BCBS are finalizing consultations for an update to the regulatory capital framework for loans secured by residential real estate properties. The potential impact to MCAN will largely be in changes to the risk weighting of mortgages as calculated in the standardized approach and a new capital charge for insured mortgages.

In late 2016, OSFI enacted revisions to the CAR Guideline effective January 1, 2017. The key revisions that impact MCAN are as follows:

- An explicit requirement that institutions have appropriate policies and procedures in place to originate, underwrite and administer insured single family mortgages so as to receive a 0% risk-weighting for these assets; otherwise they would attract a 35% or 75% risk weighting similar to uninsured single family mortgages.

- A revision to the risk-weighting of equity investments in funds. MCAN would likely use the "look through" approach that incorporates the risk-weighting of assets held inside the fund and the leverage used by the fund. This revision will impact the risk-weighting of the financial investments in Crown LP and the KingSett High Yield Fund.

Table 33: Regulatory Capital

(in thousands except %) As at	December 31 2016	September 30 2016	December 31 2015
Regulatory Ratios (OSFI)			
Share capital	$ 210,239	$ 210,239	$ 206,382
Contributed surplus	510	510	510
Retained earnings	55,923	53,846	42,617
Accumulated other comprehensive income	15,104	11,271	9,293
Deduction for equity investment in MCAP (Transitional adjustment) [1]	(13,576)	(12,892)	(7,324)
Common Equity Tier 1, Tier 1 and Total Capital (Transitional) [2]	$ 268,200	$ 262,974	$ 251,478
Deduction for equity investment in MCAP (All-in adjustment) [1]	(9,051)	(8,595)	(10,986)
Common Equity Tier 1, Tier 1 and Total Capital (All-in) [2]	$ 259,149	$ 254,379	$ 240,492
Total Exposures/Regulatory Assets [2]			
Consolidated assets	$ 2,280,855	$ 2,291,005	$ 2,246,958
Less: deductions from all-in Tier 1 Capital [1]	(22,627)	(21,487)	(18,310)
Other adjustments [3]	1,489	1,920	2,229
Total On-Balance Sheet Exposures	2,259,717	2,271,438	2,230,877
Mortgage and investment funding commitments	402,861	393,698	333,667
Less: conversion to credit equivalent amount (50%)	(201,431)	(196,849)	(166,834)
Letters of credit	30,537	31,306	35,863
Less: conversion to credit equivalent amount (50%)	(15,269)	(15,653)	(17,932)
Total Off-Balance Sheet Items	216,698	212,502	184,764
Total Exposures/Regulatory Assets	$ 2,476,415	$ 2,483,940	$ 2,415,641
Leverage ratio [2]	10.46%	10.24%	9.96%
Risk weighted assets (transitional) [2]	$ 1,167,226	$ 1,183,427	$ 1,066,558
Risk weighted assets (all-in) [2]	$ 1,149,124	$ 1,166,237	$ 1,044,586
Regulatory Capital Ratios [2]			
Common Equity Tier 1 capital to risk-weighted assets ratio (transitional)	22.98%	22.22%	23.58%
Tier 1 capital to risk-weighted assets ratio (transitional)	22.98%	22.22%	23.58%
Total capital to risk-weighted assets ratio (transitional)	22.98%	22.22%	23.58%
Common Equity Tier 1 capital to risk-weighted assets ratio (all-in)	22.55%	21.81%	23.02%
Tier 1 capital to risk-weighted assets ratio (all-in)	22.55%	21.81%	23.02%
Total capital to risk-weighted assets ratio (all-in)	22.55%	21.81%	23.02%

[1] The deduction for the equity investment in MCAP on an all-in basis is equal to the equity investment balance less 10% of the Company's shareholders' equity. In 2016, the deduction on the transitional basis is equal to 60% of the all-in adjustment (2015 - 40%). The adjustment factor will increase by 20% annually over the phase-in period until it is fully deductible by 2018.
[2] Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.
[3] Certain items, such as negative cash balances, are excluded from total exposures but included in consolidated assets.

Table 34: Regulatory Risk-Weighted Assets

(in thousands except %)	2016			2015		
As at December 31	Per Balance Sheet	Average Rate	Risk Weighted Assets	Per Balance Sheet	Average Rate	Risk Weighted Assets
On-Balance Sheet Assets						
Cash and cash equivalents	$ 111,732	20%	$ 22,644	$ 75,762	21%	$ 15,598
Cash held in trust	15,724	20%	3,145	13,112	20%	2,622
Marketable securities	55,126	100%	55,126	40,735	100%	40,735
Mortgages - corporate	904,112	71%	637,871	944,109	67%	629,171
Mortgages - securitized	1,071,849	3%	37,432	1,075,947	3%	27,288
Financial investments	57,264	100%	57,264	41,793	100%	41,793
Other loans	3,584	100%	3,584	4,176	100%	4,176
Equity investment in MCAP (all-in) [1]	50,805	55%	28,177	44,191	59%	25,879
Foreclosed real estate	529	100%	529	529	100%	529
Deferred tax asset	1,782	100%	1,782	1,125	100%	1,125
Other assets	8,348	100%	8,348	5,479	100%	5,479
			855,902			794,395
Off-Balance Sheet Items						
Letters of credit	30,537	50%	15,269	35,863	50%	17,932
Commitments	402,861	46%	184,378	333,667	44%	148,109
			199,647			166,041
Charge for operational risk			93,575			84,150
Risk-Weighted Assets (all-in)			1,149,124			1,044,586
Equity investment in MCAP (transitional adjustment) [1]			18,102			21,972
Risk-Weighted Assets (transitional)			**$ 1,167,226**			**$ 1,066,558**

[1] In calculating risk-weighted assets on the "all-in" basis, the capital deduction related to the investment in MCAP is risk weighted at 0%, while the component not deducted from capital is risk weighted at 100%. In calculating risk-weighted assets on the transitional basis, the difference between the all-in deduction and the transitional deduction is risk weighted at 200%.

Other Capital Management Activity

In conjunction with the annual strategic planning and budgeting process, we complete an Internal Capital Adequacy Assessment Process ("ICAAP") in order to ensure that we have the capital adequacy to support our business plan and risk appetite. The ICAAP assesses the capital necessary to support the various inherent risks that we face, including credit, liquidity, interest rate, market, geographic concentration and reputational risks. Our business plan is also stress-tested under various adverse scenarios in order to determine the impact on our results from operations and financial condition. The ICAAP is reviewed by both management and the Board and is submitted to OSFI annually. In addition, the Company performs stress testing on our internal forecasts for capital adequacy on a quarterly basis, and the results of such testing are reported to the Board.

LIQUIDITY MANAGEMENT

Our liquidity management process includes a Liquidity Risk Management Framework that incorporates multi scenario stress testing. Results of the stress testing are reported to management on a monthly basis and to the Risk Committee of the Board ("RCB") on a quarterly basis.

For further information on how we manage liquidity risk, refer to the "Liquidity and Funding Risk" sub-section of the "Risk Governance & Management" section of this MD&A. For information on our credit facilities refer to Note 31 to the consolidated financial statements.

OSFI's Liquidity Adequacy Requirements ("LAR") guideline establishes three minimum standards based on the Basel III framework with national supervisory discretion applied to certain treatments: the Liquidity Coverage Ratio ("LCR") and Net Cumulative Cash Flow ("NCCF") metric, which both became effective January 1, 2015, and the Net Stable Funding Ratio ("NSFR"), which is effective January 1, 2018.

As at December 31, 2016, we were in compliance with the LCR and NCCF and we believe that we will be able to comply with the NSFR requirements once enacted.

These requirements are supplemented by additional supervisory monitoring metrics including the liquidity monitoring tools and the intraday liquidity monitoring tools as considered in the Basel III framework.

The following table shows the composition of our internal liquidity ratios. These internal ratios include assumptions relating to the value of liquid assets such as the ability to sell these assets in a stressed market scenario. We manage our liquid assets to a minimum of 100% of term deposit liabilities maturing within 100 days. As at December 31, 2016, we were in compliance with our internal liquidity ratios.

Table 35: Liquidity Ratios

(in thousands except %) **As at**	**December 31 2016**	**September 30 2016**	**December 31 2015**
Tier 1 liquid assets [1]			
Cash and cash equivalents	$ 111,732	$ 80,204	$ 75,762
Tier 2 liquid assets [1]			
Marketable securities	55,126	52,901	40,735
Less: marketable securities adjustment [2]	(13,007)	(12,636)	(10,104)
Market MBS retained by MCAN [3]	36,606	37,616	21,250
	78,725	77,881	51,881
Tier 3 liquid assets [1]			
Single family insured mortgages [4]	69,899	76,338	60,399
Less: single family insured mortgages adjustment [4]	(24,293)	(29,820)	(18,503)
	45,606	46,518	41,896
Total liquid assets [1]	$ 236,063	$ 204,603	$ 169,539
100 day term deposit maturities	$ 130,357	$ 141,194	$ 92,622
Liquidity ratios [1]			
Tier 1 & 2 liquid assets to 100 day term deposit maturities	146%	112%	138%
Total liquid assets to 100 day term deposit maturities	181%	145%	183%

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*
[2] *Adjusted to reflect estimated impact to fair market value in a stressed scenario. Corporate bonds are reduced as follows: BBB- or higher (30%); below BBB- (45%). REITs are reduced as follows: constituent in TSX/S&P Composite Index (20%); not a constituent in TSX/S&P Composite Index (40%).*
[3] *Included in corporate mortgages - insured single family. For further information, refer to the "Securitization Programs" section of this MD&A.*
[4] *Single family insured mortgages exclude mortgages pledged as collateral and second mortgages not insured by CMHC. The adjustment reflects lower liquidity than Tier 1 and Tier 2 liquidity, as follows: CMHC insured (25%), CMHC insured second mortgages (50%), privately insured (50%).*

Our sources and uses of liquidity are outlined in the table below. We manage our net liquidity surplus/deficit by raising term deposits as mentioned above.

Table 36: Liquidity Analysis

(in thousands)	Within 3 Months	3 Months To 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	December 31 2016	December 31 2015
Sources of liquidity							
Cash and cash equivalents	$ 111,732	$ -	$ -	$ -	$ -	$ 111,732	$ 75,762
Marketable securities	53,953	513	629	-	31	55,126	40,735
Mortgages - corporate	118,906	420,209	314,006	38,464	12,527	904,112	944,109
Financial investments	-	-	-	-	57,264	57,264	41,793
Other loans	1,535	-	-	2,049	-	3,584	4,176
	286,126	420,722	314,635	40,513	69,822	1,131,818	1,106,575
Uses of liquidity							
Term deposits	119,472	327,739	336,926	127,729	-	911,866	903,041
Other liabilities	12,377	-	-	-	-	12,377	12,412
	131,849	327,739	336,926	127,729	-	924,243	915,453
Net liquidity surplus (deficit)	**$ 154,277**	**$ 92,983**	**$ (22,291)**	**$ (87,216)**	**$ 69,822**	**$ 207,575**	**$ 191,122**
Off-Balance Sheet							
Unfunded mortgage commitments	$ 324,680	$ 39,481	$ -	$ -	$ -	$ 364,161	$ 308,242
Commitment - KingSett High Yield Fund	-	-	-	-	38,700	38,700	25,425
	$ 324,680	$ 39,481	$ -	$ -	$ 38,700	$ 402,861	$ 333,667

Note: The above table excludes securitized assets and liabilities and pledged assets as their use is restricted to securitization program operations.

RISK GOVERNANCE AND MANAGEMENT

We are exposed to a number of risks, including credit risk, liquidity and funding risk, operational risk, strategic and business risk, reputational risk, interest rate risk, market risk and cyber risk, that can adversely affect our ability to achieve our business objectives or execute our business strategies, and which may result in a loss of earnings, capital and/or damage to our reputation. We mitigate these risks through prudent credit limits, established lending policies and procedures, effective monitoring and reporting, investment diversification and by the diligent management of assets and liabilities.

We operate in changing regulatory and economic environments. As a result, we believe that our management team and the Board are particularly diligent in their consideration of all identified and emerging risks. Our goal is not to eliminate risk, as this would result in significantly reduced earnings, but rather to be proactive in our assessment and management of risk, as a means to gain a strategic advantage and ultimately enhance shareholder value.

The risks that have been identified may not be the only risks that we face. Other risks of which we are not aware of or which we currently deem to be immaterial may surface and have a material adverse impact on our business, results from operations and financial condition.

The shaded areas of this MD&A represent a discussion of risk factors and risk management policies and procedures relating to credit, liquidity, interest rate and market risks as required under IFRS 7, *Financial Instruments: Disclosures*. The relevant MD&A sections are identified by shading within boxes and the content forms an integral part of the consolidated financial statements.

Risk Governance

The RCB is responsible for overseeing risk management across the Company. It looks to ensure the relevance of the Company's Risk Appetite Framework ("RAF") and its alignment with the Company's strategy. It has the responsibility to ensure that the risk management function is independent from the business activity it oversees, and is supported by an Enterprise Risk Management framework ("ERMF") consisting of policies, procedures and controls. The goal of the ERMF is to manage risks within the Company's risk framework and appetite.

The Chief Executive Officer ("CEO") and the executive management team are responsible for developing the strategy and a comprehensive set of enterprise wide policies, including the RAF and ERMF for approval by the Board. They are responsible for fostering a strong risk culture through the "tone at the top" and applying the approved strategy and RAF to the business operations of the Company to help maximize, within the Company's risk appetite, the benefit to shareholders and other stakeholders from a portfolio of risks that the Company is willing to accept. MCAN's Executive Committee recommends a risk appetite that aligns with the Mission Statement, Operating Philosophies and Goals and Objectives of the Company and the Operating Committee provides governance over the operations of MCAN to ensure that the strategy and tactics used by MCAN in its funding and investing activities are effective in meeting the Company's stated objectives.

The Company's operating model is predicated on the three-lines-of-defense approach to the management of risk. The operating areas headed by the CEO are the first line of defense in the Company's management of risk. They "own" the risk in their areas of responsibility and are responsible for ensuring the Company pursues only suitable business opportunities that are within the Company's risk appetite.

The second line of defense establishes the enterprise level risk management framework and policies, and provides risk guidance and oversight of the effectiveness of first line risk management practices. These activities are provided by:

- The Chief Risk Officer ("CRO"), who is responsible for providing independent review and oversight of enterprise-wide risks and for the fostering of a strong risk culture throughout the organization. The CRO has responsibility for maintaining and managing the RAF and in that regard for confirming and reporting on the significant business risks as identified by and assessed by the first line of defense of the Company.

- The Chief Financial Officer ("CFO"), who is responsible for the accuracy and integrity of the Company's accounting and financial reporting systems, financial statements, and planning and budgeting systems and documents. The CFO ensures legal and regulatory compliance for all financial matters within the Company. The CFO is responsible for the Company's financial and capital plans which are presented to the Executive Committee and the Board for annual approval. Progress against these plans is regularly reported to the Board and regulators. The Finance department, led by the CFO, also updates the plan with periodic forecasts, advises the Board of anticipated outcomes, and recommends revisions to capital plans and structures as appropriate.

- The Chief Compliance Officer ("CCO"), who is responsible for measuring, and reporting on, compliance with the Company's policies and processes that have been designed to manage and mitigate regulatory compliance risk. The

CCO is mandated to promote a sound compliance culture, report to the Board on compliance with legislative requirements and make recommendations related to compliance activities.

- The Chief Anti-Money Laundering Officer ("CAMLO"), who is responsible for the Company's adherence to the Proceeds of Crime (Money Laundering) and *Terrorist Financing Act (Canada)* with regard to its deposit taking and lending activities.

The third line of defense is provided by MCAN's internal audit group which monitors, and reports on, the effectiveness of controls, risk management, and governance practices within the Company.

Risk Appetite

MCAN's RAF sets out the approach to risk management used by the Company in pursuing its strategic and business objectives.

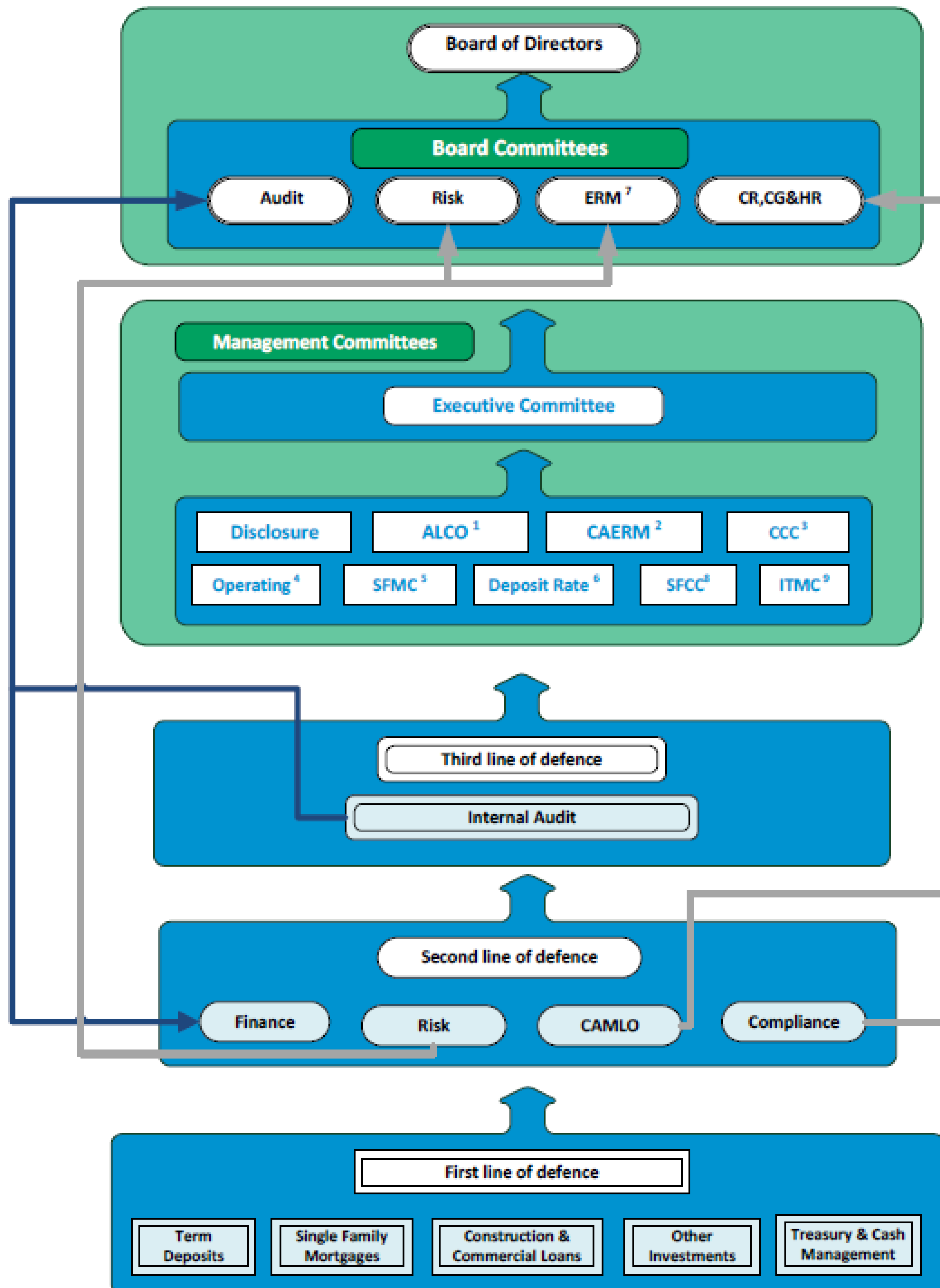
Key principles that guide MCAN's approach to risk appetite are as follows:

- MCAN's strategy, including business objectives, business plans and stakeholder expectations should be reflected in the risk appetite.
- The approach should engage both top down senior management and Board leadership and bottom up involvement of employees at all levels.
- Risk appetite considerations should be embedded in both strategic and day-to-day decisions and supported by a reinforced risk culture aligning decision making and risk.
- The approach to risk appetite should reflect good industry practices and relevant regulatory guidance.
- The approach should be forward looking and enable adaptation to changing business and market conditions; it should also give consideration to the skills, resources and technology required to manage and monitor identified risk exposures and the potential impacts of stressed conditions.

The RAF purposes and objectives are as follows:

- Define maximum levels of risk that are within MCAN's risk capacity including regulatory constraints in order to achieve its strategic objectives within appropriate and approved target returns.
- Give consideration to all material risks reflecting all key aspects of the business.
- Contain both qualitative and quantitative elements to define acceptable risk levels within MCAN's risk capacity.
- Set out limits and targets to enable the Board and senior management to assess MCAN's performance and current risk levels relative to risk appetite.
- Consider MCAN's current capital position and ability to handle the range of results that may occur under normal operating conditions and under a range of stress scenarios.

The Board has oversight responsibility for risk governance within MCAN. It provides this oversight and carries out its risk management mandate primarily through the RCB, the Audit Committee of the Board (the "Audit Committee"), the Conduct Review, Corporate Governance and Human Resources Committee of the Board (the "CR, CG & HR Committee") and the Enterprise Risk Management Ad Hoc Committee (the "ERM Ad Hoc Committee"). There is a further committee structure at the management level as illustrated in the following diagram:



Credit Risk

Credit risk is the risk of financial loss resulting from the failure of a counterparty, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from our mortgage and lending activities. Fluctuations in real estate values may increase the risk of default and may also reduce the net realizable value of the collateral property to the Company. These risks may result in defaults and credit losses, which may result in a loss of earnings. Credit losses occur when a counter party fails to meet its obligations to the Company and the value realized on the sale of the underlying security deteriorates below the carrying amount of the exposure.

Credit Risk Management

Credit and commitment exposure is closely monitored through a reporting process that includes a formal monthly review involving ALCO and a formal quarterly review involving the RCB. A CRO Report, which identifies, assesses, ranks and provides trending analysis on all material risks to the Company, is provided to the RCB on a quarterly basis. Monitoring also takes place through our Capital Commitments Committee and Single Family Credit Committee, which are both comprised of certain members of management.

Our exposure to credit risk is managed through prudent risk management policies and procedures that emphasize the quality and diversification of our investments. Credit limits, based on our risk appetite, which is approved by the Board at least annually, have been established for concentration by asset class, geographic region, dollar amount and borrower. These policies are amended on an ongoing basis to reflect changes in market conditions and our risk appetite. All members of management are subject to limits on their ability to commit the Company to credit risk.

We identify potential risks in our mortgage portfolio by way of regular review of market metrics, which are a key component of quarterly market reports provided to the RCB. We also undertake site visits of active mortgage properties. Existing risks in our mortgage portfolio are identified by arrears reporting, portfolio diversification analysis, annual reviews of large loans and risk rating trends of the entire mortgage portfolio. The aforementioned reporting and analysis provides adequate monitoring of and control over our exposure to credit risk. In the current economic environment, we have increased our monitoring of real estate market values for single family mortgages, with independent assessments of value obtained as individual mortgages exceed 90 days in arrears.

We assign a credit score and risk rating for all mortgages at the time of underwriting based on the quality of the borrower and the underlying real estate. Risk ratings are reviewed annually for large exposures, and whenever there is an amendment or a material adverse change such as a default or impairment.

We have established a methodology for determining the adequacy of our collective allowances. The adequacy of collective allowances is assessed periodically, taking into consideration economic factors such as Gross Domestic Product, employment, housing market conditions as well as the current position in the economic cycle.

We record an individual allowance to the extent that the estimated realizable value of a mortgage has decreased below its net book value. Individual allowances include all of the accumulated provisions for credit losses on a particular mortgage.

Our maximum credit exposure on our individual financial assets is equal to the carrying value of the respective assets, except for our corporate mortgage portfolio, whose maximum credit exposure also includes outstanding commitments for future mortgage fundings.

Liquidity and Funding Risk

Liquidity and funding risk is the risk that cash inflows, supplemented by assets readily convertible to cash, will be insufficient to honour all cash outflow commitments (both on and off-balance sheet) as they come due. The failure of borrowers to make regular mortgage payments increases the uncertainties associated with liquidity management, notwithstanding that we may eventually collect the amounts outstanding, which may result in a loss of earnings or capital, or have an otherwise adverse effect on our financial condition and results of operations.

For information on the contractual maturities of certain obligations of the Company, refer to notes 17, 20 and 30 to the consolidated financial statements.

Liquidity and Funding Risk Management

We closely monitor our liquidity position to ensure that we have sufficient cash to meet liability obligations as they become due. The RCB is responsible for the approval of liquidity policies. The Asset and Liability Committee ("ALCO"), which is comprised of management, is responsible for liquidity management. We have an internal target of a standard level of liquid investments (cash

and cash equivalents, marketable securities, MCAN-issued market MBS retained on our balance sheet, 75% of CMHC-insured single family mortgages, 50% of CMHC-insured single family second mortgages and 50% of privately insured mortgages) of at least 100% of term deposits maturing within 100 days. As at December 31, 2016 and December 31, 2015, we met this internal target.

In addition, all single family mortgages are readily marketable within a time frame of one to three months, providing us with added flexibility to meet unexpected liquidity needs. We have access to capital through our ability to issue term deposits eligible for CDIC deposit insurance. These term deposits also provide us with the ability to fund asset growth as needed.

We also maintain an overdraft facility to fund asset growth or meet our short-term obligations as required. The overdraft facility is a component of a larger credit facility that also has a portion which guarantees letters of credit used to support the obligations of borrowers to municipalities in conjunction with construction loans. The total facility is $75 million, with sub-limits of $50 million for overdrafts and $50 million for letters of credit. As at December 31, 2015 we also maintained a $50 million credit warehouse facility for which insured single family mortgages acted as collateral. In early 2016, the credit warehouse facility counterparty ceased its operations, and as a result thereof, the credit warehouse was terminated.

Subsequent to year end, we entered into an agreement with a Canadian Schedule I Chartered bank that enables the Company to execute repurchase agreements for liquidity purposes. This facility provides a new source of liquidity and allows the Company to encumber certain eligible securities for financing purposes. As part of the agreement, we may sell assets to the counterparty at a specified price with an agreement to repurchase at a specified future date. The interest rate on the borrowings is driven by market spot rates at the time of borrowing.

We believe that our liquidity position and our access to capital markets in the form of term deposits and the banking facility support our ability to meet current and future commitments as they come due.

Management has developed a Liquidity Risk Management Framework that is reviewed and approved annually by the Board. This framework details the daily, monthly and quarterly analysis that is performed by management. Management monitors changes in cash and cash requirements on a daily basis and formally reports to ALCO on a monthly basis. Management also completes monthly and quarterly stress testing which is reviewed by ALCO and the RCB. Management monitors trends in deposit concentration with significant term deposit brokers on a monthly basis.

We have established and maintain liquidity policies and procedures which meet the standards set under the Trust Act and regulations or guidelines issued by OSFI.

For a discussion regarding liquidity risk relating to the maturity of securitization program liabilities, refer to the "Timely Payment" sub-section of the "Securitization Programs" section of this MD&A.

Operational Risk

Operational risk is the potential for loss resulting from people, inadequate or failed internal processes, systems, or from external events. The risk of loss from people includes internal or external fraud, non-adherence to internal procedures/values/objectives or unethical behaviour. The largest components of this risk for MCAN have been separately identified as outsourcing risk and cyber risk. The remaining risks arise from the small size and entrepreneurial nature of MCAN, and the legacy systems used within it. The exposure to financial misreporting, inaccurate financial models, fraud, breaches in privacy, information security, attraction and retention of employees, and business continuity and recovery are included within operational risk.

Operational Risk Management

We manage operational risk through various committees and processes. Our management team reviews operational measures on a recurring basis as part of the Operating Committee, Compliance Audit and ERM Ad Hoc Committee, and ALCO. We also provide monthly updates to the Board on operations and other key factors and issues that arise.

We also maintain appropriate insurance coverage through a financial institution bond policy, which is reviewed at least annually by the Board for changes to coverage and our operations.

Outsourcing Risk

Within operational risk, outsourcing risk is the risk incurred when we contract out a business function to a service provider instead of performing the function ourselves, and the service provider performs at a lower standard than we would have under similar circumstances. We outsource the majority of our mortgage and loan origination, servicing and collections to MCAP and other third parties.

Outsourcing Risk Management

MCAN's Outsourcing Policy, which is approved annually by the Board, incorporates the relevant requirements of OSFI Guideline B-10, *Outsourcing of Business Activities, Functions and Processes*. We review our outsourced arrangements on an annual basis to determine if the arrangement is material. If the arrangement is material it is subjected to a risk management program, which includes detailed monitoring activities.

Risk of Accuracy and Completeness of Borrower Information

Within operational risk, in the single family mortgage underwriting process, we rely on information provided by potential borrowers and other third parties, including mortgage brokers. We may also rely on the representations of potential borrowers and third parties as to the accuracy and completeness of that information. Our financial position and performance may be negatively impacted if this information is intentionally misleading or does not fairly represent the financial condition of the potential borrower and is not detected by our internal controls.

Management of Risk of Accuracy and Completeness of Borrower Information

We frequently review and/or update our underwriting policies, procedures and control processes to strengthen our ability to detect and to better manage this risk. These updates include improvements to underwriting staff training, independent income verification procedures, internal audit, risk and other quality control and quality assurance processes.

Strategic and Business Risk

Strategic and business risk is the risk of loss due to fluctuations in the external business environment, the failure of management to adjust its strategies and business activities for external events or business results, or the inability of the business to change its cost levels in response to those changes.

Strategic and Business Risk Management

Strategic and business risk is managed by the CEO and senior management. The Board approves the Company's strategies at least annually and reviews results against those strategies at least quarterly.

Reputational Risk

Reputational risk is the negative consequence of the occurrence of other risks and can occur from an activity undertaken by the Company, its affiliated companies, or its representatives. The loss of reputation can greatly affect shareholder value through reduced public confidence, a loss of business, legal action, or increased regulatory oversight. Reputation refers to the perception of the enterprise by various stakeholders. Typically, key stakeholder groups include investors, customers, employees, suppliers and regulators. Perceptions may be impacted by various events including financial performance, specific adverse occurrences from events such as cyber security issues, unfavourable media coverage, and changes or actions of the corporation's leadership. Failure to effectively manage reputation risk can result in reduced market capitalization, loss of client loyalty, and the inability to achieve our strategic objectives.

Reputational Risk Management

We believe that the most effective way for the Company to safeguard its public reputation is through the successful management of the underlying risks in the business.

Interest Rate Risk

Interest rate risk is the potential impact of changes in interest rates on our earnings and capital. Interest rate risk arises when our assets and liabilities, both on and off-balance sheet, have mismatched repricing dates. Changes in interest rates where we have mismatched repricing dates may have an adverse effect on our financial condition and results of operations. In addition, interest rate risk may arise when changes in the underlying interest rates on assets do not match changes in the interest rates on liabilities. This potential mismatch may have an adverse effect on our financial condition and results of operations.

Our exposure to interest rate risk is discussed further in Note 32 to the consolidated financial statements.

Interest Rate Risk Management

We evaluate our exposure to a variety of changes in interest rates across the term spectrum of our assets and liabilities, including both parallel and non-parallel changes in interest rates. By managing and matching the terms of corporate assets and term

deposits so that they offset each other, we seek to reduce the risks associated with interest rate changes, and in conjunction with liquidity management policies and procedures, we also manage cash flow mismatches. ALCO reviews our interest rate exposure on a monthly basis using interest rate spread and gap analysis as well as interest rate sensitivity analysis based on various scenarios. This information is also formally reviewed by the RCB each quarter.

We are exposed to interest rate risk on insured single family mortgages between the time that a mortgage rate is committed to borrowers and the time that the mortgage is funded, or in the case of mortgages securitized through the market MBS or CMB programs, the time that the mortgage is securitized. To manage this risk, we may enter into interest rate swaps or we may match them with long-term fixed-rate term deposits.

Ultimately, risk management is monitored and controlled at the highest level of the Company. ALCO reviews and manages these risks on a monthly basis. The Board also reviews and approves all risk management policies and procedures at least annually. Management reports to the Board on the status of risk management at least quarterly.

Market Risk

Market risk is the exposure to adverse changes in the value of financial assets. Our market risk factors include price risk on marketable securities, interest rates, real estate values and commodity prices, among others. Any changes in these market risk factors may negatively affect the value of our financial assets, which may have an adverse effect on our financial condition and results of operations. We do not undertake trading activities as part of our regular operations, and therefore are not exposed to risks associated with activities such as market making, arbitrage or proprietary trading.

Market Risk Management

Our marketable securities portfolio is susceptible to market price risk arising from uncertainties about future values of the securities. We manage the equity price risk through diversification and limits on both individual and total securities. Reports on the portfolio are submitted to senior management on a regular basis and to the Board on a quarterly basis.

Cyber Risk

We collect and store confidential and personal information to the extent needed for operational purposes. Unauthorized access to the Company's computer systems could result in the theft or publication of confidential information or the deletion or modification of records or could otherwise cause interruptions in the Company's operations. In addition, despite the Company's implementation of security measures, its systems are vulnerable to damages from computer viruses, natural disasters, unauthorized access, cyber-attack and other similar disruptions. Any such system failure, accident or security breach could disrupt the Company's delivery of services and make the Company's applications unavailable or cause similar disruptions to the Company's operations. If a person penetrates the Company's network security or otherwise misappropriates sensitive data, we could be subject to liability or our business could be interrupted, and any of these developments could have a material adverse effect on the Company's business, results of operations and financial condition.

Cyber Risk Management

We manage cyber risk through oversight by management, including an IT Management Committee, as well as the use of external third party advisors and service providers to provide technical expertise. We undertook a cyber security assessment during 2016 that is intended to be updated on an annual basis. We employ the use of external security experts to assist and monitor our information technology infrastructure for cybersecurity risks. We have also undertaken external vulnerability tests performed by an independent external party. Additionally, we maintain an incident response plan and have designated officers responsible for the oversight over the cybersecurity risks. We also maintain cyber security insurance coverage for both direct and third party coverage in the event of a cyber security incident that would result in a loss.

Other Risk Factors

General Litigation

In the ordinary course of business, MCAN and its service providers (including MCAP), their subsidiaries and related parties may be party to legal proceedings that may result in unplanned payments to third parties.

To the best of our knowledge, we do not expect the outcome of any existing proceedings to have a material adverse effect on the consolidated financial position or results of operations of the Company.

Reliance on Key Personnel

Our future performance is dependent on the abilities, experience and efforts of our management team and other key personnel. There is no assurance that we will be able to continue to attract and retain key personnel, although it remains a key objective of the Company. Should any key personnel be unwilling or unable to continue their employment with MCAN, there may be an adverse effect on our financial condition and results of operations.

Economic Conditions

Factors that could impact general business conditions include changes in short-term and long-term interest rates, commodity prices, inflation, consumer, business and government spending, real estate prices and adverse economic events.

Regulatory Risk

Changes in laws and regulations, including interpretation or implementation, may affect the Company by limiting the products or services that we can provide and increasing the ability of competitors to compete with our products and services. Also, any failure by the Company to comply with applicable laws and regulations may result in sanctions and financial penalties which may adversely impact our earnings and damage our reputation. Increasing regulations and expectations as a result of the recent financial crisis, both globally and domestically, have increased the cost and resources necessary to meet regulatory expectations for the Company.

Qualification as a Mortgage Investment Corporation

If for any reason we do not maintain our qualification as a MIC under the Tax Act, taxable dividends and capital gains dividends paid by MCAN on our common shares will cease to be fully or partly deductible in computing income for tax purposes and such dividends will no longer be deemed by the rules in the Tax Act that apply to MICs to have been received by shareholders as interest or a capital gain, as the case may be. As a consequence, the rules in the Tax Act regarding the taxation of public corporations and their shareholders should apply, with the result that the combined rate of corporate and shareholder tax could be significantly greater.

Mortgage Renewal Risk

We retain renewal rights on mortgages that we originate that are either sold to third parties or retained on the consolidated balance sheet. If mortgagors are unable to renew their mortgages at their scheduled maturities, we may be required to use our own financial resources to fund these obligations until mortgage arrears are collected or proceeds are received from mortgage insurers following the sale of mortgaged properties.

Mortgage Prepayment Risk

In acquiring certain mortgages from third parties, we pay a premium to the mortgage par value based on the expected term of the mortgage. To the extent that mortgages repay prior to maturity, we may be required to accelerate the amortization of the premium and sustain a financial loss.

Competition Risk

Our operations and income are a function of the interest rate environment, the availability of mortgage products at reasonable yields and the availability of term deposits at reasonable cost. The availability of mortgage products for the Company and the yields thereon are dependent on market competition. In the event that we are unable to compete successfully against our current or future competitors or raise term deposits to fund our lending activities, there may be an adverse effect on our financial condition and results of operations.

Monetary Policy

Our earnings are affected by the monetary policies of the Bank of Canada. Changes in the supply and demand of money and the general level of interest rates could affect our earnings. Changes in the level of interest rates affect the interest spread between our mortgages, loans and investments, securitization investments and term deposits, and as a result may impact our net investment income. Changes to monetary policy and in financial markets in general are beyond our control and are difficult to predict or anticipate.

Environmental Risk

We recognize that environmental hazards are a potential liability. This risk exposure can result from non-compliance with environmental laws, either as principal or lender, which may negatively affect our financial condition and results of operations. We aim to mitigate this risk by complying with all environmental laws and by applying a rigorous environmental policy and procedures to our commercial and development lending activities.

Changes in Laws and Regulations

Changes to current laws, regulations, regulatory policies or guidelines (including changes in their interpretation, implementation or enforcement), the introduction of new laws, regulations, regulatory policies or guidelines or the exercise of discretionary oversight by regulatory or other competent authorities including OSFI, may adversely affect us, including by limiting the products or services that we provide, restricting the scope of our operations or business lines, increasing the ability of competitors to compete with our products and services or requiring us to cease carrying on business. In addition, delays in the receipt of any regulatory approvals and authorizations that may be necessary to the operation of our business may adversely affect our operations and financial condition. Our failure to comply with applicable laws and regulations may result in sanctions and financial penalties that could adversely impact our earnings and damage our reputation.

Changes in Accounting Standards and Accounting Policies

We may be subject to changes in the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes may materially impact how we record and report our financial condition and results of operations and, in certain circumstances, we may be required to retroactively apply a new or revised standard that results in our restating prior period financial statements. Please refer to the "Standards Issued But Not Yet Effective" section of this MD&A for further details.

Leverage

Leverage increases our potential exposure to all risk factors described above.

No Assurance of Achieving Investment Objectives or Payment of Dividends

As a result of the risks discussed above, there is no assurance that we will be able to achieve our investment objectives or be able to pay dividends at targeted or historic levels. The funds available for the payment of dividends to our shareholders will vary according to, among other things, the principal and interest payments received in respect of the Company's investments. There can be no assurance that the Company will generate any returns or be able to pay dividends to our shareholders in the future.

DESCRIPTION OF CAPITAL STRUCTURE

Our authorized share capital consists of an unlimited number of common shares with no par value. At December 31, 2016, there were 23,075,227 common shares outstanding (December 31, 2015 - 22,782,433). As at February 23, 2017, there were 23,147,410 common shares outstanding.

During 2016, we issued 280,376 new common shares under the DRIP (2015 - 568,588), which provides MCAN with a reliable source of new capital and existing shareholders an opportunity to acquire additional shares at a discount to market value. Under the DRIP, dividends paid to shareholders are automatically reinvested in common shares issued out of treasury at the weighted average trading price for the five days preceding such issue less a discount of 2%. Additionally, in 2016 we issued 12,418 common shares through the Executive Share Purchase Plan (2015 - nil).

In 2015, we closed a rights offering to common shareholders that raised $15.1 million of new share capital through the issuance of 1,406,084 common shares, creating $87 million of additional income tax asset capacity.

For additional information related to share capital, refer to Note 21 to the consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

We have contractual obligations relating to an operating lease, in addition to outstanding commitments for future fundings of corporate mortgages and our investment in the KingSett High Yield Fund.

We outsource the majority of our mortgage servicing and continue to pay servicing expenses as long as the mortgages remain on our balance sheet.

Table 37: Contractual Obligations

(in thousands)	Less than one year	One to three years	Three to five years	Over five years	December 31 2016	December 31 2015
Mortgage funding commitments	$ 364,161	$ -	$ -	$ -	$ 364,161	$ 308,242
Commitment - KingSett High Yield Fund	-	-	-	38,700	38,700	25,425
Operating lease	575	1,158	1,194	1,642	4,569	5,145
	$ 364,736	**$ 1,158**	**$ 1,194**	**$ 40,342**	**$ 407,430**	**$ 338,812**

We retain mortgage servicing obligations relating to securitized mortgages where balance sheet derecognition has been achieved. For further information, refer to Note 6 to the consolidated financial statements.

We provide letters of credit, which are not reflected on the consolidated balance sheet, for the purpose of supporting developer obligations to municipalities in conjunction with residential construction loans. For further information, refer to Note 31 to the consolidated financial statements.

As at December 31, 2016, of our total single family mortgage renewal rights of $1.1 billion (December 31, 2015 - $1.3 billion), $130 million related to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2015 - $219 million).

DIVIDEND POLICY AND RECORD

Our dividend policy is to pay out substantially all of our taxable income to our shareholders. As a MIC under the Tax Act, we can deduct dividends paid to shareholders during the year and within 90 days thereafter from income for tax purposes. These dividends are taxable in the shareholders' hands as interest income. In addition, as a MIC, we can pay certain capital gains dividends which are taxed as capital gains in the shareholders' hands. We intend to continue to declare dividends on a quarterly basis.

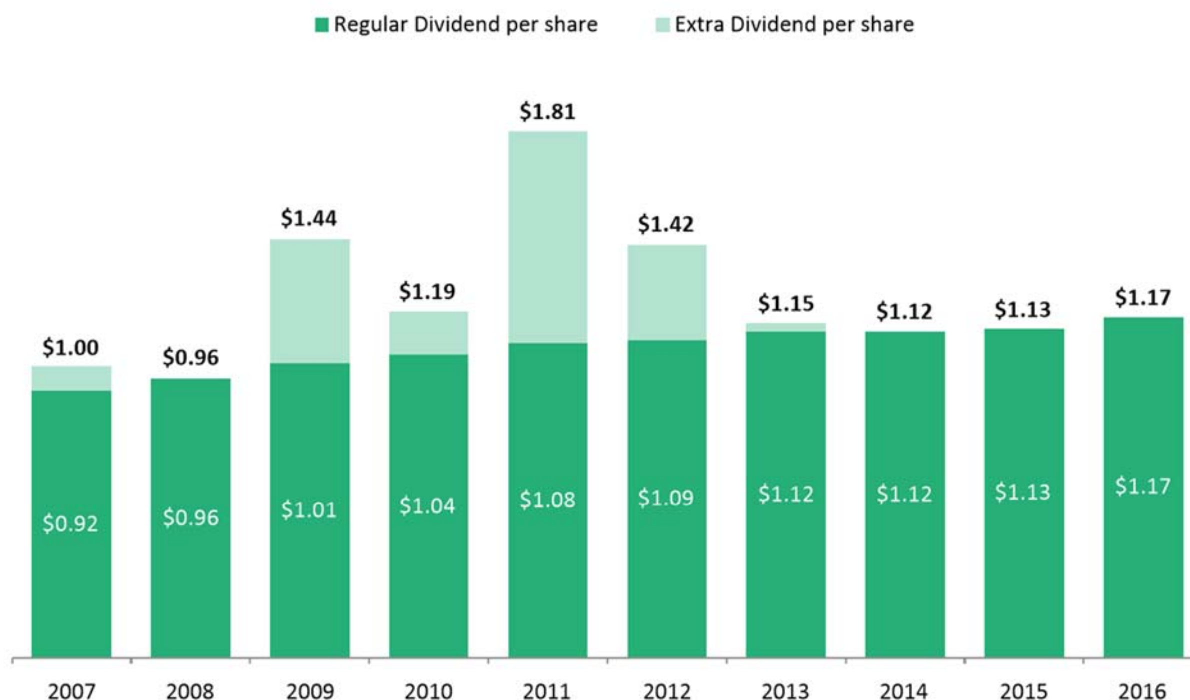
Dividends per share paid over the past three years are indicated in the table below. All dividends during this period have been regular dividends, i.e. none have been capital gains dividends.

Table 38: Dividends

Fiscal Period	2016	2015	2014
First Quarter	$ 0.29	$ 0.28	$ 0.28
Second Quarter	0.29	0.28	0.28
Third Quarter	0.29	0.28	0.28
Fourth Quarter	0.30	0.29	0.28
	$ 1.17	**$ 1.13**	**$ 1.12**

Consistent with the prior quarter dividend increase, the Board declared a first quarter dividend of $0.30 per share to be paid March 30, 2017 to shareholders of record as of March 15, 2017.

Figure 5: Dividend History



Historically, extra dividends have been paid with the regular first quarter dividend.

TRANSACTIONS WITH RELATED PARTIES

Related party transactions for the years ended December 31, 2016 and December 31, 2015 are discussed in Note 29 to the consolidated financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The majority of our consolidated balance sheet consists of financial instruments, and the majority of net income is derived from the related income, expenses, gains and losses. Financial instruments include cash and cash equivalents, cash held in trust, marketable securities, mortgages, financial investments, other loans, financial liabilities from securitization, term deposits and loans payable, which are discussed throughout this MD&A.

The use of financial instruments exposes us to interest rate, credit, liquidity and market risk. A discussion of these risks and how these risks are managed is found in the "Risk Governance and Management" section of this MD&A.

Information on the financial statement classification and amounts of income, expenses, gains and losses associated with the instruments are located in the "Results from Operations" and "Financial Position" sections of this MD&A. Information on the determination of the fair value of financial instruments is located in the "Critical Accounting Estimates and Judgments" section of this MD&A.

PEOPLE

As at December 31, 2016, we had 61 employees.

REGULATORY COMPLIANCE

Our CCO ensures that management understands the impact of all relevant legislation affecting the business, assesses compliance with current and pending legislation and works with management to address any gaps in policies and procedures. We use a Regulatory Compliance Management System that ensures all managers assess their compliance with relevant legislation on a quarterly basis. Senior management liaises with regulators to keep them apprised of company progress and changes to our business. Our CCO reports quarterly to the CR, CG & HR Committee.

INTERNAL AUDIT

The Internal Audit function, consisting of the Chief Audit Officer, has unrestricted access to our operations, records, property and personnel, including senior management, the Chair of the Audit Committee and the other members of the Board. Internal Audit formulates an annual risk-based plan for approval by the Audit Committee and then undertakes internal audit reviews throughout the year with regular and direct reporting to both senior management and the Audit Committee.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the Company's financial statements requires management to make judgments and estimations and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. Estimates are considered carefully and reviewed at an appropriate level within MCAN. We believe that our estimates of the value of our assets and liabilities are appropriate. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Critical Accounting Estimates

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated financial statements cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, estimates are required to establish fair values. These estimates include considerations of liquidity and model inputs such as discount rates, prepayment rates and default rate assumptions for certain investments.

Allowances for credit losses

The allowance for credit losses reduces the carrying value of mortgage assets to provide for an estimate of the principal amounts that borrowers may not repay in the future. In assessing the estimated realizable value of assets, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. A number of factors can affect the amount that we ultimately collect, including the quality of our own underwriting process and credit criteria, the diversification of the portfolio, the underlying security relating to the loans and the overall economic environment. Individual allowances include all of the accumulated provisions for losses on particular assets required to reduce the related assets to estimated realizable value. The collective allowance represents losses that we believe have been incurred but not yet specifically identified. The collective allowance is established by considering historical loss trends during economic cycles, the risk profile of our current portfolio, estimated losses for the current phase of the economic cycle and historic industry experience. Allowance rates depend on asset class, as different classes have varying underlying risks. Future changes in circumstances could materially affect our future provisions for credit losses from those provisions determined in the current year, and there could be a need to increase or decrease the allowance for credit losses.

We review our individually significant mortgage balances at each consolidated financial statement date to assess whether an impairment loss should be recorded. In particular, estimates by management are required in the calculation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Company makes assumptions about the borrower's financial situation and the net realizable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Mortgages that have been assessed individually and found not to be impaired and all individually insignificant mortgages are then assessed collectively, in groups of mortgages with similar risk characteristics, to determine whether a provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the mortgage portfolio (such as credit quality, levels of arrears, credit utilization, loan to value ratios, etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices and the performance of different individual groups). There have been no recent changes to the methodology, nor are any expected in the foreseeable future. No trends, events or uncertainties exist that may affect the methodology and assumptions used.

We complete a review of all provisioning policies at least annually. We continue to monitor asset performance and current economic conditions, focusing on any regionally specific issues to assess the adequacy of the current provisioning policies. Provisioning rates are reviewed on a quarterly basis.

In addition to considering current economic conditions, we assessed the probability of default, expected loss as a result of default and the mortgage exposure at the time of default when establishing our collective allowance. We continue to review our underwriting and credit requirements on a regular basis, and we have taken measures as warranted by changes in the market and economic conditions. Our current provisioning rates consider the impact of a decline in real estate values and anticipated default/loss percentages that are sufficient to offset current and historical loss experiences.

Mortgage prepayment rates

In calculating the rate at which borrowers prepay their mortgages, the Company makes estimates based on its historical experience. These assumptions impact the timing of revenue recognition and the amortization of mortgage premiums using the EIM.

Taxes

Uncertainties exist with respect to the interpretation of complex tax regulations, changes in tax laws and the amount and timing of future taxable income in the subsidiaries of the Company. Differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense already recorded in the subsidiaries of the Company.

The Company establishes provisions, based on reasonable estimates, for possible consequences of audits by relevant tax authorities. The amount of such provisions is based on various factors, such as experience of previous tax audits and interpretations of tax regulations by the responsible tax authority. As the Company assesses the probability of litigation and subsequent cash outflow with respect to taxes as remote, no contingent liability has been recognized.

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable income will be available against which the losses can be used in the subsidiaries of the Company. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized in the subsidiaries of the Company, based upon the likely timing and the level of future taxable income together with future tax planning strategies.

Impairment of financial assets

As applicable, the Company reviews financial assets at each consolidated financial statement date to assess whether an impairment loss should be recorded. In particular, estimates by management are required in the calculation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the fair value of the asset.

Critical Accounting Judgments

Going concern

The Company's management has made an assessment of the Company's ability to continue as a going concern and is satisfied that the Company has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Company's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Significant influence

In determining whether it has significant influence over an entity, the Company makes certain judgments based on the applicable accounting standards. These judgments form the basis for the Company's policies in accounting for its equity investments.

Taxes

As a MIC under the Tax Act, the Company is able to deduct from income for tax purposes dividends paid within 90 days of year-end. The Company intends to maintain its status as a MIC and intends to pay sufficient dividends in current and future years to ensure that it is not subject to income taxes in the MIC entity on a non-consolidated basis. Accordingly, the Company does not record a provision for current and deferred taxes within the MIC entity; however provisions are recorded as applicable in all subsidiaries of MCAN.

STANDARDS ISSUED BUT NOT YET EFFECTIVE

Standards issued but not yet effective up to the date of issuance of the consolidated financial statements are listed below. This listing is of standards and interpretations issued, which we reasonably expect to be applicable at a future date. We intend to adopt these standards when they become effective.

IFRS 9, *Financial Instruments*

In July 2014, the International Accounting Standards Board ("IASB") issued a final revised IFRS 9 standard, which addresses impairment, classification and measurement, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

Project Plan/Implementation
We have established an IFRS 9 Committee which includes representatives of finance, risk and other executives. The Committee is responsible for the overall implementation of IFRS 9, ensuring proper integration throughout the Company and providing review and approval of key decisions. We continue to analyze the impact of the IFRS 9 changes on our consolidated financial statements and will continue to provide details as the project progresses.

Impairment
IFRS 9 introduces a new expected credit loss ("ECL") impairment model for all financial assets, with the most significant impact on the Company's mortgage portfolio. The new ECL model will result in a collective allowance being recorded on financial assets regardless of whether there has been an actual loss event. The expected credit loss model requires the recognition of 12-month expected credit losses at origination and the recognition of expected lifetime losses on financial assets that have experienced a significant increase in credit risk since origination. IFRS 9 requires consideration of past events, current market conditions and reasonable supportable information about future economic conditions in determining whether there has been a significant increase in credit risk, and in calculating the amount of expected losses. We are in the process of developing our IFRS 9 models and we have not yet quantified the impact on our collective allowance.

Classification and Measurement
IFRS 9 requires that debt instruments are classified based on the business model for managing the assets and the contractual cash flow characteristics of the asset. The business model test determines classification based on the business purpose for holding the asset. Our debt instruments that have contractual cash flows representing only payments of principal and interest will be eligible for classification as fair value reported through other comprehensive income ("FVOCI") or amortized cost. Our equity instruments would generally be measured at FVOCI with unrealized gains and losses recognized in other comprehensive income. We are currently analyzing our business models and contractual cash flow characteristics.

Hedge Accounting
IFRS 9 has new hedge accounting principles that are aimed to align hedge accounting more closely with risk management. We currently do not have any hedging relationships eligible for hedge accounting under IFRS 9 and therefore we do not expect any impact from the introduction of IFRS 9 hedge accounting rules.

IFRS 15, *Revenue from Contracts with Customers*

IFRS 15 provides a single principle-based framework that applies to contracts with customers. IFRS 15 is effective for annual periods beginning on or after January 1, 2018. We are in the process of assessing the impact of IFRS 15 on our consolidated financial statements.

IFRS 16, *Leases*

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e., the customer ('lessee') and the supplier ('lessor'). IFRS 16 is effective for annual periods beginning on or after January 1, 2019. All leases result in a company (the lessee) obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17, *Leases* and, instead, introduces a single lessee accounting model. Applying that model, a lessee is required to recognize: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. We have not yet determined the impact of IFRS 16 on our consolidated financial statements.

IFRS 2, *Share-based Payment Transactions*

In June 2016, the IASB issued amendments to IFRS 2, which clarify how to classify and measure certain types of share-based payment transactions. These amendments are effective for annual periods beginning on or after January 1, 2018 and can be applied prospectively. We have not yet determined the impact of IFRS 2 on our consolidated financial statements.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure Controls and Procedures ("DC&P")

A disclosure committee (the "Disclosure Committee"), comprised of members of our senior management is responsible for establishing and maintaining adequate disclosure controls and procedures. As of December 31, 2016, we have evaluated the effectiveness of the design and operation of our DC&P in accordance with requirements of National Instrument 52-109 of the Canadian Securities Commission – *Certification of Disclosure in Issuers' Annual and Interim Filings* ("NI 52-109"). Our CEO and CFO supervised and participated in this evaluation. Based on the evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports we file or submit is recorded, processed, summarized and reported within the time periods specified in securities legislation and is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosure.

Internal Controls over Financial Reporting ("ICFR")

The Disclosure Committee is responsible for establishing and maintaining adequate ICFR. Under the supervision and with the participation of the Disclosure Committee, including our CEO and CFO, we evaluated the effectiveness of our ICFR based upon the framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, a recognized control model, and the requirements of NI 52-109. Based on the evaluation, our CEO and CFO concluded that our ICFR were effective as of December 31, 2016.

Ernst & Young LLP, our Independent Registered Chartered Accountants, have audited our consolidated financial statements for the year ended December 31, 2016.

Changes in ICFR

There were no changes in our ICFR that occurred during the period beginning on January 1 and ending on December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our ICFR.

Inherent Limitations of Controls and Procedures

All internal control systems, no matter how well designed, have inherent limitations. As a result, even systems determined to be effective may not prevent or detect misstatements on a timely basis, as systems can provide only reasonable assurance that the objectives of the control system are met. In addition, projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may change.

NON IFRS MEASURES

We prepare our consolidated financial statements in accordance with IFRS. We use a number of financial measures to assess our performance. Some of these measures are not calculated in accordance with IFRS, are not defined by IFRS, and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. The non-IFRS measures used in this MD&A are defined as follows:

Return on Average Shareholders' Equity
Return on average shareholders' equity is a profitability measure that presents the annualized net income available to shareholders' equity as a percentage of the capital deployed to earn the income. We calculate return on average shareholders' equity as a monthly average using all components of shareholders' equity.

Taxable Income Measures
Taxable Income Measures include taxable income and taxable income per share. Taxable income represents MCAN's net income on a non-consolidated basis calculated under the provisions of the Tax Act applicable to a MIC. Taxable income is calculated as an estimate until we complete our annual tax returns subsequent to year end, at which point it is finalized.

Average Interest Rate
The average interest rate is a profitability measure that presents the average annualized yield of an asset or liability. Average mortgage portfolio yield (corporate or securitized), term deposit average interest rate, financial liabilities from securitization average interest rate, spread of mortgages over term deposits and spread of securitized assets over liabilities are examples of average interest rates. The average asset/liability balance that is incorporated into the average interest rate calculation is calculated on either a daily or monthly basis depending on the nature of the asset/liability. Please refer to the applicable tables containing average balances for further details.

Net Interest Income
Net interest income is a profitability measure that reflects net income earned only from interest-bearing assets and liabilities.

Impaired Mortgage Ratios
The impaired mortgage ratios represent the ratio of impaired uninsured mortgages to both corporate and total (corporate and securitized) mortgage principal.

Mortgage Arrears
Mortgage arrears measures include total corporate mortgage arrears, total securitized mortgage arrears and total mortgage arrears. These measures represent the amount of mortgages from the corporate portfolio, securitized portfolio and the sum of the two, respectively, that are at least one day past due.

Common Equity Tier 1, Tier 1 and Total Capital, Total Exposures, Regulatory Assets, Leverage Ratio, Assets to Capital Multiple and Risk Weighted Assets
These measures provided in this MD&A are in accordance with guidelines issued by OSFI and are located on Table 33 of this MD&A and Note 33 to the consolidated financial statements.

Tier 1, Tier 2, Tier 3 and Total Liquid Assets and Liquidity Ratios
Tier 1, Tier 2, Tier 3 and Total Liquid Assets are internal metrics that quantify the balance sheet assets (or components of assets) that comprise various liquidity levels. Liquidity ratios represent the ratio of select tiers of liquid assets to term deposits maturing within 100 days.

Income Tax Capital Measures
Income tax assets, income tax liabilities and income tax capital represent assets, liabilities and capital as calculated on a non-consolidated basis using the provisions of the Tax Act applicable to a MIC. The calculation of the income tax assets to capital ratio and income tax liabilities to capital ratio are based on these amounts. Income tax asset capacity represents additional income tax asset growth available to yield a 5.75 income tax assets to capital ratio, which is our target ratio.

Market Capitalization
Market capitalization is calculated as the number of common shares outstanding multiplied by the closing common share price as of that date.

Book Value per Common Share
Book value per common share is calculated as total shareholders' equity divided by the number of common shares outstanding.

Limited Partner's At-Risk Amount
The value of our equity investment in MCAP for income tax purposes is referred to as the Limited Partner's At-Risk Amount ("LP ARA"), which represents the cost base of the limited partner's investment in the partnership. The LP ARA is increased (decreased) by the partner's share of partnership income (loss) on a tax basis, increased by the amount of capital contributions into the partnership and reduced by distributions received from the partnership.