# MCAN MORTGAGE CORPORATION

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

# MARCH 31, 2018

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

This Management's Discussion and Analysis of Operations ("MD&A") should be read in conjunction with the interim unaudited consolidated financial statements and accompanying notes for the quarter ended March 31, 2018 and the audited consolidated financial statements, accompanying notes and MD&A for the year ended December 31, 2017. These items and additional information regarding MCAN Mortgage Corporation ("MCAN", the "Company" or "we"), including 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. Except as indicated below, all other factors discussed and referred to in the MD&A for fiscal 2017 remain substantially unchanged. Information has been presented as at May 8, 2018.

Effective January 1, 2018, MCAN prospectively adopted IFRS 9, *Financial Instruments* and did not restate prior period information. Accordingly, financial information for the quarter ended March 31, 2018 is based on IFRS 9 and prior periods are based on IAS 39, *Financial Instruments: Recognition and Measurement*. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

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## A CAUTION ABOUT FORWARD-LOOKING INFORMATION AND STATEMENTS

This MD&A contains forward-looking information within the meaning of applicable Canadian securities laws. All information contained in this MD&A, other than statements of current and historical fact, is forward-looking information. All of the forward-looking information in this MD&A is qualified by this cautionary note. Often, but not always, forward-looking information can be identified by the use of words such as “may,” “believe,” “will,” “anticipate,” “expect,” “planned,” “estimate,” “project,” “future,” and variations of these or similar words or other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters. Forward-looking information in this MD&A includes, among others, statements and assumptions with respect to:

- the current business environment and outlook;
- possible or assumed future results;
- our ability to create shareholder value;
- our business goals and strategy;
- the potential impact of changes to regulations;
- the stability of home prices;
- the 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.

Forward-looking information is not, and cannot be, a guarantee of future results or events. Forward-looking information reflects management’s current beliefs and is based on information currently available to management. Forward-looking information is based on, among other things, opinions, assumptions, estimates and analyses that, while considered reasonable by us at the date the forward-looking information is provided, inherently are subject to significant risks, uncertainties, contingencies and other factors that may cause actual results and events to be materially different from those expressed or implied by the forward-looking information.

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

- our ability to successfully implement and realize on our business goals and strategy;
- factors and assumptions regarding interest rates;
- housing sales and residential mortgage borrowing activities;
- the effect of competition;
- government regulation of our business;
- computer failure or security breaches;
- the availability of funding and capital to meet our 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 our products in the marketplace;
- our ability to forecast future changes to borrower credit and credit scores, loan to value ratios and other forward-looking factors used in assessing expected credit losses;
- availability of key personnel;
- our operating cost structure; and
- the current tax regime.

Reliance should not be placed on forward-looking information because it involves known and unknown risks, uncertainties and other factors, which may cause actual results to differ materially from anticipated future results expressed or implied by such forward-looking information. Factors that could cause actual results to differ materially from those set forth in the forward-looking information 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;
- our 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;
- our ability to retain our executive officers and other employees;
- litigation risk;
- our 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 or revise any forward-looking information after the date of this MD&A whether as a result of new information, future events or otherwise or to explain any material difference between subsequent actual events and any forward-looking information. However, any further disclosures made on related subjects in subsequent reports should be consulted.

## *ACRONYMS*

| | | | | | |
|---|---|---|---|---|---|
| ***AFS*** | *Available for Sale* | ***FVOCI*** | *Fair Value Through Other Comprehensive Income* | ***MBS*** | *Mortgage Backed Securities* |
| ***ALCO*** | *Asset and Liability Committee* | ***FVPL*** | *Fair Value Through Profit and Loss* | ***MD&A*** | *Management's Discussion & Analysis* |
| ***BCBS*** | *Basel Committee on Banking Supervision* | ***HELOC*** | *Home Equity Line of Credit* | ***MIC*** | *Mortgage Investment Corporation* |
| ***CAR*** | *Capital Adequacy Requirements* | ***IAS*** | *International Accounting Standard* | ***NHA*** | *National Housing Act* |
| ***CDIC*** | *Canada Deposit Insurance Corporation* | ***IASB*** | *International Accounting Standards Board* | ***NSFR*** | *Net Stable Funding Ratio* |
| ***CET 1*** | *Common Equity Tier 1* | ***ICB*** | *Investment Committee of the Board* | ***OSFI*** | *Office of the Superintendent of Financial Institutions* |
| ***CHT*** | *Canada Housing Trust* | ***IFRIC*** | *IFRS Interpretations Committee* | ***PD*** | *Probability of Default* |
| ***CMB*** | *Canada Mortgage Bonds* | ***IFRS*** | *International Financial Reporting Standards* | ***POCI*** | *Purchased or Originated Credit-Impaired* |
| ***CMHC*** | *Canada Mortgage and Housing Corporation* | ***LAR*** | *Liquidity Adequacy Requirements* | ***RAF*** | *Risk Appetite Framework* |
| ***DRIP*** | *Dividend Reinvestment Plan* | ***LCR*** | *Liquidity Coverage Ratio* | ***RMBS*** | *Residential Mortgage Backed Securities* |
| ***EAD*** | *Exposure at Default* | ***LGD*** | *Loss Given Default* | ***SEDAR*** | *System for Electronic Document Analysis and Retrieval* |
| ***ECL*** | *Expected Credit Losses* | ***LP ARA*** | *Limited Partner's At-Risk Amount* | ***SPPI*** | *Solely Payment of Principal and Interest* |
| ***EIM*** | *Effective Interest Rate Method* | ***LTV*** | *Loan to Value (ratio)* | ***TSX*** | *Toronto Stock Exchange* |

## SELECTED FINANCIAL INFORMATION

### Table 1: Income Statement Highlights

| (in thousands except for per share amounts and %) | | | Change from 2017 | |
|---|---|---|---|---|
| **For the Quarters Ended March 31** | **2018 [1]** | **2017** | **($)** | **(%)** |
| **Income Statement Highlights** | | | | |
| Net investment income - corporate assets | $ 12,073 | $ 12,963 | $ (890) | (6.9%) |
| Net investment income - securitization assets | 1,301 | 1,291 | 10 | 0.8% |
| | 13,374 | 14,254 | (880) | (6.2%) |
| Other income | 1,701 | 876 | 825 | 94.2% |
| Operating expenses | 4,631 | 4,617 | 14 | 0.3% |
| Net income before income taxes | 10,444 | 10,513 | (69) | (0.7%) |
| Provision for (recovery of) income taxes | (171) | 248 | (419) | (169.0%) |
| Net income | $ 10,615 | $ 10,265 | $ 350 | 3.4% |
| Basic and diluted earnings per share | $ 0.45 | $ 0.44 | $ 0.01 | 2.3% |
| Dividends per share | $ 0.37 | $ 0.30 | $ 0.07 | 23.3% |
| Next quarter's dividend per share | $ 0.37 | | | |
| Return on average shareholders' equity [2] | 14.10% | 14.37% | | (0.27%) |
| Taxable income per share [2,4] | $ 0.19 | $ 0.38 | $ (0.19) | (50.0%) |
| **Yields** | | | | |
| Average mortgage portfolio yield - corporate [3] | 5.72% | 5.14% | | 0.58% |
| Term deposit average interest rate [3] | 2.38% | 2.20% | | 0.18% |
| Spread of mortgages over term deposits | 3.34% | 2.94% | | 0.40% |
| Average mortgage portfolio yield - securitized [3] | 2.57% | 2.61% | | (0.04%) |
| Financial liabilities from securitization - average interest rate [3] | 1.83% | 1.90% | | (0.07%) |
| Spread of mortgages over liabilities | 0.74% | 0.71% | | 0.03% |

*[1] Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

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

*[3] Refer to "Average Interest Rate" in the "Non-IFRS Measures" section of this MD&A for a definition of this measure.*

*[4] For further information refer to the "Taxable Income" section of this MD&A.*

### Table 2: Balance Sheet Highlights

| (in thousands except for per share amounts and %) | March 31 2018 [1] | December 31 2017 | Change from Prior Quarter ($) | Change from Prior Quarter (%) |
|---|---|---|---|---|
| **Balance Sheet Highlights** | | | | |
| Assets | | | | |
| Corporate | $ 1,121,806 | $ 1,182,371 | $ (60,565) | (5%) |
| Securitization | 1,032,078 | 1,034,404 | (2,326) | - |
| Total assets | $ 2,153,884 | $ 2,216,775 | $ (62,891) | (3%) |
| Mortgages - corporate | $ 859,372 | $ 863,384 | $ (4,012) | - |
| Mortgages - securitized | $ 1,013,036 | $ 1,016,724 | $ (3,688) | - |
| Liabilities | | | | |
| Corporate | $ 836,542 | $ 904,099 | $ (67,557) | (7%) |
| Securitization | 1,015,296 | 1,015,699 | (403) | - |
| Total liabilities | $ 1,851,838 | $ 1,919,798 | $ (67,960) | (4%) |
| Shareholders' equity | $ 302,046 | $ 296,977 | $ 5,069 | 2% |
| **Capital Ratios [2]** | | | | |
| Income Tax Assets to Capital Ratio | 4.33 | 4.60 | | (6%) |
| Common Equity Tier 1 Capital Ratio [4] | 21.29% | 21.26% | | 0.03% |
| Tier 1 Capital Ratio [4] | 21.29% | 21.26% | | 0.03% |
| Total Capital Ratio [4] | 21.29% | 21.26% | | 0.03% |
| Leverage ratio [3] | 11.74% | 11.31% | | 0.43% |
| **Credit Quality** | | | | |
| Impaired mortgage ratio (total) [2] | 0.10% | 0.09% | | 0.01% |
| Impaired mortgage ratio (corporate) [2] | 0.22% | 0.20% | | 0.02% |
| **Mortgage Arrears [6]** | | | | |
| Corporate | $ 9,204 | $ 8,766 | $ 438 | 5% |
| Securitized | 9,554 | 8,803 | 751 | 9% |
| Total | $ 18,758 | $ 17,569 | $ 1,189 | 7% |
| **Common Share Information (end of period)** | | | | |
| Number of common shares outstanding | 23,559 | 23,378 | | 1% |
| Book value per common share [2] | $ 12.82 | $ 12.70 | $ 0.12 | 1% |
| Common share price - close | $ 17.61 | $ 17.84 | $ (0.23) | (1%) |
| Market capitalization [2] | $ 414,874 | $ 417,064 | $ (2,190) | (1%) |

[1] *Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

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

[3] *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. For further information, refer to the "Capital Management" section of this MD&A.*

[4] *These ratios are presented on the "all-in" basis, with certain regulatory capital deductions fully phased in.*

[5] *Represents impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.*

[6] *The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.*

## HIGHLIGHTS

**Income Statement**

- We earned net income of $10.6 million compared to net income of $10.3 million earned in Q1 2017.
- Earnings per share totalled $0.45 per share in Q1 2018, up from $0.44 per share in Q1 2017.
- Return on average shareholders' equity[1] was 14.10% in Q1 2018 compared to 14.37% in Q1 2017.
- Our equity investment in MCAP Commercial LP ("MCAP") continued to provide solid equity income of $3.4 million, up from $1.9 million in Q1 2017.
- We recognized a $1.7 million gain on the sale of a portion of our partnership units in MCAP, which reduced our ownership interest from 14.41% to 13.83%.
- Income from financial investments and other loans decreased to $1.6 million in Q1 2018 from $4.3 million in Q1 2017 due to a significant non-recurring income distribution received from Crown Realty II Limited Partnership ("Crown LP") in Q1 2017.
- We prospectively adopted IFRS 9 effective January 1, 2018 and did not restate prior period financial information, which is governed by IAS 39. IFRS 9 impacts the calculation of our provision for credit losses and requires us to record unrealized gains and losses on marketable securities and financial investments through the consolidated income statement.

**Corporate Activity**

- Corporate assets, which totalled $1.12 billion at March 31, 2018, decreased by $61 million from December 31, 2017.
- The corporate mortgage portfolio decreased by $4 million during Q1 2018 to $859 million from $863 million, which included decreases of $44 million in uninsured completed inventory, $5 million in insured single family and $2 million in uninsured single family, partially offset by increases of $19 million in construction loans and $28 million in commercial loans.
- Corporate mortgage originations increased significantly to $111 million in Q1 2018 from $60 million in Q1 2017, primarily driven by increased commercial mortgage originations.
- Financial investments increased by $5 million (8%) during Q1 2018 to $73 million from $68 million.
- Cash and cash equivalents decreased to $62 million from $118 million during Q1 2018 to a level more in line with our internal liquidity targets.

**Dividend**

- Consistent with the first quarter dividend, the Board of Directors (the "Board") declared a second quarter dividend of $0.37 per share to be paid on June 29, 2018 to shareholders of record as of June 15, 2018.

**Credit Quality**

- The impaired total mortgage ratio[1,2] increased to 0.10% at March 31, 2018 from 0.09% at December 31, 2017.
- The impaired corporate mortgage ratio[1,2] increased to 0.22% at March 31, 2018 from 0.20% at December 31, 2017.
- Total mortgage arrears[1,3] were $19 million at March 31, 2018, compared to $18 million at December 31, 2017. The March 31, 2018 balance consists entirely of single family mortgages, $7.0 million of which were uninsured.
- Net write-offs were 0.6 basis points of the average corporate portfolio in Q1 2018 compared to 11.9 basis points in Q1 2017.
- The average loan to value ratio ("LTV") of our uninsured single family portfolio based on an industry index of current real estate values was 53.1% at March 31, 2018 compared to 52.6% at December 31, 2017.

**Capital**

- Our Common Equity Tier 1, Tier 1 and Total Capital to risk-weighted assets ratios[1] were 21.29% at March 31, 2018 compared to 21.26% at December 31, 2017.
- Our leverage ratio[1] was 11.74% at March 31, 2018 compared to 11.31% at December 31, 2017.
- Income tax asset capacity[1] was $356 million at March 31, 2018 compared to $287 million at December 31, 2017. This balance represents the additional amount of corporate assets in which we could invest within the rules of the *Income Tax Act (Canada)* (the "Tax Act") that govern leverage for mortgage investment corporations.

[1] *Considered to be a "Non-IFRS Measure". For further details, refer to the "Non-IFRS Measures" section of this MD&A.*
[2] *Represents impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.*
[3] *The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.*

## OUTLOOK

**Regulatory Changes**

The revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test will continue to have some impact on the proportion of mortgages that we approve and will have the largest impact on market origination activity.

**Real Estate Conditions**

Canadian residential real estate markets continue to have a mixed performance as regional markets adjust to both regulatory changes and local economic conditions. We expect Canadian housing market conditions to experience volatility and uncertainty in 2018 and continue to face headwinds as consumers face a rising interest rate environment.

We expect home sale levels to slow considerably in Ontario as buyers react to the uncertainty caused by the multiple rule changes, with significant increases in the number of days that listings are on the market and notable decreases in sales volumes. We expect to see some level of weakness in resale markets as markets adjust to fewer buyers and more available listings. We expect that the negative impact of the announced changes will impact the Greater Toronto Area ("GTA") market for the first half of 2018, similar to what occurred in the Greater Vancouver Area ("GVA") market in 2017.

We expect the GVA to see reduced sales activity in 2018 but we expect price inflation to return as demand is expected to outpace supply. There continues to be a lack of inventory in this market, which has and will continue to push prices upward.

The Prairie Provinces are expected to demonstrate stabilization following the strengthening of oil prices. We expect to see more lending opportunities in the Prairie market as conditions continue to improve.

**Impact on MCAN**

Currently, there is a significant degree of uncertainty surrounding the future performance of the mortgage market. We believe that the mortgage market will require at least two quarters to adjust to the new underwriting rules of Guideline B-20 and other new regulations. While we continue to see significantly reduced home sales and weakening prices, we will continue to moderate our origination volumes.

We expect to see some offset by way of stronger activity from the renewal of our own mortgages that are not subject to the same stress tests as newly originated mortgages. We also expect to see an increase in the level of activity from the prime mortgage market to the alternative market that fits within our XMC-originated mortgage products. In late 2017 we commenced new acquisition programs for single family mortgages from MCAP and another third party originator and we will continue examining additional opportunities in 2018.

MCAN is a diversified lender to housing markets, and temporarily adjusted its corporate mortgage portfolio composition in 2017 by opportunistically deploying capital into other business lines such as commercial and construction lending to compensate for the shortfall in the single family business given the uncertainties in that market. We believe that certain lower-risk segments of the commercial mortgage market, such as loans secured by apartment buildings, represent good lending opportunities in a slowing single family market.

Our disciplined approach to investment in mortgages resulted in MCAN not aggressively growing its uninsured single family mortgage portfolio when the GTA and GVA markets were at record high home prices. We believe that this conservative approach and the moderation of originations amidst market volatility will reduce our exposure to loss in the event of a market correction.

MCAN has considerable experience in commercial and construction lending, and has strategic lending relationships with MCAP and KingSett Capital that provide MCAN with access to origination and risk-managed participation in commercial and construction lending opportunities. We will continue to leverage our strategic business relationships to earn appropriate risk adjusted returns.

Our corporate assets decreased by 5% in the first quarter of 2018 compared to our stated annual growth target of 10%. While we maintain our stated annual growth target for corporate assets of 10% per annum, we believe that this target provides our shareholders with a measure of the long term expected pace of annual growth for the Company. As market conditions change, we may choose to deviate from this target to exercise prudent risk management, or should an appropriate opportunity arise, we may choose to exceed it. The combination of the current weakness in home values in Canada's two major markets and a tighter marketplace has led to a moderation in our single family volumes.

We expect our equity investments in MCAP, Crown LP and the KingSett High Yield Fund ("KSHYF") to positively contribute to our earnings in 2018. In the first quarter we recognized a $1.7 million gain on the partial sale of our investment in MCAP, which reduced our ownership interest from 14.41% to 13.83%. The growth of the KSHYF since Q2 2017 has advanced our investment level and is expected to continue to have a positive impact on future income from this investment. In the first quarter of 2018 we funded an additional $5 million of our capital commitment relating to our investment in the KSHYF.

With low impaired mortgage ratios and arrears, we believe that MCAN's balance sheet is well positioned in the current market. In addition, with over 50% of our consolidated balance sheet represented by insured mortgages, we believe that our asset composition provides a sound risk adjusted return to our shareholders. As the uncertainty in the current market evolves, we believe that our strong capital position and asset capacity can be deployed if and when opportunities arise.

## RESULTS OF OPERATIONS

### Table 3: Net Income - For the Quarters Ended March 31

| (in thousands except for per share amounts and %) | 2018 [1] | 2017 | Change from 2017 ($) | (%) |
|---|---|---|---|---|
| **Net Investment Income - Corporate Assets** | | | | |
| Mortgage interest | $ 12,000 | $ 11,555 | $ 445 | 4% |
| Equity income from MCAP Commercial LP | 3,439 | 1,892 | 1,547 | 82% |
| Financial investments and other loans | 1,554 | 4,263 | (2,709) | (64%) |
| Marketable securities | 878 | 846 | 32 | 4% |
| Fees | 363 | 291 | 72 | 25% |
| Interest on cash and cash equivalents | 287 | 158 | 129 | 82% |
| Unrealized gain (loss) on financial instruments [1,3] | (56) | - | (56) | - |
| | **18,465** | **19,005** | **(540)** | **(3%)** |
| Term deposit interest and expenses | 5,247 | 5,021 | 226 | 5% |
| Mortgage expenses | 951 | 959 | (8) | (1%) |
| Interest on loans payable | 20 | 32 | (12) | (38%) |
| Provision for credit losses [1,2] | 174 | 30 | 144 | 480% |
| | **6,392** | **6,042** | **350** | **6%** |
| | **12,073** | **12,963** | **(890)** | **(7%)** |
| **Other Income - Corporate Assets** | | | | |
| Gain on sale of investment in MCAP Commercial LP | 1,701 | 785 | 916 | 117% |
| Gain on dilution of investment in MCAP Commercial LP | - | 91 | (91) | (100%) |
| | **1,701** | **876** | **825** | **94%** |
| **Net Investment Income - Securitization Assets** | | | | |
| Mortgage interest | 6,493 | 6,772 | (279) | (4%) |
| Other securitization income | 72 | 36 | 36 | 100% |
| | **6,565** | **6,808** | **(243)** | **(4%)** |
| Interest on financial liabilities from securitization | 4,681 | 5,011 | (330) | (7%) |
| Mortgage expenses | 568 | 506 | 62 | 12% |
| Provision for credit losses [1,2] | 15 | - | 15 | - |
| | **5,264** | **5,517** | **(253)** | **(5%)** |
| | **1,301** | **1,291** | **10** | **1%** |
| **Operating Expenses** | | | | |
| Salaries and benefits | 2,945 | 2,594 | 351 | 14% |
| General and administrative | 1,686 | 2,023 | (337) | (17%) |
| | **4,631** | **4,617** | **14** | **0%** |
| Net Income Before Income Taxes | 10,444 | 10,513 | (69) | (1%) |
| Provision for (recovery of) income taxes | (171) | 248 | (419) | (169%) |
| **Net Income** | **$ 10,615** | **$ 10,265** | **$ 350** | **3%** |
| Basic and diluted earnings per share | $ 0.45 | $ 0.44 | $ 0.01 | 2% |
| Dividends per share | $ 0.37 | $ 0.30 | $ 0.07 | 23% |

[1] *Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

[2] *Under IFRS 9, the methodology for the calculation of mortgage allowances and provisions has changed from IAS 39, therefore provisions under IFRS 9 are not directly comparable to prior periods.*

[3] *Under IFRS 9, fair value changes in certain reclassified financial assets are presented in the income statement and are therefore not directly comparable to prior periods.*

## Net Investment Income - Corporate Assets

**Mortgage interest income**

**Table 4: Interest Income and Average Rate by Mortgage Portfolio - Q1**

| For the Quarters Ended March 31 | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands except %) | Average Balance | Interest Income | Average Rate [1] | Average Balance | Interest Income | Average Rate [1] |
| Single family | | | | | | |
| - Uninsured | $ 200,142 | $ 2,315 | 4.65% | $ 243,682 | $ 2,785 | 4.58% |
| - Insured | 66,001 | 535 | 3.26% | 106,261 | 842 | 3.17% |
| - Uninsured - completed inventory | 17,314 | 245 | 5.73% | 21,157 | 305 | 5.84% |
| Construction loans | | | | | | |
| - Residential | 394,128 | 6,140 | 6.32% | 389,383 | 5,170 | 5.39% |
| - Non residential | 4,098 | 60 | 5.91% | 7,860 | 105 | 5.44% |
| Commercial loans | | | | | | |
| - Multi family residential | 73,238 | 951 | 5.27% | 34,805 | 388 | 4.50% |
| - Other commercial | 93,602 | 1,754 | 7.61% | 105,131 | 1,960 | 7.57% |
| Mortgages - corporate portfolio | $ 848,523 | $ 12,000 | 5.72% | $ 908,279 | $ 11,555 | 5.14% |
| Term deposits | 837,715 | 5,247 | 2.38% | 867,954 | 5,021 | 2.20% |
| Spread of mortgages over term deposits | | | 3.34% | | | 2.94% |
| Mortgages - securitized portfolio | $ 1,015,325 | $ 6,493 | 2.57% | $ 1,052,243 | $ 6,772 | 2.61% |
| Financial liabilities from securitization | 1,023,721 | 4,681 | 1.83% | 1,061,015 | 5,011 | 1.90% |
| Spread of mortgages over liabilities | | | 0.74% | | | 0.71% |

*[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, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Non-recurring items were immaterial for the quarters ended March 31, 2018 and March 31, 2017. 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.*

The Bank of Canada announced two 0.25% increases in the overnight rate in the second half of 2017 and a third during Q1 2018 which had and are expected to continue to have a positive impact on mortgage interest income related to the floating rate component of our corporate mortgage portfolio. These rate increases contributed 0.69% and 0.43%, respectively, to the average interest rate for the construction and total corporate portfolios in Q1 2018, as approximately 98% and 60% of those respective portfolios are floating rate and repriced following the rate increases.

Additionally, in Q1 2018 we also recognized additional corporate mortgage interest income from the acceleration of mortgage commitment fee amortization on the early payout of certain completed inventory, construction and commercial loans, which contributed to the increase in the average interest rate from Q1 2017.

We continued to steadily grow our construction portfolio in Q1 2018, consistent with the seasonal growth experienced in Q1 2017 and prior years. Over the past two quarters, we have increased our commitment pipeline in this portfolio with a view to deploying excess asset capacity after temporarily curtailing new commitments in mid-2017 due to liquidity issues in the market. While we continue to target experienced builders in markets with favourable economic activity, we ensure that new lending fits within our risk appetite. Construction lending is based on specific loan covenants required to be satisfied prior to funding (e.g. pre-sales), which act as a risk mitigant given concerns about inflated valuations in certain real estate markets.

We have also experienced steady growth in our commercial loan portfolio, which provides a different risk profile from single family while providing appropriate risk-adjusted returns. The majority of the growth since Q1 2017 has been in the multi family residential lending category, which carries a lower risk profile as it is secured by collateral such as apartment buildings.

During Q1 2018, we experienced a significant decrease in the completed inventory portfolio as certain loans paid out after the sale and closing of completed units. This portfolio balance can be volatile given the short-term nature of completed inventory loans, which generally represent loans that have been transferred from the residential construction portfolio upon the substantial completion of housing units.

Our uninsured single family portfolio, while down from Q1 2017, has remained consistent for several quarters. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market and have steadily increased origination volumes to maintain our portfolio balance. We funded $5.4 million from external sources during Q1 2018.

Revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Our insured single family origination and securitization volumes have remained low since 2017. The impact of multiple changes to mortgage regulations enacted within the last two years have made that market segment more competitive and have also led reduced securitization economics.

Average mortgage portfolio yield is 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 from Q1 2017 was a result of higher income from non-securitized mortgages from a larger average portfolio, increased hedge gains and a decrease in income tax expense.

We recognize equity income from MCAP on a one-month lag such that our Q1 2018 equity income from MCAP is based on MCAP's net income for the quarter ended February 28, 2018. For further information on our equity investment in MCAP, refer to the "Equity investment in MCAP" sub-section of the "Financial Position" section of this MD&A.

**Other net investment income**

The decrease in income from financial investments and other loans is primarily due to $3.5 million of distribution income recognized from Crown LP in Q1 2017, compared to $0.3 million in Q1 2018. The decrease is due to the fact that we received a significant non-recurring income distribution in Q1 2017, while the Q1 2018 distribution represented a regular distribution of operating income by Crown LP.

Income from financial investments and other loans also includes $1.2 million of income from our investment in the KSHYF (Q1 2017 - $0.8 million). For further information on both of these investments, refer to the "Other Corporate Assets" sub-section of the "Financial Position" section of this MD&A.

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. We issue term deposits that are eligible for Canada Deposit Insurance Corporation ("CDIC") deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor. For further details, refer to the "Liquidity Management" section of this MD&A.

Mortgage expenses consist primarily of mortgage servicing fees paid to external mortgage servicers.

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.

## Other Income - Corporate Assets

In Q1 2018, we sold 200,000 partnership units in MCAP at a price of $22.60 per unit (compared to a net book value of $14.10 per unit), recognizing a gain on sale of $1.7 million.

In Q1 2017, we sold 100,000 partnership units in MCAP at a price of $19.47 per unit (compared to a net book value of $11.62 per unit), recognizing a gain on sale of $0.8 million. MCAP also issued additional class B units to other partners of MCAP during 2017 which diluted our equity interest. Since the new units were issued at a price in excess of our carrying value per unit, we recorded a dilution gain of $0.1 million.

The Q1 2018 unrealized loss on financial instruments consisted of an unrealized loss of $0.6 million on marketable securities and an unrealized gain of $0.5 million on financial investments. Unrealized gains and losses on marketable securities and financial investments are now recorded through the consolidated income statement as a result of the adoption of IFRS 9 effective January 1, 2018. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

## 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") NHA MBS program. In Q1 2018, our total securitization volumes were $28 million (Q1 2017 - $48 million). For further details on these programs, refer to the "Securitization Programs" section of this MD&A.

**Market MBS Program**

The average outstanding market MBS program mortgage balance decreased to $869 million in Q1 2018 from $949 million in Q1 2017, while the net spread increased to 0.76% from 0.71% as a result of higher net penalty income. As noted earlier, new securitization volumes have been low since 2017.

**CMB Program**

The average outstanding CMB program mortgage balance increased to $147 million in Q1 2018 from $103 million in Q1 2017, while the net spread decreased to 0.62% from 0.73%. Historically, the CMB program spread is higher than the market MBS program spread due to a lower funding cost. However, the tightening of spreads in CMB issuances from 2017 has made the CMB program net spread lower than that from the market MBS program.

## 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 - Q1

| For the Quarters Ended March 31 | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands except %) | Average Balance [1] | Income / Expense | Average Rate[3] | Average Balance [1] | Income / Expense | Average Rate[3] |
| **Assets** | | | | | | |
| Cash and cash equivalents | $ 104,452 | $ 287 | 1.11% | $ 78,200 | $ 158 | 0.82% |
| Marketable securities | 61,660 | 878 | 5.77% | 56,293 | 846 | 6.09% |
| Mortgages - corporate | 848,523 | 12,000 | 5.72% | 908,279 | 11,555 | 5.14% |
| Financial investments | 39,108 | 1,238 | 12.84% | 24,332 | 763 | 12.72% |
| Other loans | 2,546 | 34 | 5.42% | 3,673 | 46 | 5.08% |
| Corporate interest earning assets | 1,056,289 | 14,437 | 5.54% | 1,070,777 | 13,368 | 5.06% |
| Cash held in trust | 12,596 | 49 | 1.58% | 12,977 | 10 | 0.31% |
| Mortgages - securitized | 1,015,325 | 6,493 | 2.57% | 1,052,243 | 6,772 | 2.61% |
| Securitization interest earning assets | 1,027,921 | 6,542 | 2.58% | 1,065,220 | 6,782 | 2.58% |
| Total interest earning assets | 2,084,210 | 20,979 | 4.08% | 2,135,997 | 20,150 | 3.83% |
| Non interest earning assets | 91,977 | 282 | - | 91,035 | 3,454 | - |
| **Total assets** | $ 2,176,187 | $ 21,261 | 3.96% | $ 2,227,032 | $ 23,604 | 4.30% |
| **Liabilities and shareholders' equity** | | | | | | |
| Term deposits | $ 837,715 | $ 5,247 | 2.38% | $ 867,954 | $ 5,021 | 2.20% |
| Loans payable | 1,900 | 20 | 4.27% | 3,789 | 32 | 3.43% |
| Corporate liabilities | 839,615 | 5,267 | 2.39% | 871,743 | 5,053 | 2.21% |
| Securitization liabilities | 1,023,721 | 4,681 | 1.83% | 1,061,015 | 5,011 | 1.90% |
| Total interest bearing liabilities | 1,863,336 | 9,948 | 2.13% | 1,932,758 | 10,064 | 2.06% |
| Non interest bearing liabilities | 11,735 | - | - | 8,613 | - | - |
| Shareholders' equity | 301,116 | - | - | 285,661 | - | - |
| **Total liabilities and shareholders' equity** | $ 2,176,187 | $ 9,948 | 1.85% | $ 2,227,032 | $ 10,064 | 1.83% |
| **Net Interest Income [2]** | | $ 11,313 | | | $ 13,540 | |

*[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, unrealized gain/loss on financial instruments, 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 such as discount income, 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. Non-recurring items were immaterial for the quarters ended March 31, 2018 and March 31, 2017. 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

We prospectively adopted IFRS 9 effective January 1, 2018. Prior period information has not been restated. Under IFRS 9, we segregate the provision for credit losses between impaired mortgages and performing mortgages. The provision for credit losses on impaired mortgages under IFRS 9 replaces the individual provision under IAS 39, while the provision on performing mortgages under IFRS 9 replaces the collective provision under IAS 39. For further information on provisions for credit losses under IFRS 9, refer to Note 4 to the consolidated financial statements.

### Table 6: Provisions for Credit Losses and Write-offs

| (in thousands except basis points) | IFRS 9 | IAS 39 | Change from 2017 | |
|---|---|---|---|---|
| **For the Quarters Ended March 31** | **2018** | **2017** | **($)** | **(%)** |
| Provision (recovery) on impaired corporate mortgages [1] | | | | |
| Single family uninsured | $ 64 | $ 94 | $ (30) | (32%) |
| Provision (recovery) on performing corporate mortgages [2] | | | | |
| Single family insured | (1) | - | (1) | - |
| Single family uninsured | 32 | (81) | 113 | (140%) |
| Single family uninsured - completed inventory | (352) | 38 | (390) | (1026%) |
| Construction | 138 | 81 | 57 | 70% |
| Commercial | | | | |
| Multi family residential | 137 | 9 | 128 | 1422% |
| Other commercial | 171 | (110) | 281 | (255%) |
| | 125 | (63) | 188 | (298%) |
| Other provisions (recoveries) | (15) | (1) | (14) | 1400% |
| Corporate provision for credit losses | 174 | 30 | 144 | 480% |
| Provision (recovery) on performing securitized mortgages [2] | 15 | - | 15 | - |
| Total provision for (recovery of) credit losses | $ 189 | $ 30 | $ 159 | 530% |
| **Corporate mortgage portfolio data:** | | | | |
| Provision for (recovery of) credit losses | $ 189 | $ 31 | $ 158 | 510% |
| Net write offs | $ 13 | $ 270 | $ (257) | (95%) |
| Net write offs (basis points) | 0.6 | 11.9 | (11.3) | (95%) |

*[1] Represents impaired (stage 3) provision for credit losses on mortgages and mortgage commitments under IFRS 9 and individual provisions for credit losses under IAS 39.*
*[2] Represents performing (stage 1 and 2) provision for credit losses on mortgages and mortgage commitments under IFRS 9 and collective provisions for credit losses under IAS 39.*

Write-offs in Q1 2017 include $220,000 relating to capitalized legal fees on a construction loan for which an individual allowance had already been recorded. The remainder of the Q1 2017 balance and the entire Q1 2018 balance consist of write-offs of uninsured single family mortgages for which an individual allowance had already been recorded. Accordingly, these write-offs had no impact on net income.

## Operating Expenses

### Table 7: Operating Expenses

| (in thousands)<br>For the Quarters Ended March 31 | 2018 | 2017 | Change from 2017 ($) | Change from 2017 (%) |
|---|---|---|---|---|
| Salaries and benefits | $ 2,945 | $ 2,594 | $ 351 | 14% |
| General and administrative | 1,686 | 2,023 | (337) | (17%) |
| | **$ 4,631** | **$ 4,617** | **$ 14** | **0%** |

The increase in salaries and benefits is a result of an increase in the number of employees from Q1 2017. Our headcount has increased since 2017 as we have continued to expand our risk management and corporate governance departments.

General and administrative expenses were higher in Q1 2017 due to expenditures associated with the development of systems and processes related to single family mortgage operations. At that time, we were undertaking multiple projects to improve governance and mitigate risk.

## Provision for Income Taxes

### Table 8: Income Taxes

| (in thousands)<br>For the Quarters Ended March 31 | 2018 | 2017 | Change from 2017 ($) | Change from 2017 (%) |
|---|---|---|---|---|
| Deferred tax provision (recovery) | $ (171) | $ 248 | $ (419) | $ (169%) |
| | **$ (171)** | **$ 248** | **$ (419)** | **$ (169%)** |

Deferred tax provisions (recoveries) are generally due to taxable income (losses) recognized at the subsidiary level.

As at March 31, 2018, 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, 2017 - $11 million). The benefit of these loss carry-forwards are not reflected in deferred taxes due to the fact that we have the ability to pay sufficient dividends in current and future years to ensure that we are not subject to income taxes in the MIC entity. Tax activity for fiscal 2017 has not been reflected in the loss carry-forward balance as our 2017 tax position has not been officially finalized. For further information, refer to Notes 4 and 14 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 XMC and other subsidiaries as it does not directly impact MCAN's non-consolidated taxable income.

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)<br>For the Quarters Ended March 31 | 2018 | 2017 |
|---|---|---|
| Net income for accounting purposes | $ 10,615 | $ 10,265 |
| Adjustments: | | |
| Deduct: Equity income from MCAP - accounting purposes | (3,439) | (1,892) |
| Add: MCAP taxable income (loss) | (3,737) | 2,287 |
| Deduct: Accounting gain on partial sale of MCAP [4] | (1,701) | (785) |
| Add: Taxable gain on partial sale of MCAP [4] | 1,425 | 536 |
| Provision for (recovery of) credit losses [2] | 145 | (81) |
| Amortization of upfront securitization program costs [3] | 1,772 | 1,661 |
| Securitization program mortgage origination costs [3] | (319) | (723) |
| Unrealized loss on financial instruments [2] | 575 | - |
| Equity income from subsidiaries [2] | (392) | (1,892) |
| Other securitization program cash outflows | (269) | (582) |
| Gain on dilution of investment in MCAP [2] | - | (91) |
| Other items | (204) | 143 |
| **Taxable Income** | **$ 4,471** | **$ 8,846** |

*[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] For tax purposes, the accounting gain is excluded and only 50% of the taxable gain is included.*

The significant decrease in taxable income in Q1 2018 was driven primarily by timing differences between accounting and taxable income in respect of a number of securitization transactions that MCAP completed during Q1 2018. These timing differences are expected to reverse over the duration of the associated transactions.

The key differences between taxable income and pre-tax net income for accounting purposes include differences between equity income from MCAP and XMC for accounting and tax purposes and the treatment of securitization program origination costs, securitization gains and losses, unrealized gains (losses) on marketable securities, capital gains income, collective provisions for credit losses and the amortization of upfront securitization program costs for tax purposes.

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 Q1 2018, we incurred $0.3 million of origination costs on securitized mortgages, including market MBS held by MCAN (Q1 2017 - $0.7 million). As at March 31, 2018, the unamortized origination fee balance was $10.8 million (December 31, 2017 - $11.9 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.

MCAN's MIC status allows it 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 above.

As a MIC, we typically pay out all of our taxable income to shareholders through dividends. MCAN's dividend objective is to provide shareholders with a consistent and stable regular dividend, wherein dividend changes over time follow MCAN's long term growth. From quarter to quarter, timing differences between taxable income and accounting income are considered by the Board in the determination of the quarterly dividend.

**Table 10: Quarterly Net Income**

| (in thousands except per share amounts and %)<br>For the Quarters Ended | March 31<br>2018 | December 31<br>2017 | Change from Prior Quarter<br>($) | (%) |
|---|---|---|---|---|
| **Net Investment Income - Corporate Assets** | | | | |
| Mortgage interest | $ 12,000 | $ 12,109 | $ (109) | (1%) |
| Equity income from MCAP Commercial LP | 3,439 | 5,457 | (2,018) | (37%) |
| Financial investments and other loans | 1,554 | 1,517 | 37 | 2% |
| Marketable securities | 878 | 854 | 24 | 3% |
| Fees | 363 | 321 | 42 | 13% |
| Interest on cash and cash equivalents | 287 | 320 | (33) | (10%) |
| Unrealized gain (loss) on financial instruments [1,3] | (56) | - | (56) | - |
| | **18,465** | **20,578** | **(2,113)** | **(10%)** |
| Term deposit interest and expenses | 5,247 | 5,233 | 14 | 0% |
| Mortgage expenses | 951 | 951 | - | - |
| Interest on loans payable | 20 | 2 | 18 | 900% |
| Provision for credit losses [1,2] | 174 | 33 | 141 | 427% |
| | **6,392** | **6,219** | **173** | **3%** |
| | **12,073** | **14,359** | **(2,286)** | **(16%)** |
| **Other Income - Corporate Assets** | | | | |
| Gain on sale of investment in MCAP Commercial LP | 1,701 | - | 1,701 | - |
| | **1,701** | **-** | **1,701** | **-** |
| **Net Investment Income - Securitization Assets** | | | | |
| Mortgage interest | 6,493 | 6,449 | 44 | 1% |
| Other securitization income | 72 | 82 | (10) | (12%) |
| | **6,565** | **6,531** | **34** | **1%** |
| Interest on financial liabilities from securitization | 4,681 | 4,594 | 87 | 2% |
| Mortgage expenses | 568 | 521 | 47 | 9% |
| Provision for credit losses [1,2] | 15 | - | 15 | - |
| | **5,264** | **5,115** | **149** | **3%** |
| | **1,301** | **1,416** | **(115)** | **(8%)** |
| **Operating Expenses** | | | | |
| Salaries and benefits | 2,945 | 2,595 | 350 | 13% |
| General and administrative | 1,686 | 2,707 | (1,021) | (38%) |
| | **4,631** | **5,302** | **(671)** | **(13%)** |
| Net Income Before Income Taxes | 10,444 | 10,473 | (29) | (0%) |
| Provision for (recovery of) income taxes | (171) | (334) | 163 | (49%) |
| **Net Income** | **$ 10,615** | **$ 10,807** | **$ (192)** | **(2%)** |
| Basic and diluted earnings per share | $ 0.45 | $ 0.47 | $ (0.02) | (4%) |
| Dividends per share | $ 0.37 | $ 0.37 | $ - | - |

[1] *Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

[2] *Under IFRS 9, the methodology for the calculation of mortgage allowances and provisions has changed from IAS 39, therefore provisions under IFRS 9 are not directly comparable to prior periods.*

[3] *Under IFRS 9, fair value changes in certain reclassified financial assets are presented in the income statement and are therefore not directly comparable to prior periods.*

## Q1 2018 vs. Q4 2017

**Net Investment Income - Corporate Assets**

### Table 11: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

| For the Quarters Ended | March 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands except %) | Average Balance | Interest Income | Average Rate [1] | Average Balance | Interest Income | Average Rate [1] |
| Single family | | | | | | |
| - Uninsured | $ 200,142 | $ 2,315 | 4.65% | $ 200,797 | $ 2,366 | 4.72% |
| - Insured | 66,001 | 535 | 3.26% | 84,468 | 696 | 3.30% |
| - Uninsured - completed inventory | 17,314 | 245 | 5.73% | 51,826 | 885 | 6.78% |
| Construction loans | | | | | | |
| - Residential | 394,128 | 6,140 | 6.32% | 376,059 | 5,570 | 5.88% |
| - Non residential | 4,098 | 60 | 5.91% | 6,995 | 100 | 5.69% |
| Commercial loans | | | | | | |
| - Multi family residential | 73,238 | 951 | 5.27% | 56,684 | 701 | 4.91% |
| - Other commercial | 93,602 | 1,754 | 7.61% | 89,136 | 1,791 | 7.98% |
| Mortgages - corporate portfolio | $ 848,523 | $ 12,000 | 5.72% | $ 865,965 | $ 12,109 | 5.56% |
| Term deposits | 837,715 | 5,247 | 2.38% | 847,523 | 5,233 | 2.29% |
| Spread of mortgages over term deposits | | | 3.34% | | | 3.27% |
| Mortgages - securitized portfolio | $ 1,015,325 | $ 6,493 | 2.57% | $ 1,001,708 | $ 6,449 | 2.57% |
| Financial liabilities from securitization | 1,023,721 | 4,681 | 1.83% | 1,012,852 | 4,594 | 1.81% |
| Spread of mortgages over liabilities | | | 0.74% | | | 0.76% |

*[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, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Non-recurring items were immaterial for the quarters ended March 31, 2018 and December 31, 2017. 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.*

The 0.25% increase in the overnight rate by the Bank of Canada during Q1 2018 contributed approximately 0.20% and 0.13%, respectively, to the average interest rate for the construction and total corporate portfolios in Q1 2018 compared to Q4 2017, as approximately 98% and 60% of those respective portfolios are floating rate and repriced following the rate increases.

Changes in the average balances for individual portfolios are consistent with the analysis in the "Mortgage Interest Income" sub-section of the "Net Investment Income - Corporate Assets" section of this MD&A.

Equity income from MCAP in Q4 2017 was significantly higher than usual due to higher origination fee income, higher net interest income on securitized mortgages and a lower income tax expense, partially offset by lower financial instrument gains. Equity income from MCAP and the gain on sale of MCAP from Q1 2018 are discussed in the "Net Investment Income - Corporate Assets" section of this MD&A.

**Net Investment Income - Securitization Assets**

The net spread of securitized mortgages over liabilities was comparable to Q4 2017, as the current quarter securitization had a minimal impact on net spread.

**Operating Expenses and Income Taxes**

Salaries and benefits were lower in Q4 2017 as a result of a lower variable compensation expense driven by the finalization of year-end accruals. General and administrative expenses were higher in Q4 2017 as a result of non-recurring professional fee accruals.

For a discussion of deferred tax activity, refer to the "Provision for Income Taxes" sub-section of the "Results of Operations" section of this MD&A.

## Cash Flows

Operating activities used cash flows of $52 million in Q1 2018 and used $8 million in Q1 2017. In Q1 2018, we had higher net outflows related to term deposits and financial liabilities from securitization, and lower inflows from mortgages.

Investing activities provided cash flows of $8 million in Q1 2018 and provided $3 million in Q1 2017. In Q1 2018, we received proceeds from a partial sale of our equity investment in MCAP of $4.5 million.

Financing activities used cash flows of $11 million in Q1 2018 and used $12 million in Q1 2017. In Q1 2018, there was an increase in outflows from dividends paid.

## FINANCIAL POSITION

### Table 12: Assets

| (in thousands except %)<br>As at | March 31<br>2018 [1] | December 31<br>2017 | Change from Prior Quarter<br>($) | <br>(%) |
|---|---|---|---|---|
| **Corporate Assets** | | | | |
| Cash and cash equivalents | $ 62,463 | $ 117,571 | $ (55,108) | (47%) |
| Marketable securities | 61,429 | 62,518 | (1,089) | (2%) |
| Mortgages | 859,372 | 863,384 | (4,012) | - |
| Financial investments | 73,446 | 68,190 | 5,256 | 8% |
| Other loans | 2,655 | 2,612 | 43 | 2% |
| Equity investment in MCAP Commercial LP | 56,398 | 59,189 | (2,791) | (5%) |
| Foreclosed real estate | 435 | 435 | - | - |
| Deferred tax asset | 2,874 | 2,672 | 202 | 8% |
| Other assets | 2,734 | 5,800 | (3,066) | (53%) |
| | **1,121,806** | **1,182,371** | **(60,565)** | **(5%)** |
| **Securitization Assets** | | | | |
| Cash held in trust | 15,073 | 13,441 | 1,632 | 12% |
| Mortgages | 1,013,036 | 1,016,724 | (3,688) | - |
| Other assets | 3,969 | 4,239 | (270) | (6%) |
| | **1,032,078** | **1,034,404** | **(2,326)** | **-** |
| | **$ 2,153,884** | **$ 2,216,775** | **$ (62,891)** | **(3%)** |

[1] *Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

## Mortgages - Corporate & Securitized

### Table 13: Mortgage Summary

| (in thousands)<br>As at | March 31<br>2018 | December 31<br>2017 | Change from 2017<br>($) | (%) |
|---|---|---|---|---|
| **Corporate portfolio:** | | | | |
| Single family mortgages | | | | |
| - Uninsured | $ 196,624 | $ 198,354 | $ (1,730) | (1%) |
| - Insured | 75,698 | 80,377 | (4,679) | (6%) |
| - Uninsured - completed inventory | 7,410 | 51,190 | (43,780) | (86%) |
| Construction loans | | | | |
| - Residential | 404,987 | 386,562 | 18,425 | 5% |
| - Non-residential | 5,014 | 4,840 | 174 | 4% |
| Commercial loans | | | | |
| - Multi family residential | 73,026 | 64,655 | 8,371 | 13% |
| - Other commercial | 96,613 | 77,406 | 19,207 | 25% |
| | **859,372** | **863,384** | **(4,012)** | **-** |
| **Securitized portfolio:** | | | | |
| Single family insured - Market MBS program | 867,149 | 867,406 | (257) | - |
| Single family insured - CMB program | 145,887 | 149,318 | (3,431) | (2%) |
| | **1,013,036** | **1,016,724** | **(3,688)** | **-** |
| | **$ 1,872,408** | **$ 1,880,108** | **$ (7,700)** | **-** |

## Corporate and Securitized Mortgage Portfolio Analysis

### Q1 2018 Summary

During Q1 2018 we experienced multiple changes in individual mortgage lines of business. Over the past two quarters, the construction portfolio has grown steadily as we have increased our commitment pipeline with a view to deploying our excess asset capacity. While we continue to target experienced builders in markets with favourable economic activity, we ensure that new lending fits within our risk appetite. Construction lending is based on specific loan covenants required to be satisfied prior to funding (e.g. pre-sales), which act as a risk mitigant given concerns about inflated valuations in certain real estate markets.

We have also experienced growth in our commercial loan portfolio, which provides a different risk profile from single family while providing appropriate risk-adjusted returns. We believe that certain lower-risk segments of the commercial mortgage market, such as loans secured by apartment buildings, represent good lending opportunities in a slowing single family market as they are counter-cyclical to home sales.

During the quarter, we experienced a significant decrease in the completed inventory portfolio as certain loans paid out after the sale and closing of completed units. This portfolio balance can be volatile given the short-term nature of completed inventory loans, which generally represent loans that have been transferred from the residential construction portfolio upon the substantial completion of housing units.

After a significant decrease since 2016, the uninsured single family portfolio balance has remained steady over the last several quarters. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market. In late 2017, we commenced new acquisition programs for uninsured single family mortgages from MCAP and another third party origination source. We have targeted additional sources for uninsured single family mortgage origination given the attractive risk-adjusted returns and our excess balance sheet capacity.

OSFI implemented significant changes to Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures*, effective January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Our insured single family origination and securitization volumes have remained low since 2017. The impact of multiple changes to mortgage regulations enacted within the last two years have made that market segment more competitive and have also led reduced securitization economics.

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

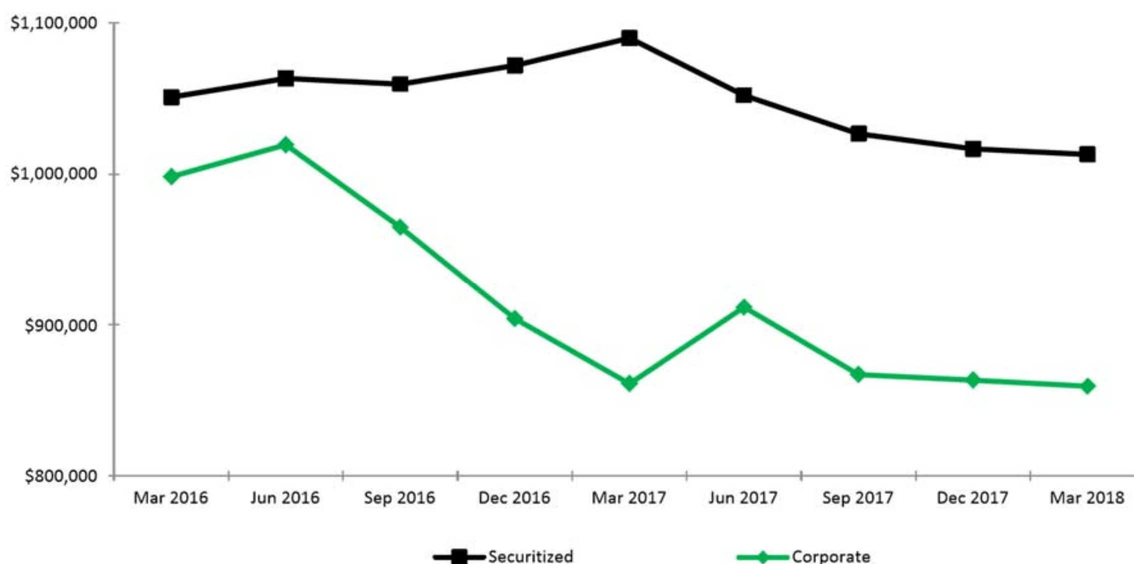
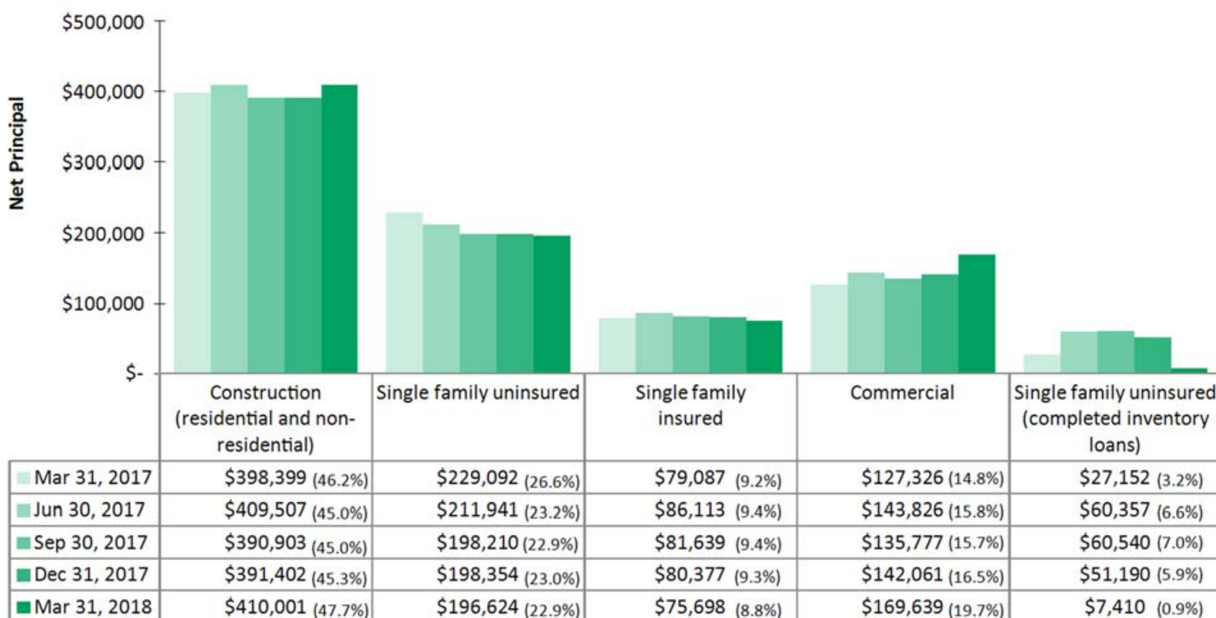


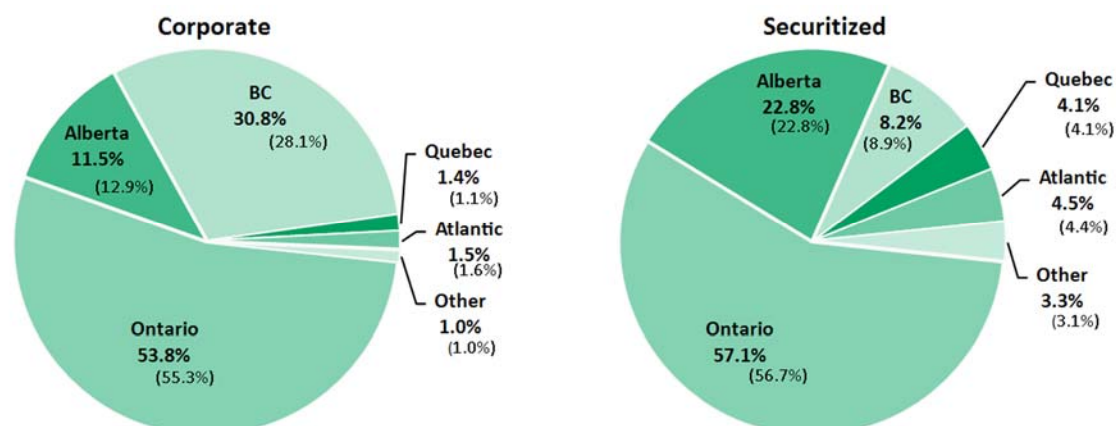

**Figure 2: Corporate Mortgage Portfolio Composition by Product Type (in thousands)**




| | Construction (residential and non-residential) | Single family uninsured | Single family insured | Commercial | Single family uninsured (completed inventory loans) |
|---|---|---|---|---|---|
| Mar 31, 2017 | $398,399 (46.2%) | $229,092 (26.6%) | $79,087 (9.2%) | $127,326 (14.8%) | $27,152 (3.2%) |
| Jun 30, 2017 | $409,507 (45.0%) | $211,941 (23.2%) | $86,113 (9.4%) | $143,826 (15.8%) | $60,357 (6.6%) |
| Sep 30, 2017 | $390,903 (45.0%) | $198,210 (22.9%) | $81,639 (9.4%) | $135,777 (15.7%) | $60,540 (7.0%) |
| Dec 31, 2017 | $391,402 (45.3%) | $198,354 (23.0%) | $80,377 (9.3%) | $142,061 (16.5%) | $51,190 (5.9%) |
| Mar 31, 2018 | $410,001 (47.7%) | $196,624 (22.9%) | $75,698 (8.8%) | $169,639 (19.7%) | $7,410 (0.9%) |

Note: Amounts in parentheses represent the percentage of the corporate portfolio represented by the individual mortgage portfolio. Commercial consists of commercial - multi family residential and commercial - other.

**Figure 3: Mortgage Portfolio Geographic Distribution as at March 31, 2018 (December 31, 2017)**




Since 2017, we have focused on reducing our exposure to Alberta in the corporate mortgage portfolio while increasing exposure to Ontario and British Columbia.

## Corporate Mortgages

### Single family mortgages

We invest in insured and uninsured single family mortgages in Canada, primarily originated through XMC 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 noted in the Corporate Mortgage Summary, in late 2017 we commenced new acquisition programs for uninsured single family mortgages from third party sources, including MCAP.

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) that are close to completion. Qualification criteria for the completed inventory classification include no substantial remaining construction risk, commencement of occupancy permits, potential sale and closing with a purchaser within 3-4 months or units being at least at a drywall stage with completion of plumbing and electrical.

### Construction loans

Residential construction loans are made to homebuilders to finance residential construction projects. These loans generally have a floating interest rate and loan 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 multi family residential loans (e.g. loans secured by apartment buildings), and other commercial loans, which consist of commercial term mortgages (e.g. loans secured by retail/industrial buildings) and high ratio mortgage loans (e.g. loans that do not meet standard residential construction loan parameters).

### Other items

The Canadian mortgage industry continues to experience falsification of supporting documents provided to lenders in the mortgage underwriting process, and we have observed this activity in our own underwriting processes. We have enhanced and continue to enhance our underwriting processes, and we maintain a rigorous due diligence process.

To date, the impact of this document falsification has not had a material impact on MCAN or its financial position or performance. We do not expect to experience any material impact to our financial position or performance in the future relating to such document falsification.

**Mortgage renewal rights**

Through our XMC origination platform, 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 March 31, 2018, we had the renewal rights to $923 million of single family mortgages (December 31, 2017 - $931 million). The majority of these renewal rights relate to mortgages held on the consolidated balance sheet as corporate or securitized mortgages, while $27 million relates to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2017 - $42 million).

**Arrears and Impaired Mortgages**

The adoption of IFRS 9 effective January 1, 2018 has impacted the calculation of impaired mortgages, mortgage arrears and mortgage allowances for credit losses. Under IFRS 9, the impaired insured single family mortgage balance has increased as the calculation now includes all mortgages over 90 days in arrears. Under IAS 39, the calculation consisted only of mortgages over 365 days in arrears.

Further details are included in the footnotes below the following table.

**Table 14: Arrears and Impaired Mortgages**

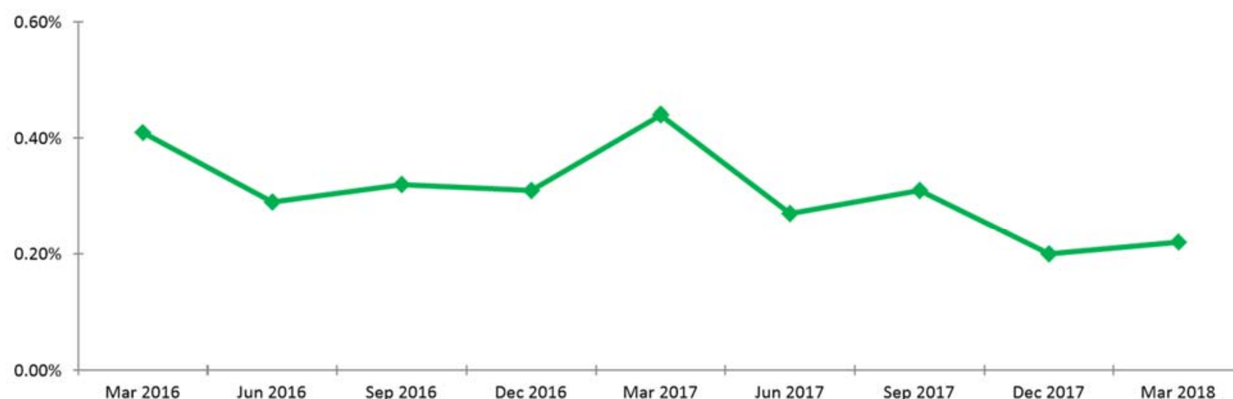
| (in thousands except %) | IFRS 9 | IAS 39 | | |
|---|---|---|---|---|
| | March 31 | December 31 | Change from Prior Quarter | |
| As at | 2018 | 2017 | ($) | (%) |
| **Impaired mortgages [2]** | | | | |
| Corporate | | | | |
| Single family - uninsured | $ 1,873 | $ 1,696 | $ 177 | 10.4% |
| Single family - insured | 1,945 | 832 | 1,113 | 133.8% |
| | 3,818 | 2,528 | 1,290 | 51.0% |
| Securitized | 966 | - | 966 | - |
| Total impaired mortgages | $ 4,784 | $ 2,528 | $ 2,256 | 89.2% |
| Impaired mortgage ratio (total) [1] | 0.10% | 0.09% | | 0.01% |
| Impaired mortgage ratio (corporate) [1] | 0.22% | 0.20% | | 0.02% |
| **Mortgage arrears [5]** | | | | |
| Corporate | | | | |
| Single family - uninsured | $ 6,978 | $ 5,912 | $ 1,066 | 18.0% |
| Single family - insured | 2,226 | 2,854 | (628) | (22.0%) |
| Total corporate mortgage arrears [1] | 9,204 | 8,766 | 438 | 5.0% |
| Total securitized mortgage arrears [1] | 9,554 | 8,803 | 751 | 8.5% |
| Total mortgage arrears [1] | $ 18,758 | $ 17,569 | $ 1,189 | 6.8% |
| **Allowance for credit losses** | | | | |
| Corporate | | | | |
| Allowance on performing mortgages [3] | $ 4,865 | $ 4,748 | $ 117 | 2.5% |
| Allowance on impaired mortgages [4] | 173 | 62 | 111 | 179.0% |
| | 5,038 | 4,810 | 228 | 4.7% |
| Securitized - allowance on performing mortgages [3] | 32 | - | 32 | - |
| Total allowance for credit losses | $ 5,070 | $ 4,810 | $ 260 | 5.4% |

*[1] Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.*
*[2] Represents impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.*
*[3] Represents performing (stage 1 and 2) allowances for credit losses on mortgages and mortgage commitments under IFRS 9 and collective allowances for credit losses under IAS 39.*
*[4] Represents impaired (stage 3) allowances for credit losses on mortgages and mortgage commitments under IFRS 9 and individual allowances for credit losses under IAS 39.*
*[5] The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.*

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 closely monitor our mortgage portfolio for early indicators of potential performance concerns by maintaining a "watch list" for these loans, whether they are in arrears or not.

During 2017, a land developer in Western Canada filed for protection under the Companies' Creditors Arrangement Act ("CCAA"). We held $15.4 million of outstanding mortgages from the borrower legal entity that are not in arrears as at March 31, 2018. If the individual loans enter into arrears, we do not believe that we would incur a loss of principal or interest based on the value of the underlying collateral and accordingly have not recorded an individual allowance on either loan. Subsequent to quarter end, one of the mortgages, in the amount of $10 million and classified as corporate - other commercial, paid out with no loss of principal or interest at which point $5.4 million of outstanding loans remained.

### Figure 4: Impaired Corporate Mortgage Ratio




The ratio as presented above incorporates impaired (stage 3) mortgages under IFRS 9 for data presented after January 1, 2018. Data prior to this time incorporates impaired mortgages under IAS 39. Refer to the "Non-IFRS Measures" section of this MD&A for a full definition of impaired mortgage ratios.

### Table 15: Mortgage Originations

| (in thousands)<br>**For the Quarters Ended March 31** | **2018** | **2017** |
|---|---|---|
| Single family - insured | $ 12,992 | $ 10,063 |
| Single family - uninsured | 12,415 | 6,561 |
| Residential construction | 37,977 | 39,668 |
| Non-residential construction | 2,646 | - |
| Commercial | 44,819 | 3,229 |
| | **$ 110,849** | **$ 59,521** |

New uninsured single family origination volumes have increased modestly since mid-2017, which has stabilized the portfolio balance in recent quarters. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market.

In late 2017, we commenced new acquisition programs for uninsured single family mortgages from MCAP and another third party origination source. Q1 2018 acquisition volumes of $5.4 million are included in the table above. We will seek to identify additional sources for uninsured single family mortgage origination consistent with our risk and quality standards, given the attractive risk-adjusted returns and our excess balance sheet capacity.

Insured single family originations have remained low as a result of changes to mortgage regulations enacted within the last two years that have made that market segment more competitive and have led to reduced securitization economics.

Revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of

Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Construction, commercial and completed inventory originations represent first advances on newly originated loans, i.e. they exclude additional fundings on existing loans in the portfolio or reclassifications between portfolios. Commercial originations increased significantly in Q1 2018 as a result of several significant new individual loan fundings during the quarter, relating primarily to loans secured by apartment buildings.

### Table 16: Average Loan to Value (LTV) Ratio for Uninsured Single Family Mortgage Originations

| (in thousands except for %)<br>For the Quarters Ended March 31 | 2018 | Average LTV | 2017 | Average LTV |
|---|---|---|---|---|
| Ontario | $ 7,641 | 67.0% | $ 6,169 | 69.8% |
| Alberta | 472 | 77.6% | - | - |
| British Columbia | 3,273 | 64.6% | 225 | 50.6% |
| Other | 1,029 | 72.0% | 167 | 66.8% |
| | **$ 12,415** | **67.2%** | **$ 6,561** | **69.0%** |

### Table 17: Average Mortgage Loan to Value (LTV) Ratios

| As at | March 31 2018 | December 31 2017 |
|---|---|---|
| **Corporate portfolio:** | | |
| Single family mortgages | | |
| - Uninsured | 67.6% | 67.5% |
| - Uninsured completed inventory | 57.6% | 64.2% |
| - Insured | 79.6% | 78.1% |
| Construction loans | | |
| - Residential | 60.0% | 61.6% |
| - Non-residential | 51.2% | 47.0% |
| Commercial loans | | |
| - Multi family residential | 68.8% | 67.9% |
| - Other commercial | 62.8% | 64.6% |
| | 64.4% | 65.3% |
| **Securitized portfolio:** | | |
| Single family insured - Market MBS Program | 85.4% | 85.8% |
| Single family insured - CMB Program | 82.1% | 82.0% |
| | 85.0% | 85.3% |
| | | |
| | 75.5% | 76.0% |

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 67.2% as at March 31, 2018 (December 31, 2017 - 66.8%). Based on an industry index that incorporates current real estate values, the ratios would be 53.1% and 52.6%, respectively.

Note: The LTV ratios in the above table represent the LTV at origination, not as at the reporting dates.

## 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 18: Single Family Mortgages by Province as at March 31, 2018

| (in thousands except %) | Corporate | | | | | | Securitized | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Insured | % | Uninsured | % | HELOCs | % | Insured | % | Total | % |
| Ontario | $ 42,479 | 56.2% | $ 124,260 | 60.9% | $ 95 | 65.5% | $ 578,407 | 57.1% | $ 745,241 | 57.6% |
| Alberta | 16,386 | 21.7% | 36,914 | 18.1% | 47 | 32.4% | 230,691 | 22.8% | 284,038 | 22.0% |
| British Columbia | 3,492 | 4.6% | 25,315 | 12.4% | 3 | 2.1% | 82,961 | 8.2% | 111,771 | 8.6% |
| Quebec | 4,759 | 6.3% | 4,746 | 2.3% | - | - | 41,638 | 4.1% | 51,143 | 4.0% |
| Atlantic Provinces | 6,201 | 8.2% | 6,340 | 3.1% | - | - | 45,924 | 4.5% | 58,465 | 4.5% |
| Other | 2,236 | 3.0% | 6,459 | 3.2% | - | - | 33,415 | 3.3% | 42,110 | 3.3% |
| **Total** | **$ 75,553** | **100.0%** | **$ 204,034** | **100.0%** | **$ 145** | **100.0%** | **$ 1,013,036** | **100.0%** | **$ 1,292,768** | **100.0%** |

### Table 19: Single Family Mortgages by Province as at December 31, 2017

| (in thousands except %) | Corporate | | | | | | Securitized | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Insured | % | Uninsured | % | HELOCs | % | Insured | % | Total | % |
| Ontario | $ 47,391 | 59.1% | $ 159,788 | 64.1% | $ 114 | 67.5% | $ 576,785 | 56.6% | $ 784,078 | 58.2% |
| Alberta | 14,932 | 18.6% | 47,396 | 19.0% | 48 | 28.4% | 231,335 | 22.8% | 293,711 | 21.8% |
| British Columbia | 3,026 | 3.8% | 25,169 | 10.1% | 7 | 4.1% | 90,174 | 8.9% | 118,376 | 8.8% |
| Quebec | 4,504 | 5.6% | 4,853 | 1.9% | - | - | 41,449 | 4.1% | 50,806 | 3.8% |
| Atlantic Provinces | 7,142 | 8.9% | 6,539 | 2.6% | - | - | 44,924 | 4.4% | 58,605 | 4.4% |
| Other | 3,213 | 4.0% | 5,799 | 2.3% | - | - | 32,057 | 3.2% | 41,069 | 3.0% |
| **Total** | **$ 80,208** | **100.0%** | **$ 249,544** | **100.0%** | **$ 169** | **100.0%** | **$ 1,016,724** | **100.0%** | **$ 1,346,645** | **100.0%** |

### Table 20: Single Family Mortgages by Amortization Period as at March 31, 2018

| (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 | $ 49,974 | $ 69,085 | $ 158,814 | $ 1,859 | $ - | $ 279,732 |
| | 17.9% | 24.7% | 56.7% | 0.7% | - | 100.0% |
| Securitized | $ 218,868 | $ 495,987 | $ 227,991 | $ 69,850 | $ 340 | $ 1,013,036 |
| | 21.6% | 49.0% | 22.5% | 6.9% | - | 100.0% |
| **Total** | **$ 268,842** | **$ 565,072** | **$ 386,805** | **$ 71,709** | **$ 340** | **$ 1,292,768** |
| | **20.8%** | **43.7%** | **30.0%** | **5.5%** | **-** | **100.0%** |

### Table 21: Single Family Mortgages by Amortization Period as at December 31, 2017

| (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 | $ 98,172 | $ 69,868 | $ 158,200 | $ 3,681 | $ - | $ 329,921 |
| | 29.8% | 21.2% | 48.0% | 1.0% | - | 100.0% |
| Securitized | $ 205,764 | $ 502,032 | $ 231,282 | $ 77,305 | $ 341 | $ 1,016,724 |
| | 20.2% | 49.4% | 22.7% | 7.7% | - | 100.0% |
| **Total** | **$ 303,936** | **$ 571,900** | **$ 389,482** | **$ 80,986** | **$ 341** | **$ 1,346,645** |
| | **22.6%** | **42.5%** | **28.9%** | **6.0%** | **-** | **100.0%** |

## Other Corporate Assets

**Cash and cash equivalents**

Cash and cash equivalents, which include cash balances with banks and overnight term deposits, decreased by $55 million in Q1 2018 to arrive at a level more in line with our internal liquidity targets. 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”), decreased by $1 million in Q1 2018. 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.

On the adoption of IFRS 9 effective January 1, 2018, we reclassified our marketable securities portfolio from available for sale (“AFS”) under IAS 39, with fair value changes recorded through accumulated other comprehensive income, to fair value reported through profit and loss (“FVPL”) under IFRS 9, with unrealized gains and losses recorded in net income. The carrying value of our marketable securities portfolio did not change upon the adoption of IFRS 9.

**Financial investments**

We hold a $41 million (December 31, 2017 - $36 million) investment in the KSHYF, in which we have an 8.0% equity interest (December 31, 2017 - 8.1%). KSHYF invests in mortgages secured by real estate with a focus on mezzanine, subordinate and bridge mortgages. We carry our investment in the KSHYF at fair value. As mortgage advances are made by the KSHYF, we advance our proportionate share. The KSHYF pays a base distribution of 9% per annum, and distributes any additional income earned on a quarterly basis. Our Q1 2018 return was 12.9% (Q1 2017 - 12.6%). 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 throughout the life of the KSHYF. As at March 31, 2018, the unfunded commitment was $22 million (December 31, 2017 - $26 million).

We also hold a $32 million (December 31, 2017 - $32 million) investment in Crown LP, in which we have a 14.1% equity interest (December 31, 2017 - 14.1%). Crown LP invests primarily in commercial office buildings and separates them into its core fund, which consists of buildings expected to provide stable cash flows over a longer time horizon, and its opportunity fund, which consists of 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.

On the adoption of IFRS 9 effective January 1, 2018, we reclassified our investments in the KSHYF and Crown LP from AFS under IAS 39, with fair value changes recorded through accumulated other comprehensive income, to FVPL under IFRS 9, with unrealized gains and losses recorded in net income. We were unable to elect to continue to record changes in fair value through accumulated other comprehensive income, therefore they were reclassified as FVPL. The carrying value of financial investments did not change upon the adoption of IFRS 9.

**Equity investment in MCAP**

We hold a 13.83% equity interest in MCAP (December 31, 2017 - 14.41%), which represents 4.0 million units held by MCAN (December 31, 2017 - 4.2 million) of the 28.9 million total outstanding MCAP partnership units (December 31, 2017 - 29.1 million). The investment had a net book value of $56 million as at March 31, 2018 (December 31, 2017 - $59 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 $33

million as at March 31, 2018 (December 31, 2017 - $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 has been fully phased in as of January 1, 2018. 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. MCAP's origination volumes were $3.1 billion in Q1 2018 (Q1 2017 - $3.0 billion). MCAP had $66.8 billion of assets under administration as at February 28, 2018 (November 30, 2017 - $65.9 billion).

Since MCAP's fiscal year end is November 30, we record equity income from MCAP on a one-month lag. To the extent that MCAP has a material transaction during the one-month lag, we are required to reflect the transaction in the month in which it occurred.

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 over MCAP through our entitlement to a position on MCAP's Board of Directors. If we experience further dilution our influence may be diminished and 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 FVPL or fair value through other comprehensive income ("FVOCI").

As an "investment in associate" under IAS 28, the equity investment in MCAP is not directly in the scope of the classification and measurement principles of IFRS 9, which govern financial instruments. Since MCAP's fiscal year end is November 30, MCAP will not officially adopt IFRS 9 until December 1, 2018. However, IAS 28 requires MCAN to consistently apply its accounting policies in accounting for investments in associates, and therefore the principles of IFRS 9 (including applicable policy choices by MCAN) have been reflected in equity income from MCAP and the carrying value of the equity investment based on MCAN's internal analysis. Based on this analysis, the adoption of IFRS 9 effective January 1, 2018 did not impact the carrying value of our equity investment in MCAP.

Amongst the interparty rights in the MCAP partnership agreement, the majority partner in MCAP has the right to acquire MCAN's entire partnership interest in MCAP at "fair market value", which would be determined by an independent valuator agreed upon by both parties.

## Securitization Assets

Securitization assets consist primarily of single family insured mortgages securitized through the market MBS program and CMB program. During Q1 2018 we recognized $28 million of new securitized mortgages on our balance sheet.

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

**Table 22: Liabilities and Shareholders' Equity**

| (in thousands)<br>As at | March 31<br>2018 [1] | December 31<br>2017 | Change from 2017<br>($) | <br>(%) |
|---|---|---|---|---|
| **Corporate Liabilities** | | | | |
| Term deposits | $ 823,604 | $ 884,460 | $ (60,856) | (7%) |
| Loans payable | 3,020 | - | 3,020 | - |
| Deferred tax liabilities | 3,603 | 3,572 | 31 | 1% |
| Other liabilities | 6,315 | 16,067 | (9,752) | (61%) |
| | **836,542** | **904,099** | **(67,557)** | **(7%)** |
| **Securitization Liabilities** | | | | |
| Financial liabilities from securitization | 1,015,296 | 1,015,699 | (403) | - |
| | **1,015,296** | **1,015,699** | **(403)** | **-** |
| | **1,851,838** | **1,919,798** | **(67,960)** | **(4%)** |
| **Shareholders' Equity** | | | | |
| Share capital | 217,817 | 214,664 | 3,153 | 1% |
| Contributed surplus | 510 | 510 | - | - |
| Retained earnings | 83,719 | 65,365 | 18,354 | 28% |
| Accumulated other comprehensive income | - | 16,438 | (16,438) | (100%) |
| | **302,046** | **296,977** | **5,069** | **2%** |
| | **$ 2,153,884** | **$ 2,216,775** | **$ (62,891)** | **(3%)** |

*[1] Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

To fund our corporate operations, we issue term deposits that are eligible for CDIC deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor. 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, where we have sold MBS to third parties but have not derecognized the related mortgages from our balance sheet. Activity in Q1 2018 consisted of the creation of $28 million of new liabilities from our participation in the market MBS program and CMB program less $28 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 Q1 2018 reflects new common shares issued through the Dividend Reinvestment Plan ("DRIP") and the Executive Share Purchase Plan ("ESPP"). The DRIP participation rate for the March 31, 2018 dividend was 20% (March 31, 2017 - 15%). For further information, refer to Note 16 to the consolidated financial statements.

Retained earnings activity for Q1 2018 consists of net income of $10.6 million and the IFRS 9 transition adjustment of $16.4 million less dividends of $8.7 million.

On the adoption of IFRS effective January 1, 2018, the accumulated other comprehensive income balance was reclassified to retained earnings.

The impact of the transition to IFRS 9 as at January 1, 2018 on retained earnings and accumulated other comprehensive income was as follows:

| Retained earnings | | |
|---|---|---|
| **Closing balance under IAS 39, December 31, 2017** | $ | 65,365 |
| Recognition of expected credit losses on corporate mortgages | | (52) |
| Recognition of expected credit losses on securitized mortgages | | (17) |
| Other adjustments - corporate mortgages | | 51 |
| Reclassification of AFS financial investments to FVPL | | 13,125 |
| Reclassification of AFS marketable securities to FVPL | | 3,313 |
| **Opening balance under IFRS 9, January 1, 2018** | $ | 81,785 |

| Accumulated other comprehensive income | | |
|---|---|---|
| **Closing balance under IAS 39, December 31, 2017** | $ | 16,438 |
| Reclassification of AFS financial investments to FVPL | | (13,125) |
| Reclassification of AFS marketable securities to FVPL | | (3,313) |
| **Opening balance under IFRS 9, January 1, 2018** | $ | - |

## SELECTED QUARTERLY FINANCIAL DATA

### Table 23: Selected Quarterly Financial Data

| (in thousands except for per share amounts and %) | Q1/18 [2] | Q4/17 | Q3/17 | Q2/17 | Q1/17 | Q4/16 | Q3/16 | Q2/16 |
|---|---|---|---|---|---|---|---|---|
| Net investment income - corporate assets [2] | $ 12,073 | $ 14,359 | $ 12,913 | $ 12,178 | $ 12,963 | $ 11,684 | $ 12,396 | $ 16,996 |
| Other income - corporate assets | 1,701 | - | - | - | 876 | - | - | - |
| Net investment income - securitization assets [2] | 1,301 | 1,416 | 1,534 | 1,372 | 1,291 | 1,519 | 1,594 | 1,421 |
| | 15,075 | 15,775 | 14,447 | 13,550 | 15,130 | 13,203 | 13,990 | 18,417 |
| Operating expenses | 4,631 | 5,302 | 4,686 | 4,613 | 4,617 | 4,471 | 4,323 | 4,650 |
| Net income before income taxes | 10,444 | 10,473 | 9,761 | 8,937 | 10,513 | 8,732 | 9,667 | 13,767 |
| Provision for (recovery of) income taxes | (171) | (334) | (157) | (1) | 248 | (268) | (108) | 131 |
| Net income | $ 10,615 | $ 10,807 | $ 9,918 | $ 8,938 | $ 10,265 | $ 9,000 | $ 9,775 | $ 13,636 |
| Basic and diluted earnings per share | $ 0.45 | $ 0.47 | $ 0.42 | $ 0.39 | $ 0.44 | $ 0.39 | $ 0.43 | $ 0.59 |
| Dividends per share | $ 0.37 | $ 0.37 | $ 0.32 | $ 0.32 | $ 0.30 | $ 0.30 | $ 0.29 | $ 0.29 |
| Return on average shareholders' equity [1] | 14.10% | 14.63% | 13.63% | 12.37% | 14.37% | 12.94% | 14.08% | 20.10% |
| Average mortgage portfolio yield - corporate [1] | 5.72% | 5.56% | 5.25% | 5.28% | 5.12% | 4.99% | 5.14% | 5.21% |
| Average term deposit interest rate [1] | 2.38% | 2.29% | 2.25% | 2.21% | 2.20% | 2.20% | 2.22% | 2.22% |
| Average mortgage portfolio balance - corporate ($ million) | $ 849 | $ 866 | $ 908 | $ 914 | $ 908 | $ 954 | $ 1,008 | $ 1,017 |
| Average mortgage portfolio yield - securitized [1] | 2.57% | 2.57% | 2.63% | 2.67% | 2.61% | 2.74% | 2.74% | 2.73% |
| Average financial liability from securitization rate [1] | 1.83% | 1.81% | 1.83% | 1.93% | 1.90% | 2.01% | 2.01% | 2.02% |
| Average mortgage portfolio balance - securitized ($ million) | $ 1,015 | $ 1,002 | $ 1,028 | $ 1,057 | $ 1,052 | $ 1,032 | $ 1,032 | $ 1,028 |

[1] *Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*
[2] *Provisions for credit losses are included in both net investment income from corporate and securitization assets. Effective Q1 2018, we prospectively adopted IFRS 9 and did not restate prior period information. Under IFRS 9, the methodology for the calculation of mortgage allowances and provisions has changed from IAS 39, therefore provisions under IFRS 9 are not directly comparable to prior periods.*

Net investment income from corporate and securitization assets is largely driven by changes in the average mortgage portfolio balance and interest rate. Additionally, corporate net investment income was impacted by significant distribution income from

Crown LP in Q2 2016 and Q1 2017 and substantial equity income from MCAP in Q2 2016, Q2 2017 and Q4 2017. Operating expenses increased in Q4 2017 as a result of non-recurring professional fee accruals.

Corporate mortgage interest yields have increased since Q3 2017 as a result of increases to the overnight rate by the Bank of Canada given that the majority of the corporate portfolio is floating rate and repriced following the rate increases.

The securitized mortgage portfolio has gradually decreased since Q1 2017 as a result of a reduction in securitization volumes.

## 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, MBS investors 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 Q1 2018, we securitized $28 million of MBS to third parties (Q1 2017 - $6 million). This mortgage transaction, in addition to the majority of our previous market MBS securitizations, did not achieve derecognition for accounting purposes as we retained significant continuing involvement with the mortgages. As such, the associated mortgages remained on the balance sheet while a corresponding liability was incurred. The mortgage interest income and interest expense associated with the financial liability from securitization related to these mortgages are recognized on the accrual basis over the term of the mortgages.

We may issue market MBS through the NHA MBS program and retain the underlying MBS security for liquidity purposes instead of selling it to a third party. As at March 31, 2018, we held $28 million of retained MBS on our balance sheet (December 31, 2017 - $29 million), which is included in the insured single family classification within corporate mortgages.

### 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 requires the reinvestment by the issuer of mortgage principal repayments received during their term into certain permitted assets. 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 did not securitize any insured single family mortgages through the CMB program during Q1 2018 (Q1 2017 - $42 million). Similar to the market MBS program, we do not derecognize the securitized mortgages from the consolidated balance sheet when we retain significant continuing involvement with the assets such that the associated mortgages remain on the consolidated balance sheet while a corresponding liability is 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.

### 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 have been evaluated as 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 subject to final review and declaration by the Board. 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 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.

The adoption of IFRS 9 effective January 1, 2018 had a minimal impact on our income tax assets and capital due to the fact that allowances on performing mortgages are excluded from both amounts. The reclassification of marketable securities and financial investments to FVPL had no impact on income tax assets and capital due to the fact that the tax values of these assets were not impacted by IFRS 9 reclassifications.

Table 24: Income Tax Capital [1]

| (in thousands except ratios)<br>As at | March 31 2018 [2] | December 31 2017 |
|---|---|---|
| **Income tax assets [1]** | | |
| Consolidated assets | $ 2,153,884 | $ 2,216,775 |
| Adjustment for assets in subsidiaries | 6,403 | 5,435 |
| Non-consolidated assets in MIC entity | 2,160,287 | 2,222,210 |
| Add: mortgage allowances | 4,883 | 4,750 |
| Less: securitization assets [3] | (1,028,356) | (1,030,020) |
| Less: equity investments in MCAP and subsidiaries | (48,061) | (42,411) |
| Other adjustments | (7,286) | (7,475) |
| | $ 1,081,467 | $ 1,147,054 |
| **Income tax liabilities [1]** | | |
| Consolidated liabilities | $ 1,851,838 | $ 1,919,798 |
| Adjustment for liabilities in subsidiaries | (6,488) | (7,852) |
| Non-consolidated liabilities in MIC entity | 1,845,350 | 1,911,946 |
| Less: securitization liabilities [3] | (1,013,854) | (1,014,258) |
| | $ 831,496 | $ 897,688 |
| **Income tax capital [1]** | $ 249,971 | $ 249,366 |
| **Income tax asset capacity [1]** | $ 355,867 | $ 286,801 |
| **Income tax capital ratios [1]** | | |
| Income tax assets to capital ratio | 4.33 | 4.60 |
| Income tax liabilities to capital ratio | 3.33 | 3.60 |

*[1] Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.*
*[2] Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*
*[3] 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 having a materially adverse effect on 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. The adjustment factor was increased by 20% annually over the phase-in period such that as of January 1, 2018 this deduction was fully phased in. The "transitional" basis as presented in previous years reflects the component of the adjustment phased in as at that time.

- 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 minimum 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 80% in 2018. 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 18%. 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.

The adoption of IFRS 9 effective January 1, 2018 did not have a material impact on our regulatory capital or ratios.

**Table 25: Regulatory Capital**

| (in thousands except %)<br>As at | March 31 2018 [1] | December 31 2017 |
|---|---|---|
| **Regulatory Ratios (OSFI)** | | |
| Share capital | $ 217,817 | $ 214,664 |
| Contributed surplus | 510 | 510 |
| Retained earnings | 83,719 | 65,365 |
| Accumulated other comprehensive income | - | 16,438 |
| Deduction for equity investment in MCAP (Transitional adjustment) [2] | n/a | (23,593) |
| **Common Equity Tier 1, Tier 1 and Total Capital (Transitional) [3]** | n/a | $ 273,384 |
| Deduction for equity investment in MCAP (All-in adjustment) [2] | (26,193) | (5,898) |
| **Common Equity Tier 1, Tier 1 and Total Capital (All-in) [3]** | $ 275,853 | $ 267,486 |
| **Total Exposures/Regulatory Assets [3]** | | |
| Consolidated assets | $ 2,153,884 | $ 2,216,775 |
| Less: deductions from all-in Tier 1 Capital [2] | (26,193) | (29,491) |
| Other adjustments [4] | 1,530 | 2,915 |
| **Total On-Balance Sheet Exposures** | 2,129,221 | 2,190,199 |
| Mortgage and investment funding commitments | 397,790 | 317,687 |
| Less: conversion to credit equivalent amount (50%) | (198,895) | (158,844) |
| Letters of credit | 44,178 | 32,164 |
| Less: conversion to credit equivalent amount (50%) | (22,089) | (16,082) |
| **Total Off-Balance Sheet Items** | 220,984 | 174,925 |
| **Total Exposures/Regulatory Assets** | $ 2,350,205 | $ 2,365,124 |
| Leverage ratio [3] | 11.74% | 11.31% |
| Risk weighted assets (all-in) [3] | $ 1,295,953 | $ 1,258,171 |
| Risk weighted assets (transitional) [3] | n/a | $ 1,269,967 |
| **Regulatory Capital Ratios [3]** | | |
| Common Equity Tier 1 capital to risk-weighted assets ratio (all-in) | 21.29% | 21.26% |
| Tier 1 capital to risk-weighted assets ratio (all-in) | 21.29% | 21.26% |
| Total capital to risk-weighted assets ratio (all-in) | 21.29% | 21.26% |
| Common Equity Tier 1 capital to risk-weighted assets ratio (transitional) | n/a | 21.53% |
| Tier 1 capital to risk-weighted assets ratio (transitional) | n/a | 21.53% |
| Total capital to risk-weighted assets ratio (transitional) | n/a | 21.53% |

*[1] Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*

*[2] 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. As of January 1, 2018, the deduction was fully deductible whereas in 2017, the deduction on the transitional basis was equal to 80% of the all-in adjustment.*

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

*[4] Certain items, such as negative cash balances, are excluded from total exposures but included in consolidated assets.*

Table 26: Regulatory Risk-Weighted Assets

| (in thousands except %) | March 31, 2018 [1] | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| As at | Per Balance Sheet | Average Rate | Risk Weighted Assets | Per Balance Sheet | Average Rate | Risk Weighted Assets |
| **On-Balance Sheet Assets** | | | | | | |
| Cash and cash equivalents | $ 62,463 | 20% | $ 12,799 | $ 117,571 | 20% | $ 24,097 |
| Cash held in trust | 15,073 | 20% | 3,015 | 13,441 | 20% | 2,688 |
| Marketable securities | 61,429 | 100% | 61,429 | 62,518 | 100% | 62,518 |
| Mortgages - corporate | 859,372 | 77% | 658,403 | 863,384 | 76% | 656,384 |
| Mortgages - securitized | 1,013,036 | 3% | 31,111 | 1,016,724 | 3% | 32,182 |
| Financial investments | 73,446 | 245% | 179,620 | 68,190 | 251% | 170,922 |
| Other loans | 2,655 | 100% | 2,655 | 2,612 | 100% | 2,612 |
| Equity investment in MCAP (all-in) [2] | 56,398 | 54% | 30,205 | 59,189 | 50% | 29,697 |
| Foreclosed real estate | 435 | 100% | 435 | 435 | 100% | 435 |
| Deferred tax asset | 2,874 | 100% | 2,874 | 2,672 | 100% | 2,672 |
| Other assets | 6,703 | 100% | 6,703 | 10,039 | 100% | 10,039 |
| | | | 989,249 | | | 994,246 |
| **Off-Balance Sheet Items** | | | | | | |
| Letters of credit | 44,178 | 50% | 22,089 | 32,164 | 50% | 16,082 |
| Commitments | 397,790 | 44% | 176,040 | 317,687 | 45% | 142,043 |
| | | | 198,129 | | | 158,125 |
| Charge for operational risk | | | 108,575 | | | 105,800 |
| **Risk-Weighted Assets (all-in)** | | | **$ 1,295,953** | | | 1,258,171 |
| Equity investment in MCAP (transitional adjustment) [2] | | | n/a | | | 11,796 |
| **Risk-Weighted Assets (transitional)** | | | n/a | | | **$ 1,269,967** |

*[1] Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.*
*[2] In calculating risk-weighted assets on the "all-in" basis, the capital deduction related to the investment in MCAP is risk weighted at 0%. In 2017, the component not deducted from capital was risk weighted at 100% and the difference between the all-in deduction and the transitional deduction was risk weighted at 200% in calculating risk-weighted assets on the transitional basis.*

## 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 sufficient capital 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 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 Investment Committee of the Board ("ICB") on a quarterly basis.

We fund our corporate operations by issuing term deposits that are eligible for CDIC deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor.

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 24 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 are both currently in effect, and the Net Stable Funding Ratio ("NSFR"), which is effective January 1, 2020.

As at March 31, 2018, we were in compliance with the LCR and NCCF. Based on our current financial and liquidity position, 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 Tier 1 & 2 and Total liquid assets to a minimum of 60% and 100% of term deposit liabilities maturing within 100 days, respectively, and a maximum of 150% for both ratios.

### Table 27: Liquidity Ratios

| (in thousands except %)<br>**As at** | **March 31 2018** | **December 31 2017** |
|---|---|---|
| Tier 1 liquid assets [1] | | |
| Cash and cash equivalents | $ 62,463 | $ 117,571 |
| Tier 2 liquid assets [1] | | |
| Marketable securities | 61,429 | 62,518 |
| Less: marketable securities adjustment [2] | (14,002) | (14,391) |
| Market MBS retained by MCAN [3] | 28,040 | 28,597 |
| | 75,467 | 76,724 |
| Tier 3 liquid assets [1] | | |
| Single family insured mortgages [4] | 47,310 | 51,711 |
| Less: single family insured mortgages adjustment [4] | (16,619) | (17,713) |
| | 30,691 | 33,998 |
| Total liquid assets [1] | $ 168,621 | $ 228,293 |
| 100 day term deposit maturities | $ 158,910 | $ 103,632 |
| **Liquidity ratios [1]** | | |
| Tier 1 & 2 liquid assets to 100 day term deposit maturities | 87% | 187% |
| Total liquid assets to 100 day term deposit maturities | 106% | 220% |

[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. For further information on our off-balance sheet commitment associated with our investment in the KingSett High Yield Fund, refer to the "Off-Balance Sheet Arrangements" section of this MD&A.

**Table 28: Liquidity Analysis**

| (in thousands) | Within 3 Months | 3 Months To 1 Year | 1 to 3 Years | 3 to 5 Years | Over 5 Years | March 31 2018 | December 31 2017 |
|---|---|---|---|---|---|---|---|
| **Sources of liquidity** | | | | | | | |
| Cash and cash equivalents | $ 62,463 | $ - | $ - | $ - | $ - | $ 62,463 | $ 117,571 |
| Marketable securities | 61,402 | - | - | - | 27 | 61,429 | 62,518 |
| Mortgages - corporate | 150,788 | 403,365 | 281,017 | 21,001 | 3,201 | 859,372 | 863,384 |
| Financial investments | - | - | 41,255 | - | 32,191 | 73,446 | 68,190 |
| Other loans | 1,108 | 232 | 1,315 | - | - | 2,655 | 2,612 |
| | 275,761 | 403,597 | 323,587 | 21,001 | 35,419 | 1,059,365 | 1,114,275 |
| **Uses of liquidity** | | | | | | | |
| Term deposits | 153,009 | 199,941 | 327,782 | 142,872 | - | 823,604 | 884,460 |
| Loans payable | - | 3,020 | - | - | - | 3,020 | - |
| Other liabilities | 6,315 | - | - | - | - | 6,315 | 16,067 |
| | 159,324 | 202,961 | 327,782 | 142,872 | - | 832,939 | 900,527 |
| **Net liquidity surplus (deficit)** | **$ 116,437** | **$ 200,636** | **$ (4,195)** | **$ (121,871)** | **$ 35,419** | **$ 226,426** | **$ 213,748** |
| **Off-Balance Sheet** | | | | | | | |
| Unfunded mortgage commitments | $ 141,552 | $ 125,411 | $ 108,394 | $ - | $ - | $ 375,357 | $ 291,204 |
| Commitment - KSHYF | - | - | 22,433 | - | - | 22,433 | 26,483 |
| | $ 141,552 | $ 125,411 | $ 130,827 | $ - | $ - | $ 397,790 | $ 317,687 |

*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 or which we currently deem to be immaterial may surface in future periods 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.

For a detailed discussion of risks that the Company is exposed to, refer to the "Risk Governance and Management" section of the 2017 Annual MD&A.

**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 13, 15 and 23 to the consolidated financial statements.

**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, depositors, 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, reduced access to deposit funding and the inability to achieve our strategic objectives.

**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, business model and business activities for external events, business results, changes in the competitive environment or the inability of the business to change its cost levels in response to those changes.

**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.

***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.

***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.

**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.

**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.

**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 25 to the consolidated financial statements.

**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.

**Risk Management**

For a detailed discussion of how we manage the risks noted above, refer to the "Risk Governance and Management" section of the 2017 Annual MD&A.

**Credit Risk - Impairment Assessment Under IFRS 9**

The analysis of MCAN's IFRS 9 impairment assessment and measurement approach discussed below should be read in conjunction with Note 4 to the consolidated financial statements.

*Probability of Default*

The probability of default ("PD") is driven by historical arrears performance, and incorporates the rate at which mortgages move from performing status to defaulted status. Key macroeconomic variables, borrower Beacon scores and internal mortgage risk ratings (where applicable) are also used in calculating this rate. Where historical arrears performance is limited or not available, the Company uses external arrears/default data for similar loans and mortgages.

*Exposure at default*

The exposure at default ("EAD") represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the borrower's ability to increase its exposure while approaching default and potential early repayments.

To calculate the EAD for a Stage 1 loan, the Company assesses the possible default events within 12 months for the calculation of the 12 month ECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the EAD is considered for events over the lifetime of the instruments.

The Company determines EADs by determining the period of exposure and modelling the change in loan exposures over time. Except for some revolving credit facilities, the maximum period over which ECL is measured is the maximum contractual period. For revolving credit facilities that include both a loan component and an undrawn commitment component, assessment is made with respect to whether the Company's exposure to credit losses is not limited to the contractual notice period. Once the period of exposure is determined, EAD is modelled based on loan terms, prepayment assumptions, commitment drawing patterns and other relevant forward-looking information.

*Loss given default*

Loss given default ("LGD") is modelled using a common LGD methodology that incorporates specific relevant data where appropriate. The LGD estimation takes into account all relevant and forward-looking information including but not limited to expected EAD, forecast of future collateral valuations including expected sales costs and discounts, debt structure and cross-collateralisation, and varies with macroeconomic scenarios.

The Company segments its corporate mortgage portfolio into individual lines of business, outlined in Note 8. The segmentation is based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and other transaction characteristics as applicable.

Additional data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each mortgage. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, regional housing price indexes or other factors that are indicative of losses in the group. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 IFRS 9 segment of each mortgage. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

*Grouping financial assets measured on a collective basis*

The Company calculates ECLs either on a collective or individual basis for the corporate mortgage portfolio based on the line of business (per Note 8). ECLs are calculated on an individual basis for all mortgages in Stage 3 and are calculated on a collective basis for all mortgages in Stage 1 and Stage 2.

*Analysis of inputs into the ECL model under multiple economic scenarios*

An overview of the approach to estimating ECLs is set out in Notes 4 and 5. As part of the model input process, macroeconomic data are obtained from third party sources (e.g. rating agencies, bank economic forecasts), and its Risk Management department verifies the quality of data and assumptions in the Company's ECL models including determining the weights attributable to the multiple scenarios.

## DESCRIPTION OF CAPITAL STRUCTURE

Our authorized share capital consists of an unlimited number of common shares with no par value. At March 31, 2018, there were 23,559,145 common shares outstanding (December 31, 2017 - 23,377,785). As at May 8, 2018, there were 23,559,145 common shares outstanding.

During Q1 2018, we issued 181,360 new common shares under the DRIP (Q1 2017 - 142,019), 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%.

In Q1 2018, we did not issue any common shares through the Executive Share Purchase Plan (Q1 2017 - 6,709).

For additional information related to share capital, refer to Note 16 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 KSHYF. We are obligated to advance additional fundings on the investment at any time subject to capital calls by the KSHYF.

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 29: Contractual Obligations

| (in thousands) | Less than one year | One to three years | Three to five years | Over five years | March 31 2018 | December 31 2017 |
|---|---|---|---|---|---|---|
| Mortgage funding commitments | $ 266,963 | $ 108,394 | $ - | $ - | $ 375,357 | $ 291,204 |
| Commitment - KSHYF | - | 22,433 | - | - | 22,433 | 26,483 |
| Operating lease | 852 | 1,753 | 1,769 | 4,164 | 8,538 | 8,652 |
| | **$ 267,815** | **$ 132,580** | **$ 1,769** | **$ 4,164** | **$ 406,328** | **$ 326,339** |

We retain mortgage servicing obligations relating to securitized mortgages where balance sheet derecognition has been achieved. For further information, refer to Note 11 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 24 to the consolidated financial statements.

As at March 31, 2018, of our total single family mortgage renewal rights of $923 million (December 31, 2017 - $931 million), $27 million related to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2017 - $42 million).

MCAP is actively defending a claim arising from a power of sale process with respect to a defaulted land development loan previously funded by MCAN. The plaintiff has claimed improvident sale and has claimed damages of approximately $6 million. MCAP was awarded a judgment for approximately $500,000 against the same plaintiff in related proceedings. We may be subject to the indemnification of MCAP for certain liabilities that may be incurred as part of the proceedings under a mortgage servicing agreement between the two parties. Based on, among other things, the current status of the proceedings, we do not expect to incur any material liability arising out of this indemnification obligation to MCAP and accordingly have not recorded a provision.

## DIVIDENDS

Consistent with the prior quarter, the Board declared a second quarter dividend of $0.37 per share, to be paid on June 29, 2018 to shareholders of record as of June 15, 2018.

## TRANSACTIONS WITH RELATED PARTIES

Related party transactions for the quarters ended March 31, 2018 and March 31, 2017 and related party balances as at March 31, 2018 are discussed in Note 22 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 March 31, 2018, we had 76 employees (December 31, 2017 - 69).

## CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the Company's financial statements requires management to make judgments, 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 may 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 by 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. Allowances on impaired mortgages include all of the accumulated provisions for losses to reduce the assets to their estimated realizable value. Allowances depend on asset class, as different classes have varying underlying risks. Future changes in circumstances could materially affect net realizable values and lead to an increase or decrease the allowance for credit losses.

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Company's ECL calculations are model outputs with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Company's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a lifetime ECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulas and the choice of inputs; and
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs.

We review our ECL models on a quarterly basis. 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.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the consolidated financial statements. To reflect this, we may make temporary qualitative adjustments or overlays using expert credit judgment when such differences are significantly material.

**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 the tax treatment of income and expenses 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 associated with these assets 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.

## CHANGES IN ACCOUNTING POLICY

We prospectively adopted IFRS 9, *Financial Instruments*, effective January 1, 2018 and did not restate prior period information. The most significant impacts of the adoption of IFRS 9 on MCAN's financial statements relate to impairment and classification and measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

## STANDARDS ISSUED BUT NOT YET EFFECTIVE

Standards issued but not yet effective include IFRS 16, *Leases,* IFRS 2, *Share-based Payment Transactions* and IFRIC 23, *Uncertainty over Income Tax Treatments*. For further information on these standards, refer to Note 4 to the consolidated financial statements.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

As at March 31, 2018, the CEO and CFO of MCAN, along with the assistance of the Company's disclosure committee comprised of members of senior management, have designed disclosure controls and procedures to provide reasonable assurance that (i) material information relating to MCAN is made known to the CEO and CFO and (ii) 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 have designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

There were no changes in our internal controls over financial reporting that occurred during the interim period ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

We adopted IFRS 9 effective January 1, 2018 and has updated and modified certain internal controls over financial reporting as a result of the new accounting standard.

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.

**Notice required under National Instrument 51-102, "Continuous Disclosure Obligations," Part 4.3 (3) (a).**

The accompanying consolidated interim financial statements of MCAN have not been reviewed by an auditor.

The Company is in compliance with the interim Management's Discussion and Analysis of Operations requirements set out by National Instrument 51-102.

## 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 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 interest 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 25 of this MD&A and Note 26 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.