CAPSTONE FIRST MORTGAGE FUND

Q3 Commentary

CAPSTONE
ASSET MANAGEMENT™

AT A GLANCE

SEPTEMBER 30, 2023

- Construction and development mortgages in Canada
- Investing in the most secure portion of the debt stack; considered bank grade and traditionally provided by lending agencies such as Canadian banks, Trust companies and Credit Unions
- Terms are 3 to 36 months
- Low to no correlation to bond and equity markets
- Liquidity is accommodated twice per year (January and July) with 90 days' notice
- $68 MM AUM
- Current price: $105.0722 (Class 0)

MARKET & FUND UPDATE

The Capstone First Mortgage Fund LP generates interest income for investors by providing construction financing to reputable, Canadian developers known for quality projects and providing achievable business plans, resulting in solid returns with excellent security. The mortgages are currently all secured on properties located in the province of Ontario and, more specifically, concentrated in the Greater Toronto Area (GTA). As of September 30th, the one-year performance for this fund is 9.72%.

Compared to its historical average of 7.09% annually, this portfolio is beginning to reflect higher interest rates in a real estate environment that has rapidly adjusted to significant changes over the past year and a half. The last interest rate policy change occurred in July, and this has brought the Bank of Canada rate to an even 5%. This is the highest interest rate policy set in Canada in well over 20 years.

Through the first half of 2023, the Canadian real estate market remained surprisingly robust because of Canada's expansive immigration policy. Supply remained low by historical standards while demand surged. This combination produced stable, if not increasing, housing prices across Canada right through the spring market. However, the July increase in interest rates caused the tide to turn through the summer. Listings steadily increased while demand for homes has dropped. While interest rates remain high, most pundits expect a significant slowdown in the real estate space for at least the next 6 months. While higher interest rates push some buyers to the sidelines, we are of the opinion that Canada's housing supply will not keep pace with demand and that this will assist in mitigating a significant, prolonged real estate correction.

Since the adoption of IFRS 9 in 2018, all of Capstone's mortgage portfolios are required to include a loan loss provision (bad debt allowance) to mitigate default risk. Capstone continually monitors and adjusts this allocation to ensure that the mortgage portfolio is fairly valued for a given period. If a mortgage or the general market outlook becomes worse, investors should expect a higher percentage of interest income to be directed to this bad debt fund. If it improves, then there will be a reversal with a portion of the reserve being directed back to investors. This mechanism ensures that the valuation of the portfolio is current throughout the year, but it may cause additional distribution fluctuations that were not seen in the earlier years of this fund.

With the expectation that the Canadian real estate market could correct at any time, we at Capstone have spent the past few years expanding our due diligence procedures while being conservative in the ongoing development of our lending criteria. We believe that our prudence will provide excellent value to our investors in both the long term as well as during shorter periods when the real estate market may be more volatile.

This investment continues to carry a low to medium risk profile and is an excellent complement to a traditional investment portfolio. We continue to expect a long-term return in the range of 6-7%.

PERFORMANCE (Gross of Fees)

Performance figures are those of Class O units as of September 30, 2023. Performance is annualized for periods longer than one year.

1 MO.	3 MO.	6 MO.	1 YR.	3 YR.	5 YR.	INCEPTION*
0.64 %	2.12%	4.35%	9.72%	7.97%	7.48%	7.09%

** Annualized as of first trade date July 31, 2016*