

# CAPSTONE FIRST MORTGAGE FUND

Q4 Commentary

CAPSTONE  
ASSET MANAGEMENT™

## AT A GLANCE

DECEMBER 31, 2022

- 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
- \$57 MM AUM
- Current price: \$104.4004 (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). In 2022, this fund returned 8.49% to investors while the broad fixed income market in Canada yielded -11.67% (represented by the XBB iShares Universal Bond Index ETF). While the Capstone First Mortgage Fund certainly surpassed the return available in the traditional arena, over the past year the fund also exceeded its long-term average of 6.88%.

The big story for 2022 was, of course, rising inflation and the rapid increase of interest rates around the world to counteract it. In Canada, the Bank of Canada (BOC) interest rate rose 4% between March 1<sup>st</sup> and December 31<sup>st</sup>. Moving forward, the biggest impediment to further rate hikes will likely be recessionary signals, especially any rise in unemployment numbers. However, with both employment numbers and inflation remaining strong right through December 2022, the BOC may yet attempt to raise rates at least one more time in early 2023. While higher interest rates tend to reward lenders over time, they are an additional burden to the borrower. For this reason, we continue to keep a close eye on the quality of all mortgage holdings. Additionally 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, taking an increasingly conservative approach to our lending criteria. We believe that our prudence will provide excellent value to our investors in both the long term and also during shorter periods when the real estate market may be more volatile.

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. In December, this fluctuation was especially prevalent as the fund saw a reversal in the loan loss reserve which assisted in a record performance of 2.06% for the month.

This investment continues to carry a low to medium risk profile and is an excellent complement to a traditional investment portfolio. The Fund continues to target a long-term return of 6%.

This is not an offer to sell securities. The Subscription Documents and Information Memorandum should be read carefully as they contain important facts about risks, liquidity, fees, and expenses. Past performance may not be repeated.

## PERFORMANCE (Gross of Fees)

Performance figures are those of Class O units as of December 31, 2022. Performance is annualized for periods longer than one year.



1 MO.	3 MO.	6 MO.	1 YR.	3 YR.	5 YR.	INCEPTION*
2.06 %	2.92%	4.66%	8.49%	7.33%	7.17%	6.88%

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