

CAPSTONE MORTGAGE POOL

Q1 Commentary

CAPSTONE
ASSET MANAGEMENT™

AT A GLANCE

MARCH 31, 2023

- Construction and development mortgages in Canada
- Diversified by developer and development type
- Mortgage terms are 3 to 36 months
- Low to no correlation to bond and equity markets
- Liquidity is accommodated monthly with one month's notice
- \$292 MM AUM
- Current price: \$9.7948 (Series I)

MARKET & POOL UPDATE

Over this first quarter, the Capstone Mortgage Pool (I series) returned 2.31% which is slightly above its historical average over a 3 month period. This portfolio is now beginning to reflect the higher interest rates in a real estate environment that has rapidly adjusted to significant changes over the past year. It was only 1 year ago that the Bank of Canada policy rate was at 0.5%. Since then, it has increased 4% to settle at the existing 4.50% of today. These interest rate increases resulted in months of delays in mortgage executions as well as a reduced pipeline of good quality mortgage opportunities. During the first quarter of 2023, we began to see more balance in the real estate market and, as traditional lenders have reduced their lending quota in response, this has opened doors for private lenders such as Capstone.

Supporting the real estate market throughout Canada is the incredible demand for housing. It can be argued that this "more heads than beds" phenomenon is led by Canada's expansive immigration policy. While rental supply has been increasing, demand is surging much faster than the supply can keep up with. Additionally, new housing builds have been repressed due to ever-increasing red tape at municipal levels combined with expensive land, and building inputs plagued by supply constraints. 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 even if interest rates increase in 2023.

It is important for investors to note that fluctuations in the interest distributions are more common now since the mortgage portfolio's adoption of the IFRS 9 accounting standard in 2018. All of Capstone's mortgage portfolios are required to include a loan loss provision (bad debt allowance) to mitigate default risk. While the higher interest rates are likely to reward investors over time, they are punitive to developers and may cause some to experience credit challenges. Therefore, in these cases, Capstone increases the loan loss provision to ensure that the mortgage portfolio is fairly valued for the given period. If the market outlook becomes worse, investors should expect a higher percentage of interest income to be directed to this bad debt fund. Conversely, market improvement will lead to 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 can cause additional distribution fluctuations that the Pool did not experience in prior years.

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. Furthermore, while a higher interest rate environment does take some time to be reflected in this portfolio's holdings, we are beginning to see higher rates applied to new mortgages than we have historically. This investment continues to carry a medium risk profile and it is an excellent complement to a traditional investment portfolio.

For more information on this Pool, please contact your Portfolio Manager.

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 Series I units as of March 31, 2023. Performance is annualized for periods longer than one year.



1 MO.	3 MO.	6 MO.	1 YR.	3 YR.	5 YR.	10 YR.	INCEPTION*
0.74%	2.31%	3.73%	7.80%	8.40%	8.86%	9.04%	8.95%

* Annualized as of first trade date April 30, 2012