CAPSTONE MORTGAGE POOL

Q2 Commentary

CAPSTONE
ASSET MANAGEMENT™

AT A GLANCE

JUNE 30, 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
- $303 MM AUM
- Current price: $9.8058 (Series I)

MARKET & POOL UPDATE

Over the past quarter, the Capstone Mortgage Pool (Series I) returned 2.26%. This portfolio is now beginning to reflect higher interest rates in a real estate environment that has rapidly adjusted to significant changes over the past year. Through the last half of 2022, the rapid interest rate increases resulted in months of delays in mortgage executions and a reduced pipeline of good quality mortgage opportunities. This year to date, we have begun to see more balance in the real estate market and, as traditional lenders have reduced their lending portfolios, this has opened doors for private lenders such as Capstone.

Even within the current interest rate environment – the highest rates in more than 20 years - there is very strong demand for housing which is supporting the real estate market throughout Canada. 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 pace of supply. While the number of homes for sale did increase through this past quarter, it is still much lower than its historical average. 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 and inflationary pressures. While further interest rate increases may 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.

It is important for investors to note that fluctuations in interest distributions are more common 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 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. 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.

PERFORMANCE (Gross of Fees)

Performance figures are those of Series I units as of June 30, 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**
0.56%	2.26%	4.61%	7.86%	8.44%	8.88%	9.01%	8.96%

** Annualized as of first trade date April 30, 2012*