CAPSTONE MORTGAGE POOL

Q3 Commentary

CAPSTONE ASSET MANAGEMENT™

AT A GLANCE

SEPTEMBER 30, 2022

- 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 30 days' notice
- $270 MM AUM
- Current price: 9.8231 (Series I)

MARKET & POOL UPDATE

Over the past quarter, the economy has been materially impacted by rising inflation, rapidly increasing interest rates and geopolitical considerations. Adding to these factors, many people have experienced investment challenges in the broader equity and bond markets, and the real estate construction industry has also been impacted by these difficulties. Earlier this year commodity prices soared causing pricing pressure for materials and goods. Yet, over this past quarter some of these pressures have eased which should be a help going forward if these price adjustments continue to broaden out. However, rising interest rates are probably the greatest pressure point for developers as many construction mortgages, including those in this portfolio, have a variable rate using a Prime + model. The increased borrowing costs continue to eat into our contingency reserves and will potentially require equity infusions, or additional financing. If we consider the real estate market specifically in BC and Ontario, where this fund is positioned, interest rates are playing a huge role in moderating the demand side, while strong immigration remains to support the market in one respect and supply continues to be tight as BC and Ontario's long history of not producing the housing units that would support its population continues.

Performance for this portfolio year-to-date was +5.96% and while this is slightly below its historical average, it still provides a significant premium over the Canadian fixed income market as a whole, which returned -12.09% over the same period (as represented by the iShares Core Canadian Universe Bond Index). On the positive side of the interest rate equation, we have seen increases to rates on both new and existing holdings. This is, of course, a double-edged sword as developers must remain vigilant if their margins are decreasing. Detracting from fund performance over this past quarter is the continued cash drag caused by maturing loans not being quickly replaced with new mortgages due to the significant delays in the real estate space. These delays have been an ongoing issue in the portfolio since the spring of 2020, but their impact has been particularly strong the past few months. In addition, we have continued to direct a greater allocation towards the bad debt reserve (loan loss reserve) to ensure that any identified credit weakness on our loans is addressed. If economic conditions deteriorate, it is reasonable to assume that reserves will also increase, and this may contribute to weaker monthly distributions in the short term.

As a result of these influences, this fund's short-term performance has tracked behind its historical average and this was evident in this quarter's monthly distributions. With what we currently know and expect over the short term with the timelines of capital calls and current market pressures, we expect it to take a few months for this to normalize. Overall, despite the current market conditions, there are still some fundamental reasons for the real estate market being strong for so long – most notable is that inadequate housing supply has not been addressed over the past decade. Price and sales volatility in 2021 was an obviously temporary market distortion, and unsustainable, so a pull back in the market was both likely and probably necessary. Going forward, we expect the Capstone Mortgage Pool to offer investors a risk premium that corelates to the underlying nature of this holding and the long term target for this portfolio remains at 9%.

PERFORMANCE (Gross of Fees)

Performance figures are those of Series I units as of September 30, 2022. Performance is annualized for periods longer than one year.

1 MO.	3 MO.	6 MO.	1 YR.	3 YR.	5 YR.	10 YR.	INCEPTION*
0.54%	1.69%	3.93%	8.39%	8.99%	8.46%	9.10%	9.02%

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