



**MANAGEMENT DISCUSSION & ANALYSIS**

**YEAR ENDED DECEMBER 31, 2022**

**FRONTENAC MORTGAGE INVESTMENT CORPORATION  
MANAGEMENT DISCUSSION & ANALYSIS  
YEAR ENDED DECEMBER 31, 2022**

**BASIS OF PRESENTATION**

The Corporation has adopted International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) as its basis of financial reporting. The Corporation’s functional and reporting currency is the Canadian dollar. This Management Discussion & Analysis (“MD&A”) is prepared in accordance with National Instrument 51-102 “Continuous Disclosure”.

This Management Discussion & Analysis (“MD&A”) is dated January 31, 2023 and should be read in conjunction with the audited financial statements of the Corporation and the notes thereto for the years ended December 31, 2022 and 2021, the audited financial statements and the notes thereto for the years ended December 31, 2021 and 2020.

**OUR BUSINESS**

Frontenac Mortgage Investment Corporation (the “Corporation”) is a non-bank lender that operates as a mortgage investment corporation as defined under the Income Tax Act (Canada).

The Corporation’s primary investment objective is the preservation of shareholders’ equity while providing shareholders with a stable stream of dividends from the Corporation’s investments.

The Corporation achieves its investment objective predominantly by lending on the security of short-term residential first mortgages in the province of Ontario. The mortgage loans transacted by the Corporation will not generally meet the underwriting criteria of conventional lenders and/or involve borrowers in rural areas generally not well serviced by major lenders. As a result, the Corporation’s investments are expected to earn a higher rate of interest than what is generally obtainable through conventional mortgage lending activities.

W.A. Robinson Asset Management Ltd. (the “Manager”) manages the Corporation’s investment portfolio and manages the distribution of the Corporation’s shares. Pillar Financial Services Inc. (the “Administrator”) serves as the Corporation’s loan originator, underwriter, and servicer.

As a mortgage investment corporation, the Corporation does not pay corporate income taxes on any earnings that are distributed out to its shareholders provided that it continues to meet the requirements of subsection 130.1(6) of the Income Tax Act (Canada). Dividends received by shareholders are generally treated as interest income for personal income tax purposes.

## HIGHLIGHTS

Frontenac Mortgage Investment Corporation continues to meet its primary objective of offering its shareholders capital preservation while providing a stable stream of monthly dividend income. The carrying value per share remained stable at \$30 at December 31, 2022 with an annualized dividend yield, assuming dividends are re-invested under the Corporation's dividend re-investment plan, of 6.02% for the twelve months ended December 31 2022.

As at December 31, 2022, the Corporation's assets totaled \$225.8 million including a mortgage investment portfolio totaling \$216.9 million with shareholder's equity of \$201.7 million. Total assets and mortgage investments are up slightly from December 31, 2021, when the Corporation's assets totaled \$203.5 million including a mortgage investment portfolio of \$183.3 million while shareholders' equity has decreased from \$202.7 million as at December 31, 2021.

The outbreak of the novel strain of coronavirus, specifically identified as "COVID-19", has resulted in a widespread health crisis that has affected economies and financial markets around the world resulting in significant economic uncertainty. As at the date of this MD&A, the performance of the Corporation has not been materially impacted; however, the Corporation continues to monitor the potential impact COVID-19 could have on its business activities including potential changes related to default rates from borrowers, demand for borrowing or the value of the underlying security of the mortgage portfolio. Further discussion of the potential impacts on the Corporation of this continuing outbreak is included in this MD&A under Results of Operations.

Global financial markets continue to be volatile in part due to high levels of inflation and rising interest rates. There remains uncertainty associated with the estimates, judgements and assumptions made by management in the preparation of the financial statements. Given the economic uncertainty, it is difficult to predict with certainty the impact these will have on the Company's estimate of credit losses.

**MORTGAGE INVESTMENT PORTFOLIO**

The carrying value of the Corporation's mortgage investment portfolio totaled \$216,933,310 as at December 31, 2022 as compared to \$183,318,440 as at December 31, 2021. Key metrics related to the mortgage investment portfolio include the following.

**Breakdown of the mortgage investment portfolio by type**

	Dec 31, 2022			Dec 31, 2021		
	#	\$ (000's)	% of total	#	\$ (000's)	% of total
Residential	137	45,163	20.8%	181	50,573	27.6%
Residential construction	222	140,542	64.8%	187	84,483	46.1%
Residential developments	5	12,388	5.7%	6	31,409	17.1%
Commercial	2	426	0.2%	8	1,654	0.9%
Vacant land	57	18,414	8.5%	52	15,199	8.3%
<b>Total</b>	<b>423</b>	<b>216,933</b>	<b>100.0%</b>	<b>434</b>	<b>183,318</b>	<b>100.0%</b>

Residential construction comprises construction loans for single residential buildings for housing one to three units, typically single-family residences. Residential development mortgages comprise larger multi-unit construction or land development projects including sub-division developments or multi-unit housing builds. Commercial mortgages have a municipal commercial zoning component but typically also involve a residential component.

The Corporation has strategically decided for the long term that the percentage of the portfolio dedicated to residential developments will be reduced over the next few years to instead focus on its rural residential and residential construction core business. As at December 31, 2022, loans reported in this category represented 5.7% of the mortgage loan portfolio; down from 17.1% as at December 31, 2021 and 26.0% as at December 31, 2020. As at December 31, 2021, there were two outstanding residential developments in the mortgage portfolio. In Q1 2022, the loans related to one residential development project were paid out when the project was re-financed and no resulting write-off was required. As at December 31, 2022 there is one outstanding residential development with 4 related loans that have a total principal value of \$13.6 million. Included in stage 3 is an expected credit loss provision of \$1.5 million with respect to these loans. The Corporation is actively working with the borrower and anticipates the loans to be discharged in 2023. The expected credit loss provision is subject to significant estimation and actual amounts and results could differ from these estimates and judgements.

**Breakdown of the mortgage investment portfolio by location**

	Dec 31, 2022			Dec 31, 2021		
	#	\$ (000's)	% of total	#	\$ (000's)	% of total
Ontario – East	273	140,623	64.8%	271	109,161	59.5%
Ontario – Southwest	31	15,939	7.3%	44	34,156	18.6%
Ontario – Central	49	36,120	16.7%	45	24,210	13.2%
Ontario – North	70	24,251	11.2%	73	15,761	8.6%
Quebec	0	0	0.0%	1	30	0.1%
<b>Total</b>	<b>423</b>	<b>216,933</b>	<b>100.0%</b>	<b>434</b>	<b>183,318</b>	<b>100.0%</b>
<b>Loans on Ontario rural property</b>	<b>275</b>	<b>118,263</b>	<b>54.5%</b>	<b>289</b>	<b>113,935</b>	<b>62.2%</b>

The above location allocations are made using Canadian postal codes for the related real estate. Ontario – East comprises the K postal code; Ontario – Southwest comprises the N postal code; Ontario- Central comprises the L and M postal codes; and Ontario – North comprises the P postal code. Rural properties comprise postal codes designated as rural general delivery.

The Corporation's mortgage portfolio has been historically centered on the Ontario – East market, which aside from the Ottawa and Kingston markets is primarily a rural and small-town market area. As the Corporation's assets grow, management is targeting to diversify the mortgage loan portfolio to include a greater allocation to the rural areas of Ontario – Southwest to further mitigate any geographic concentration risk in the mortgage portfolio. As discussed above under the "Portfolio by Type" section, in January 2022, loans related to a single large development were repaid. As this development was located in Ontario – Southwest, the repayment of these loans resulted in a decline in the percentage of the portfolio located in Ontario – Southwest as at December 31, 2022.

As at December 31, 2022, only two of the Ontario – Central loans were for properties located in the Toronto market (postal code M – one in December 31, 2021).

**Breakdown of the mortgage investment portfolio by interest rate**

	Dec 31, 2022			Dec 31, 2021		
	#	\$ (000's)	% of total	#	\$ (000's)	% of total
5%	1	17	0.1%	1	618	0.3%
6%	1	6,626	3.0%	1	7,528	4.1%
7%						
8%	9	8,214	3.8%	13	8,964	4.9%
9%	51	24,353	11.2%	83	28,447	15.5%
10%	277	150,484	69.4%	301	114,093	62.3%
11%	54	19,614	9.0%	23	5,147	2.8%
12%	27	7,654	3.5%	11	18,321	10.0%
13%				1	200	0.1%
<b>Total</b>	<b>423</b>	<b>216,933</b>	<b>100.0%</b>	<b>434</b>	<b>183,318</b>	<b>100.0%</b>

Substantially all of the mortgage loans are issued with either 1 or 2 year terms, have fixed interest rates and can be repaid in full before maturity without penalty. The weighted average interest rate as at December 31, 2022 was 9.82%, up from 9.78% as at December 31, 2021. Without the large loan deal that was paid out in January 2022, the adjusted weighted average interest rate as at December 31, 2021 would have been 9.55%.

**Breakdown of the gross mortgage investment portfolio by maturity date**

	Dec 31, 2022			Dec 31, 2021		
	#	\$ (000's)	% of total	#	\$ (000's)	% of total
Within one year	399	212,882	97.2%	414	177,254	96.2%
Within following year	24	6,104	2.8%	19	6,885	3.7%
Thereafter				1	14	0.1%
<b>Total</b>	<b>423</b>	<b>218,986</b>	<b>100.0%</b>	<b>434</b>	<b>184,153</b>	<b>100.0%</b>

The amounts shown in the table represent principal repayments based on contractual maturity dates at their gross amounts before any provisions for impairment losses. The new mortgage loans are offered under terms of one to two years with the vast majority of loans offered under a one year term. The Corporation targets borrowers that do not meet the underwriting criteria of the major banks and that require short-term financing. The Corporation benefits from this short-term financing strategy as it allows the mortgage portfolio of the Corporation to be repriced frequently to current market interest rates, allows loan-to-value figures to be reset to current real estate market prices, and mitigates duration risk with borrowers.

**Breakdown of the mortgage investment portfolio by first mortgage loans**

	Dec 31, 2022			Dec 31, 2021		
	#	\$ (000's)	% of total	#	\$ (000's)	% of total
First mortgage loans	422	216,830	99.9%	432	183,180	99.9%
Average gross loan balance		518			424	

**Mortgage impairments and provision for impairment losses**

The following is a breakdown of the impaired loans and related provision for impairment losses by mortgage type:

(All figures \$000's)

	Dec 31, 2022			Dec 31, 2021		
	Gross loan amount (1)	Allowance for impairment losses	Net carrying amount	Gross loan amount (1)	Allowance for impairment losses	Net carrying amount
Residential	848	-	848	2,478	360	2,118
Residential construction	-	-	-			
Residential developments	13,636	1,532	12,104		120	(120)
Commercial	-	-	-			
Vacant land	-	-	-	195	48	147
<b>Total</b>	<b>14,484</b>	<b>1,532</b>	<b>12,952</b>	<b>2,673</b>	<b>528</b>	<b>2,145</b>

(1) Gross amount shown at amortized cost

Based on its risk profile of the mortgage loan borrowers for its niche in the mortgage marketplace, the Corporation expects that and would consider normal that, on average in any given year, 5% of the Corporation's mortgage portfolio would be considered impaired. A definition of impairment is included in the section "Critical Accounting Estimates and Policies – (i) Mortgage Investments" of this MD&A. On those impaired loans, the Corporation would project losses of capital of 0.50% of shareholders' equity or \$0.15 per share based on the Corporation's historical carrying value per share of \$30. Once a mortgage is considered impaired, the Corporation recognizes interest revenue using the effective interest method at the net carrying amount of the impaired loan which in turn may reduce revenue per share.

As at December 31, 2022, there were 10 mortgages totaling \$14,484,975 (December 31, 2021 – 5 mortgages totaling \$2,672,805) which were considered by management to be impaired with a total provision for impairment losses of \$1,504,778 (December 31, 2021 - \$528,130) against those loans. As discussed above under the "Portfolio by Type" section, 4 of the 10 impaired loans related to a single large residential development project with the same borrower. The remaining 6 impaired mortgage loans have a total provision of \$nil.

During the three-month period ending December 31, 2022, the four loans with the same borrower for a single large residential development project loan were moved from stage 2 to stage 3. The dollar value and expected credit loss of the loans was \$13,636,732 and \$1,531,594 respectively as of December 31, 2022. The Corporation entered into a forbearance agreement with the borrower earlier in 2022 on these loans. The forbearance agreement expired in December 2022 but was extended to May 2023 to help facilitate the sale of one the buildings in the development project. The Corporation is actively working with the borrower and anticipates to recover these loans in 2023. This represents the last large loan residential development project in excess of \$10 million in a business line the Company strategically decided to exit. As at December 31, 2022 the Company's next largest loan value was \$3,134,776.



## RESULTS OF OPERATIONS

Net income and comprehensive income for the Corporation for the twelve months ended December 31, 2022 increased on a gross basis to \$12.3 million from \$10.4 million for the twelve months ended December 30, 2021 while, on a per share basis, net earnings increased to \$1.76 from \$1.62 per common share.

Revenues for the Corporation for the twelve months ended December 31, 2022 increased on a gross basis to \$19.6 million as compared to \$15.7 million for the twelve months ended December 31, 2021 while, on a per share basis, revenues increased to \$2.81 from \$2.44 per common share. The increase in revenue is attributable primarily to an 18% growth of the mortgage portfolio, and the Corporation carrying a 21% lower average cash and cash equivalent monthly balances as compared to the same period in 2021. Cash balances earn little to no return.

Total operating expenses, excluding provision for impairment losses, for the twelve months ended December 31, 2022 increased on a gross basis to \$6.2 million from \$5.0 million for the twelve months ended December 31, 2021 while, on a per share basis, these expenses increased to \$0.85 from \$0.78 per common share. Management and administration fees increased by \$0.5 million as total assets increased from \$203.5 million to \$225.8 million. Interest expense on the bank line of credit increased by \$0.5 million year over year as the Corporation utilized its line in the second half of the year to smooth out cashflows from share sales and mortgage payouts with share redemptions and mortgage advances.

For the year ended December 31, 2022 the provision for mortgage impairment losses increased to \$1.1 million from \$0.2 million in the year ended December 31, 2021 primarily due to a single large residential development project whereby four loans became impaired. Please refer to the Mortgage impairments and provision for impaired losses section of the MD&A for more details.

**Summary of Quarterly Results - (Unaudited)**

(All figures in thousands except per share figures. Q1 is three months ended March 31; Q2 is three months ended June 30; Q3 is three months ended September 30; Q4 is three months ended December 31)

	<b>Q4 2022</b>	<b>Q3 2022</b>	<b>Q2 2022</b>	<b>Q1 2022</b>	<b>Q4 2021</b>	<b>Q3 2021</b>	<b>Q2 2021</b>	<b>Q1 2021</b>
Interest income	5,360	5,230	4,965	4,016	4,396	3,870	3,729	3,676
Management & admin fees	1,234	1,143	1,139	1,141	1,094	1,084	1,032	932
Interest on credit line	372	119	4	-	-	-	-	1
Provision for impairment losses	495	270	227	156	217	66	(63)	28
Other operating expenses	253	274	268	225	224	180	280	204
Total operating expenses	2,354	1,806	1,638	1,522	1,535	1,330	1,240	1,165
Net income and comprehensive income	3,006	3,424	3,328	2,494	2,861	2,540	2,489	2,511
Earnings per share – basic and fully diluted	0.44	0.49	0.47	0.35	0.42	0.38	0.39	0.43

Interest income has increased each quarter in 2022 primarily due to the growth of the mortgage investment portfolio.

Management and administration fees are based on a fixed percentage of total assets of the Corporation with 1% per annum paid by the Manager and 1% per annum paid to the Administrator calculated and paid on a monthly basis. Management and administration fees have increased each quarter because total assets have increased each quarter.

The Corporation does not use leverage as a long term strategy but does utilize its line of credit in the short term to smooth out its cash inflows and outflows related to mortgage advances and repayments as well as share sales and redemptions. The amount of interest expense in any quarter fluctuates with the actual utilization of the available credit line.

Other operating expenses comprise of legal, audit, directors fees and expenses, and other operating costs of the Corporation and may fluctuate based on the timing of these expenses throughout the year. Other operating expenses increased in 2022 due to higher bank fees associated with an amendment to the credit facility, increased processing fees and increased meeting expense fees. Meetings in 2021 were held virtually due to Covid.

The provision for impairment losses has increased in each quarter in 2022 compared to 2021 primarily due to increases in the forward-looking probability of defaults as well as increased credit risk for a residential development project loan (see Mortgage impairments and provision for impairment losses).

## RECENT DEVELOPMENTS

### COVID-19

The coronavirus disease 2019 (“COVID-19”) outbreak was declared a pandemic by the World Health Organization in March, 2020. Steps taken over the course of 2020 by governments around the world, including in Frontenac’s primary lending market in the Province of Ontario, to contain the spread of the COVID-19 virus included legislated closures of non-essential businesses and services and social distancing measures slowing economic activity and resulting in layoffs and lost jobs as businesses struggle with the economic effects.

In general, throughout the pandemic period, the number of arrangements made by the Corporation with its borrowers to defer mortgage loan payments has not been significant in relation to the mortgage portfolio as a whole. For the year ended December 31, 2022, the Corporation had no active deferral arrangements with borrowers and only one late but not impaired mortgage as a result of COVID-19 impacts. For the year ended December 31, 2021, there were 11 mortgage deferral arrangements and 2 impaired mortgages as a result of COVID-19.

The impact of COVID-19 on the future performance of the Corporation continues to depend largely on the scope and duration of the pandemic. As at the date of this MD&A, most people and businesses have essentially transitioned back to normal business practices.

### Inflation and Rising Interest Rates

The inflation rate in Canada hit 6.3% in December 2022 on a year-over-year basis according to Statistics Canada and has been stronger-than-expected. This is down from a peak increase of 8.1% experienced in June 2022. Global factors such as the war in Ukraine, supply chain issues, and domestic price pressures have fueled inflation to levels not seen since the early 1980’s. The average monthly year-over-year inflation increase in 2021 was 3.4% while in 2022 it increased to 6.8%.

Controlling inflation has now become the Bank of Canada’s primary concern. The Bank of Canada has rapidly increased interest rates in 2022. There have been seven Bank of Canada increases from March to December for a total of 400 bps taking the overnight rate to 4.25%. The prime interest rate charged by banks and credit unions has increased at the same rate as the Bank of Canada’s policy rate increases. Most economists believe interest rates will continue to increase in the first Bank of Canada meeting of 2023 but further increases or decreases in 2023 will be dependent on the rate of inflation, the state of economy and labour market. The principal risk cited by most economists is that the Bank of Canada increases interest rates too much and risks having the economy fall into a hard recession. In addition to interest rate increases, the Bank of Canada announced in April 2022 that it was ending the reinvestment phase of its asset purchase program and beginning quantitative tightening.

As interest rates increase, the interest expense on our line of credit facility will also increase as it is tied to the bank’s prime rate. The line of credit balance as at December 31, 2022 was \$23.2 million compared to a balance of nil at the end of December 31, 2021. In addition, it affords the Corporation the opportunity to increase interest rates on loans and improve the average interest rate on the mortgage portfolio.

The real estate market is highly influenced by interest rate changes by the Bank of Canada. Per the Ontario Real Estate Association, residential sales fell by 32% on a year over year basis in Ontario in 2022; however, the year over year % change in price increased by 6.8%. Factors contributing to the stability of prices include a chronic housing shortage, supply chain delays, skilled labour shortages and increased levels of immigration.

It is unclear whether recent interest rate increases, together with any future interest rate increases, will trigger a recession which could negatively impact FMIC's financial performance due to recessionary effects such as higher unemployment and the curtailment of real estate development. Higher unemployment may lead to the Corporation experiencing an increase in impairments and as such, an increase would translate into lower earnings due to the unlikely collectability of further interest on those loans. The curtailment of real estate development may lead the Corporation to experience lower construction mortgage origination volumes.

The potential for an increase in losses on impaired loans requires a decline in home values below the carrying value of the related loans or inability by the borrower to pay the interest and loan payments. Frontenac's underwriting policies of focusing on first mortgage loans to a maximum loan-to-value at origination of 80% or less provides some room for a decline in home values. In addition, the Corporation's loans are short-term, generally offered for 12-month terms, allowing for loan-to-value ratios on mortgage loans to be reassessed against current market conditions. Lastly, the majority of Frontenac's loans relate to owner-occupied principal residences, and in down economic times, cash outflows related to personal housing are among the last to be cut by people. Essentially, impairment or default is several steps down the road for most borrowers only after they have exhausted cash reserves, cut down on other expenses, and worked with government assistance.

Nevertheless, the market demand for FMIC's loans remains strong as experienced by the year over year growth of the mortgage portfolio. Our conservative lending approach coupled with our professional underwriting expertise, and our focus on high quality lending opportunities will serve our loan portfolio well. To the end of the fourth quarter, the Corporation has not experienced any significant loan loss provision increases due to higher interest rates and real estate market changes.

## LIQUIDITY AND CAPITAL RESOURCES

The Corporation is authorized to issue an unlimited number of common shares. Under the terms of the Corporation's continuous offering prospectus, Frontenac issues common shares on a monthly basis. Shareholders may redeem shares in the Corporation on a quarterly basis, subject to a 30-day notice period. As at December 31, 2022, there were 6,723,982 common shares issued and outstanding with a total book value of \$201,610,430.

Growth in the mortgage portfolio is financed by the issuance of common shares. We expect to be able to generate sufficient funds for future growth in net mortgage loans by utilizing this funding source only. The Corporation has not historically, and does not intend in the future, to supplement this funding using leverage.

The Corporation is a public issuer under Canadian securities law and, in May 2020, completed a transition from regulatory oversight as an investment fund to regulatory oversight as a corporate finance issuer. This change did not have any material impact how the Corporation raises new capital through the issuance of new common shares nor its ability to do so.

The Corporation has a revolving line of credit with a major Canadian chartered bank with a limit equal to 15% of shareholders' equity and to a maximum limit of \$40 million. The line of credit is secured by a General Security Agreement and a first ranking interest in the mortgages, is repayable on demand, and bears interest at bank prime rate plus 1%. Financial covenants require the Corporation to maintain minimum levels for equity, debt to equity ratio, and percentage of residential mortgages. As at December 31, 2022 and December 31, 2021, the Corporation was in compliance with the bank's financial covenants, and management expects to remain in compliance with such covenants going forward.

The line of credit is used to smooth out the cash flows of the Corporation and as a reserve for unexpected share redemptions and is not used to extend the Corporation's investment capacity beyond its available equity. As at December 31, 2022, the Corporation was using \$23.2 million (December 31, 2021 - \$nil) of its available credit line.

Subsequent to the reporting period, the Company issued 70,719 common shares for total proceeds of \$2,121,562. Common shares as at January 31, 2023 total 6,794,701.

**CHANGES IN FINANCIAL POSITION**

The Corporation is authorized to issue an unlimited number of common shares. Under the terms of its continuous offering prospectus, the Corporation issues common shares on a monthly basis. The following table presents a summary of outstanding share data and transactions for the twelve months ended December 31, 2022 and the year ended December 31, 2021:

	<b>Year ended December 30, 2022</b>		<b>Year ended December 31, 2021</b>	
Common shares:	<b>#</b>	<b>\$</b>	<b>#</b>	<b>\$</b>
Balance – beginning of period	6,757,281	202,609,406	5,721,384	171,532,472
Issued for cash	1,607,091	48,212,723	1,279,533	38,386,002
Issued under dividend re- investment plan	207,667	6,230,020	130,239	3,907,184
Redeemed	(1,848,057)	(55,441,719)	(373,875)	(11,216,252)
<b>Balance – end of period</b>	<b>6,723,982</b>	<b>201,610,430</b>	<b>6,757,281</b>	<b>202,609,406</b>

Under the Corporation’s dividend policy and dividend re-investment plan, unless a shareholder elects to receive their dividends in cash, monthly dividends are automatically re-invested into additional shares of the Corporation at the then prevailing carrying value per share.

Under the terms of the Corporation’s prospectus, up to November 30, 2021, shareholders have had the ability to redeem shares in the Corporation only once per year, on November 30, except in certain exceptional circumstances. After November 30, 2021, shareholders have the opportunity to redeem shares on a quarterly basis, with the first quarterly redemption date being February 28, 2022.

During 2022, shares issued for cash increased by \$10 million to \$48 million. This increase is primarily attributed to an improved communication strategy with advisors, more effective marketing practices, higher advisor activity and increased interest in alternative investments in the marketplace.

During 2022, the Corporation experienced an increase in redemptions, year over year. For reference purposes, aggregate redemptions for the year ended December 31, 2021 were \$11,216,252 and for the year ended December 31, 2022 were \$55,441,719. Most of this increase in redemptions, and the timing of such increases, resulted from the decision by the Manager to exit its advisory business by way of direct managed accounts, beginning in the first quarter of 2022. Almost all of the Manager's managed accounts included Common Shares. In late November 2021, the Manager decided to exit its advisory business and began to develop an orderly plan to do so. Such plan was completed in late January 2022 and presented to the Board at the annual strategy meeting of the Board held on February 7, 2022. The detailed plan included a budget that outlined the Manager's best estimate as to the timing and amount of redemptions of Common Shares from the Manager's direct managed accounts, as they migrated to other advisers, for 2022 and the resulting effect of such projected redemptions on the Corporation's operations. Budgeted 2022 redemptions were prepared by the Manager in the context of unprecedented circumstances, including the fact that 2022 was the first full year of quarterly redemptions which had been implemented during 2021 to provide investors with additional liquidity, the Manager's exit from its advisory business and that the amount and timing of redemptions of Shares in accounts formerly managed by the Manager would not be under the control of the Manager but is rather a decision made by the successor adviser and their client. The Manager gave notice to its Qualified Investor clients in February 2022 that it would be exiting its managed accounts business and that they would need to transition their accounts to other advisers.

The estimated increase in redemptions of Common Shares in 2022 resulting from the Manager's exit from the managed accounts business was not projected in February 2022 to have a material effect on the Corporation due to projected Common Share sales increases and available cash from the Corporation's practice of reserving 5% of its NAV in cash, the fact that the Corporation's cash balance at the end of January, 2022 was approximately \$30 million (including payout proceeds of approximately \$18 million received in January, 2022 from a residential development loan refinancing), plus the Corporation's credit line which it uses to smooth out cash flow requirements. The Corporation's cash resources come from (1) sales of Shares (2) payouts of maturing mortgage loans, and (3) the Corporation's line of credit. The Corporation's cash requirements are principally used for (1) mortgage loans, (2) the Corporation's expenses, and (3) redemptions. Based on the Corporation's anticipated cash availability and cash requirements the Manager can adjust, on a monthly basis, one or more of the Corporation's (1) cash reserves (2) funded loans, and/or (3) utilization of its line of credit. As part of its cash management function the Manager reviews quarterly redemption requests and determines whether adequate cashflow is available to fund redemption requests.

Actual 2022 redemptions of Common Shares held in accounts managed or formerly managed by the Manager in 2022 were approximately \$4.5 million, being approximately 54% of total redemptions in the first quarter, approximately \$19.2 million, being approximately 91% of total redemptions in the second quarter, approximately \$13 million, being approximately 76% in the third quarter, and approximately \$2.9 million, being approximately 32% in the fourth quarter. The increase in actual redemptions on a year to date basis, though greater than the aggregate amount budgeted in February, 2022, were funded by the Corporation's available cash resources, including from increased Shares sales, mortgage payouts, retained cash and the Corporation's line of credit, without materially impacting the Corporation's financial performance.

Common Shares are no longer distributed to clients of the Manager who are Qualified Investors. The transition of managed accounts from the Manager to third party advisers, and the redemption of Common Shares in those accounts were in all material respects completed by the end of 2022.

The Corporation permitted redemptions to exceed 5% of the Corporation's Net Asset Value in both the second and third quarters of 2022 in order to ensure the orderly transition of managed accounts from the Manager without delay, to permit all other redemption requests to be treated on the same basis without any delay, and because the Corporation had sufficient cash resources to process such redemptions without materially impacting the Corporation's financial performance or viability. These instances of exceeding the 5% redemption limit do not reflect a change in the Corporation's redemption policy but rather are special circumstances meant to accommodate the Manager's exit from its advisory business by way of direct managed accounts, a one-time non-recurring event.

The Corporation will continue to generally refrain from redeeming Common Shares for which a notice of redemption is received if redemption orders received in respect of any Redemption Date exceed 5% of the Corporation's NAV calculated as of the Redemption Date. However, on a go-forward basis, the Board will review and approve all redemptions, whether above or below 5%, and if above 5% the Board may waive the 5% restriction if it deems it appropriate to do so based on input and advice from the Manager.



**CONTRACTUAL OBLIGATIONS**

Contractual obligations due at December 31, 2022 are all due within one year and are as follows:

	\$
Dividends payable	410,922
Accounts payable and accrued liabilities	357,720
	<u>768,642</u>

As at December 31, 2022, the Corporation has commitments to advance additional funds of \$77.9 million under existing mortgages (Dec 31, 2021 - \$64.6 million). These outstanding commitments are generally expected to be funded over the next 12 months. These commitments relate primarily to residential construction mortgages where funds are advanced as projects are completed subject to third party inspections and other underwriting controls and procedures. In our experience, a portion of the unfunded commitments on existing mortgage loans will never be drawn.

**TRANSACTIONS WITH RELATED PARTIES**

Transactions with related parties are in the normal course of business.

Pillar Financial Services Inc. (“Pillar”) is the administrator and W.A. Robinson Asset Management Ltd. (“W.A.”) is the manager for the Corporation. These companies are related parties in that they share common management. The Corporation signed new contracts for these services in 2008 under which Pillar and W.A. each charge an annual fee of 1% of the total asset value calculated on a monthly basis. These contracts were renewed for further five-year periods in 2013 and 2018.

Administration and management fees paid under these agreements totaled \$1.2 million for the three months ended December 31, 2022 (three months ended December 30, 2021 - \$1.1 million) including applicable sales taxes. Administration and management fees paid under these agreements totaled \$4.7 million for the twelve months ended December 31, 2022 (twelve months ended December 30, 2021 - \$4.1 million) including applicable sales taxes. The increase in the dollar value of the administration and management fees in each of the three month and twelve months periods from 2021 reflects a year-over-year increase in the average total assets of the Corporation.

## CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of financial statements in accordance with IFRS requires management to make assumptions, estimates and judgements. These affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses for the year, as well as the disclosure of contingent assets and liabilities at the date of the financial statements.

In making estimates and judgements, the Manager relies on external information and observable conditions where possible supplemented by internal analysis as required. Unless as otherwise disclosed, those estimates and judgements have been applied in a manner consistent with the prior period and there are no known trends, commitments, events, or certainties that are believed to materially affect the methodology or assumptions utilized in making those estimates in these financial statements. Actual amounts could differ from these estimates. Changes in estimates are recorded in the accounting period in which they are determined. Significant estimates used in determining the recorded amount for assets and liabilities in the financial statements are as follows:

(i) Mortgage investments:

The Corporation is required to make an assessment as to whether the credit risk of a mortgage has changed significantly since initial recognition and is also required to determine the impairment of mortgage investments. The Corporation considers a number of factors when assessing if there has been a significant increase in credit risk. Mortgages with payments over 30 days in arrears are immediately flagged as potentially being in Stage 2. Other factors that the Corporation considers when confirming if there has been a significant increase in credit risk include changes in the financial condition of the borrower, responsiveness of the borrower, and other borrower or property specific information that may be available. Mortgage investments are considered to be impaired only if objective evidence indicates that one or more events have occurred after its initial recognition that have a negative effect on the estimated future cash flows of that asset. The estimation of future cash flows includes assumptions about local real estate market conditions, market interest rates, availability and terms of financing, underlying value of the security and various other factors. These assumptions are limited by the availability of reliable comparative market data, economic uncertainty and the uncertainty of future events. Accordingly, by their nature, estimates of impairment are subjective and may not necessarily be comparable to the actual outcome. Should the underlying assumptions change, the estimated future cash flows could vary.

The quantitative aspect of the expected credit loss begins with the use of an Autoregressive Distributed Lag (ARDL) model. The ARDL model indicates that expected credit losses are largely explained by borrower specific information such as credit score, debt servicing ratios, borrower equity and age and are not a function of statistics or forecasts of national economic performance. As a result, the firm incorporates borrower specific information to estimate the probability of default over the life of the mortgage to estimate expected credit losses. In instances where qualitative information about a mortgage indicates that the borrower may have experienced an increase in credit risk, the firm incorporates the new information and re-estimates the probability of default. This new estimate is then used to evaluate the probability of default between the occurrence of the increased credit risk and the end of the mortgage term. In all cases, the probability of default is used as a weighting factor in determining expected credit losses on each individual mortgage within the portfolio.

IFRS 9 uses an expected credit loss (“ECL”) model to determine the provision for credit losses.

The ECL allowances are calculated through three probability-weighted forward-looking scenarios including base, optimistic, and pessimistic, that measures the expected cash shortfalls on the financial assets related to default events either (i) over the next 12 months or (ii) over the expected life based on the maximum contractual period over which the Corporation is exposed to credit risk. The expected life of certain revolving credit facilities is based on the period over which the Corporation is exposed to credit risk and where the credit losses would not be mitigated by management actions. The three scenarios are updated at each reporting date, and the probability weights and the associated scenarios are determined through a management review process that involves significant judgement and review by the Corporation's Finance and Risk management groups.

Upon initial recognition of financial assets, the Corporation recognizes a 12-month ECL allowance which represents the portion of lifetime ECL that result from default events that are possible within the next 12 months (Stage 1). If there has been a Significant Increase in Credit Risk ("SICR"), the Corporation then recognizes a lifetime ECL allowance resulting from possible default events over the expected life of the financial asset (Stage 2). The SICR is determined through changes in the lifetime probability of default ("PD") since initial recognition of the financial assets, using a combination of borrower specific and account specific attributes with a presumption that credit risk has increased significantly when contractual payments are more than 30 days past due. This assessment considers all reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions that impact the Corporation's credit risk assessment. Criteria for assessing SICR are defined at a portfolio level and vary based on the risk of default at the origination of the portfolio. If credit quality subsequently improves such that the increase in credit risk since initial recognition is no longer significant, the loss allowances will revert back to be measured based on a 12-month ECL, and the financial asset will transfer from Stage 2 back to Stage 1. Stages 1 and 2 comprise all non-impaired financial assets.

Management developed a modelling of the Stage 2 estimate which requires a reassessment of the overall credit risk resulting from a SICR. The model developed for SICR assumes a complete degradation in credit quality as proxied by the borrower's Beacon Score. This enters into a logistic regression to estimate lifetime probability of default based on this new assumption. The lifetime probability of default estimate then enters into the Survival Analysis as a parameter to allow probability of default to be estimated over the remaining term to maturity.

In addition, management exercises expert credit judgements in assessing exposures that have experienced a SICR and in determining the amount of ECL allowances required at each reporting date by considering reasonable and supportable information that are not already included in the quantitative models. Expert credit judgements are performed by considering emergence of economic, environmental or political events, as well as expected changes to parameters, models or data that are not currently incorporated. Significant judgements made by management may impact the amount of ECL allowances recognized. ECL is calculated as the product of PD, loss given default ("LGD"), and exposure at default ("EAD"), and is calculated over the remaining expected life of the financial asset and discounted to the reporting date at the respective effective interest rate. PD measures the estimated likelihood of default over a given time period. PD estimates are updated for each scenario at each reporting date and is based on current information. LGD provides the estimate of loss when default occurs at a given time, and is determined based on historical write-off events, recovery payments, borrower specific attributes and direct costs. The estimate is updated at each reporting date for each scenario based on current information. EAD estimates the exposure at the future default date.

As at December 31, 2022 and 2021, no adjustments were deemed necessary to the ECL modelling to account for potential impacts arising from the COVID-19 pandemic. As at December 31, 2022, the Company had no active deferral arrangements with borrowers on account of COVID-19 (December 31, 2021 - one active deferral arrangement). Further commentary on the impact of COVID-19 is provided in Note 2 of the financial statements and under the Operating Results section of this MD&A. Impacts as a result of changing economic environment are incorporated in the probability of default and loss given default within the ECL modelling.

Financial assets with objective evidence of impairment as a result of loss events that have a negative impact on the estimated future cash flows are considered to be impaired requiring the recognition of lifetime ECL allowances (Stage 3). Deterioration in credit quality is considered objective evidence of impairment and includes observable data that comes to the attention of the Corporation, such as significant financial difficulty of the borrower. The Corporation defines default as when there is identification of objective evidence of impairment (which could, for example, be delinquency of 90 days or more). A financial asset is no longer considered impaired when past due amounts have been recovered, and the objective evidence of impairment is no longer present.

Financial assets are written off, either partially or in full against the related allowances for credit losses when the Corporation believes there are no reasonable expected future recoveries through payments or the sale of the related security. Any recoveries of amounts previously written off are credited against provision for credit losses in the statements of income and comprehensive income.

#### Loan Modification

The Corporation defines loan modification as changes to the original contractual terms of the financial asset that represents a fundamental change to the contract or changes that may have a significant impact on the contractual cash flow of the asset. The Corporation derecognizes the original asset when the modification results in significant change or expiry in the original cash flows; a new asset is recognized based on the new contractual terms. The new asset is assessed for staging and SICR to determine the corresponding ECL measurement required at the date of modification. If the Corporation determines the modifications do not result in derecognition, then the asset will retain its original staging and SICR assessments.

#### (ii) Fair value measurements:

In accordance with IFRS, the Corporation must classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making its fair value measurements. The following hierarchy has been used in determining and disclosing fair value of financial instruments:

- Level 1: quoted prices in active markets for the same instrument (i.e. without modification or repackaging);
- Level 2: quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data; and
- Level 3: valuation techniques for which any significant input is not based on observable market data.

The Corporation's cash and cash equivalents are valued using Level 1 measures and the properties held for sale under foreclosure are valued using Level 3 measures as there are no quoted prices in an active market for these investments. As explained in more detail in Note 12 of the interim financial statements, management makes its determination of fair value of mortgages by discounting future cash flows at the Corporation's prevailing rate of return on new mortgages of similar type, term, and credit risk.

These assumptions are limited by the availability of reliable comparative market data, economic uncertainty and the uncertainty of future events. Accordingly, by their nature, measurements of fair value are subjective and may not necessarily be comparable to the actual outcome. Should the underlying assumptions change, the estimates could vary.

### **FINANCIAL INSTRUMENTS**

The Corporation's most significant financial asset consists of its mortgage investments. Mortgage investments are classified as measured at amortized cost. The financial risks associated with the Corporation's mortgage investments and the Corporation's management of those risks are discussed in note 8 of the interim financial statements.

The Corporation's other financial assets consist of cash and cash equivalents, due from administrator in trust, and accrued interest receivable. The Corporation's financial liabilities consist of bank line of credit, dividends payable, and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Corporation is not exposed to significant interest or currency risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying value, unless otherwise noted.

The Corporation classifies its financial assets as one of the following: measured at amortized cost or fair value through profit or loss ("FVTPL") or fair value through other comprehensive income ("FOCI"). Financial liabilities are classified as: FVTPL or financial liabilities at amortized cost. The Corporation has designated its financial assets and financial liabilities as follows:

(i) Financial assets:

Cash and cash equivalents are classified as FVTPL. Due from administrator in trust, accrued interest receivable, and mortgage investments are classified as measured at amortized cost.

(ii) Financial liabilities:

Bank line of credit, dividends payable, and accounts payable and accrued liabilities are classified as financial liabilities at amortized cost.

The tables in note 9 of the financial statements present the fair values of the Corporation's financial instruments as at December 31, 2022 and December 31, 2021.

### **CHANGES IN ACCOUNTING POLICIES**

Significant accounting policies are described in note 4 of the Corporation's financial statements.

At the date of authorization of this MD&A, certain new standards, and amendments to existing standards have been published by the International Accounting Standards Board ("IASB"). Information on those expected to be relevant to the Corporation's financial statements is provided below.

Management anticipates that all relevant pronouncements will be adopted in the Corporation's accounting policies for the first period beginning after the effective date of the pronouncement. New standards, interpretations, and amendments not either adopted or listed below did not have a material impact on the Corporation's financial statements.

#### **IAS 1 - Presentation of Financial Statements**

In January 2020, the IASB issued an amendment to IAS 1, Presentation of Financial Statements, to come into effect January 1, 2022. The amendment is to provide clarification on the classification of liabilities as current or non-current. On July 15, 2020, the effective date of these amendments was deferred by one year to January 1, 2023, with early adoption permitted. The Corporation will adopt the amendments in its financial statements for the annual period beginning January 1, 2023. The Corporation does not expect the amendments to have a material impact on its financial statements.

#### **IAS 1 - Presentation of Financial Statements**

In February 2021, the IASB issued an amendment to IAS 1, Presentation of Financial Statements, to come into effect on January 1, 2023. The amendment is to provide clarification to financial statement preparers on which accounting policies to disclose in the financials statements. The Corporation will adopt the amendments in its financial statements for the annual period beginning January 1, 2023. Based on a preliminary assessment, the Corporation does not expect the amendments to have a material impact on its financial statements.

#### **IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors**

In February 2021, the IASB issued an amendment to IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, to come into effect January 1, 2023. The amendment is to help entities to distinguish between accounting policies and accounting estimates. The Corporation will adopt the amendments in its financial statements for the annual period beginning January 1, 2023. The Corporation is currently assessing the impact of this amendment on its financial statements. Based on a preliminary assessment, the Corporation does not expect this amendment to have a significant impact on its financial statements.

### **RISKS AND UNCERTAINTIES**

The Corporation is subject to many risks and uncertainties that may limit our ability to execute on our strategies and achieve our objectives. We have processes and procedures in place to control or mitigate certain risks, while others cannot be or are not mitigated. Material risks that cannot be mitigated include a significant decline in the general economy and general real estate market, a significant change in interest rates, an inability to make mortgage loans at rates consistent with rates historically achieved and having an insufficient amount of new mortgage loan opportunities presented.

See “Forward-Looking Information” below and the Risk Factors section of the Corporation’s prospectus for further information on risks and uncertainties faced by the Corporation. The Corporation’s prospectus is available on [www.sedar.com](http://www.sedar.com) and on the Corporation’s website at [www.fmic.ca](http://www.fmic.ca).

A discussion of the impact and potential impact on the operations and performance of the Corporation of the on-going COVID-19 outbreak as well as the interest and inflationary environment is included in this MDA under Operating Results.

### **FORWARD-LOOKING INFORMATION**

From time to time in our public communications we provide forward-looking statements. Such statements are disclosures regarding possible events, conditions, results of operations or changes in financial position that are based upon assumptions and expectations. These are not based on historical facts but are with respect to management’s beliefs, estimates, and intentions. Forward-looking statements generally can be identified by the use of forward-looking terminology such as “outlook”, “objective”, “may”, “will”, “expect”, “intent”, “estimate”, “anticipate”, “believe”, “should”, “plans”, or “continue” or other similar expressions suggesting future outcomes or events. Forward-looking statements regarding performance of the economy in general and real estate markets in particular. Forward-looking statements generally assume that our revenues and expenses continue to follow current trends, and that current trends in our mortgage portfolio continue.

All forward-looking statements reflect management’s current beliefs and are based on information currently available to management. These statements are not guarantees of future performance and are based on our estimates and assumptions that are subject to risks and uncertainties which could cause our actual results to differ materially from the forward-looking statements contained in this MD&A or elsewhere. Those risks and uncertainties include risks associated with mortgage lending, competition for mortgage lending, real estate values, interest rate fluctuations, environmental matters, and the general economic environment. For other risks and uncertainties, please refer to “Risks and Uncertainties” above and to the “Risk Factors” section of the Corporation’s prospectus which is available at [www.sedar.com](http://www.sedar.com) and [www.fmic.ca](http://www.fmic.ca). That list is not exhaustive as other factors could adversely affect our results, performance, or achievements. The reader is cautioned against undue reliance on any forward-looking statements.

Although the forward-looking information contained in this MD&A is based on what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. We will not publicly update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise, unless required to do so by law.

### **RESPONSIBILITY OF MANAGEMENT AND THE BOARD OF DIRECTORS**

Management is responsible for the information disclosed in this MD&A and has in place the appropriate information systems, procedures and controls to ensure the information used internally by management and externally is materially complete and reliable. In addition, our audit committee and board of directors provide an oversight role with respect to our public financial disclosures and have reviewed and approved this MD&A and the financial statements as at December 31, 2022.

**ADDITIONAL INFORMATION**

Additional information about Frontenac Mortgage Investment Corporation, including the audited financial statements for the year ended December 31, 2022 and the audited financial statements for the year ended December 31, 2021, is available on SEDAR at [www.sedar.com](http://www.sedar.com) or on our website at [www.fmic.ca](http://www.fmic.ca). You may also obtain information by contacting the Corporate Secretary for Frontenac Mortgage Investment Corporation by telephone at (613) 279-2116 or by email at [amber.kehoe@robinsonsgroup.com](mailto:amber.kehoe@robinsonsgroup.com).