



MCAN MORTGAGE CORPORATION

**MANAGEMENT'S DISCUSSION AND
ANALYSIS OF OPERATIONS**

JUNE 30, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

This Management's Discussion and Analysis of Operations ("MD&A") should be read in conjunction with the interim unaudited consolidated financial statements and accompanying notes for the quarter ended June 30, 2018 and the audited consolidated financial statements, accompanying notes and MD&A for the year ended December 31, 2017. These items and additional information regarding MCAN Mortgage Corporation ("MCAN", the "Company" or "we"), including continuous disclosure materials such as the Annual Information Form are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com and our website at www.mcanmortgage.com. Except as indicated below, all other factors discussed and referred to in the MD&A for fiscal 2017 remain substantially unchanged. Information has been presented as at August 9, 2018.

Effective January 1, 2018, MCAN prospectively adopted IFRS 9, *Financial Instruments* and did not restate prior period information. Accordingly, financial information as at June 30, 2018 and for the quarter and six months ended June 30, 2018 is based on IFRS 9 and prior periods are based on IAS 39, *Financial Instruments: Recognition and Measurement*. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

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A CAUTION ABOUT FORWARD-LOOKING INFORMATION AND STATEMENTS

This MD&A contains forward-looking information within the meaning of applicable Canadian securities laws. All information contained in this MD&A, other than statements of current and historical fact, is forward-looking information. All of the forward-looking information in this MD&A is qualified by this cautionary note. Often, but not always, forward-looking information can be identified by the use of words such as “may,” “believe,” “will,” “anticipate,” “expect,” “planned,” “estimate,” “project,” “future,” and variations of these or similar words or other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters. Forward-looking information in this MD&A includes, among others, statements and assumptions with respect to:

- the current business environment and outlook;
- possible or assumed future results;
- our ability to create shareholder value;
- our business goals and strategy;
- the potential impact of changes to regulations;
- the stability of home prices;
- the effect of challenging conditions on us;
- factors affecting our competitive position within the housing markets;
- the price of oil and its impact on housing markets in Western Canada;
- sufficiency of our access to capital resources; and
- the timing of the effect of interest rate changes on our cash flows.

Forward-looking information is not, and cannot be, a guarantee of future results or events. Forward-looking information reflects management’s current beliefs and is based on information currently available to management. Forward-looking information is based on, among other things, opinions, assumptions, estimates and analyses that, while considered reasonable by us at the date the forward-looking information is provided, inherently are subject to significant risks, uncertainties, contingencies and other factors that may cause actual results and events to be materially different from those expressed or implied by the forward-looking information.

The material factors or assumptions that we identified and were applied by us in drawing conclusions or making forecasts or projections set out in the forward-looking information include, but are not limited to:

- our ability to successfully implement and realize on our business goals and strategy;
- factors and assumptions regarding interest rates;
- housing sales and residential mortgage borrowing activities;
- the effect of competition;
- government regulation of our business;
- computer failure or security breaches;
- the availability of funding and capital to meet our requirements;
- the value of mortgage originations;
- the expected margin between interest earned on mortgage portfolios and interest paid on deposits;
- the relative continued health of real estate markets;
- acceptance of our products in the marketplace;
- our ability to forecast future changes to borrower credit and credit scores, loan to value ratios and other forward-looking factors used in assessing expected credit losses;
- availability of key personnel;
- our operating cost structure; and
- the current tax regime.

Reliance should not be placed on forward-looking information because it involves known and unknown risks, uncertainties and other factors, which may cause actual results to differ materially from anticipated future results expressed or implied by such forward-looking information. Factors that could cause actual results to differ materially from those set forth in the forward-looking information include, but are not limited to:

- global market activity;
- worldwide demand for and related impact on oil and other commodity prices;
- changes in government and economic policy;
- changes in general economic, real estate and other conditions;
- changes in interest rates;
- changes in Canada Mortgage Bonds (“CMB”) and mortgage-backed securities (“MBS”) spreads and swap rates;
- MBS and mortgage prepayment rates;
- mortgage rate and availability changes;

- adverse legislation or regulation;
- availability of CMB and MBS issuer allocation;
- technology changes;
- confidence levels of consumers;
- our ability to raise capital and term deposits on favourable terms;
- our debt and leverage;
- competitive conditions in the homebuilding industry, including product and pricing pressures;
- our ability to retain our executive officers and other employees;
- litigation risk;
- our relationships with our mortgage originators;
- additional risks and uncertainties, many of which are beyond our control, referred to in this MD&A and our other public filings with the applicable Canadian regulatory authorities.

Subject to applicable securities law requirements, we undertake no obligation to publicly update or revise any forward-looking information after the date of this MD&A whether as a result of new information, future events or otherwise or to explain any material difference between subsequent actual events and any forward-looking information. However, any further disclosures made on related subjects in subsequent reports should be consulted.

ACRONYMS

AFS	<i>Available for Sale</i>	FVOCI	<i>Fair Value Through Other Comprehensive Income</i>	MBS	<i>Mortgage Backed Securities</i>
ALCO	<i>Asset and Liability Committee</i>	FVPL	<i>Fair Value Through Profit and Loss</i>	MD&A	<i>Management's Discussion & Analysis</i>
BCBS	<i>Basel Committee on Banking Supervision</i>	HELOC	<i>Home Equity Line of Credit</i>	MIC	<i>Mortgage Investment Corporation</i>
CAR	<i>Capital Adequacy Requirements</i>	IAS	<i>International Accounting Standard</i>	NHA	<i>National Housing Act</i>
CDIC	<i>Canada Deposit Insurance Corporation</i>	IASB	<i>International Accounting Standards Board</i>	NSFR	<i>Net Stable Funding Ratio</i>
CET 1	<i>Common Equity Tier 1</i>	ICB	<i>Investment Committee of the Board</i>	OSFI	<i>Office of the Superintendent of Financial Institutions</i>
CHT	<i>Canada Housing Trust</i>	IFRIC	<i>IFRS Interpretations Committee</i>	PD	<i>Probability of Default</i>
CMB	<i>Canada Mortgage Bonds</i>	IFRS	<i>International Financial Reporting Standards</i>	POCI	<i>Purchased or Originated Credit-Impaired</i>
CMHC	<i>Canada Mortgage and Housing Corporation</i>	LAR	<i>Liquidity Adequacy Requirements</i>	RAF	<i>Risk Appetite Framework</i>
DRIP	<i>Dividend Reinvestment Plan</i>	LCR	<i>Liquidity Coverage Ratio</i>	RMBS	<i>Residential Mortgage Backed Securities</i>
EAD	<i>Exposure at Default</i>	LGD	<i>Loss Given Default</i>	SEDAR	<i>System for Electronic Document Analysis and Retrieval</i>
ECL	<i>Expected Credit Losses</i>	LP ARA	<i>Limited Partner's At-Risk Amount</i>	SPPI	<i>Solely Payment of Principal and Interest</i>
EIM	<i>Effective Interest Rate Method</i>	LTV	<i>Loan to Value (ratio)</i>	TSX	<i>Toronto Stock Exchange</i>

SELECTED FINANCIAL INFORMATION

Table 1: Income Statement Highlights

(in thousands except for per share amounts and %)	Q2	Q2	Change	YTD	YTD	Change
For the Periods Ended June 30	2018 ¹	2017	(%)	2018 ¹	2017	(%)
Income Statement Highlights						
Net investment income - corporate assets	\$ 15,063	\$ 12,179	24%	\$ 27,136	\$ 25,142	8%
Net investment income - securitization assets	1,317	1,374	(4%)	2,618	2,665	(2%)
	16,380	13,553	21%	29,754	27,807	7%
Other income	-	-	-	1,701	876	94%
Operating expenses	5,142	4,616	11%	9,773	9,233	6%
Net income before income taxes	11,238	8,937	26%	21,682	19,450	11%
Provision for (recovery of) income taxes	113	(1)	114%	(58)	247	(123%)
Net income	\$ 11,125	\$ 8,938	24%	\$ 21,740	\$ 19,203	13%
Basic and diluted earnings per share	\$ 0.47	\$ 0.39	21%	\$ 0.92	\$ 0.83	11%
Dividends per share	\$ 0.37	\$ 0.32	16%	\$ 0.74	\$ 0.62	19%
Next quarter's dividend per share	\$ 0.37					
Return on average shareholders' equity ²	14.54%	12.37%	2.17%	14.32%	13.37%	0.95%
Taxable income per share ^{2,4}	\$ 0.48	\$ 0.43	12%	\$ 0.67	\$ 0.81	(17%)
Yields						
Average mortgage portfolio yield - corporate ³	5.65%	5.28%	0.37%	5.68%	5.20%	0.48%
Term deposit average interest rate ³	2.48%	2.21%	0.27%	2.43%	2.21%	0.22%
Spread of mortgages over term deposits	3.17%	3.07%	0.10%	3.25%	2.99%	0.26%
Average mortgage portfolio yield - securitized ³	2.59%	2.67%	(0.08%)	2.58%	2.64%	(0.06%)
Financial liabilities from securitization						
- average interest rate ³	1.83%	1.93%	(0.10%)	1.83%	1.92%	(0.09%)
Spread of mortgages over liabilities	0.76%	0.74%	0.02%	0.75%	0.72%	0.03%

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

² Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.

³ Refer to "Average Interest Rate" in the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

⁴ For further information refer to the "Taxable Income" section of this MD&A.

Table 2: Balance Sheet Highlights

(in thousands except for per share amounts and %)	June 30 2018 ¹	March 31 2018 ¹	December 31 2017	Change from Prior Quarter	
				(\$)	(%)
Balance Sheet Highlights					
Assets					
Corporate	\$ 1,212,078	\$ 1,121,806	\$ 1,182,371	\$ 90,272	8%
Securitization	993,992	1,032,078	1,034,404	(38,086)	(4%)
Total assets	\$ 2,206,070	\$ 2,153,884	\$ 2,216,775	\$ 52,186	2%
Mortgages - corporate	\$ 919,053	\$ 859,372	\$ 863,384	\$ 59,681	7%
Mortgages - securitized	\$ 964,507	\$ 1,013,036	\$ 1,016,724	\$ (48,529)	(5%)
Liabilities					
Corporate	\$ 923,205	\$ 836,552	\$ 904,099	\$ 86,653	10%
Securitization	976,769	1,015,296	1,015,699	(38,527)	(4%)
Total liabilities	\$ 1,899,974	\$ 1,851,848	\$ 1,919,798	\$ 48,126	3%
Shareholders' equity	\$ 306,096	\$ 302,036	\$ 296,977	\$ 4,060	1%
Capital Ratios ²					
Income Tax Assets to Capital Ratio	4.60	4.33	4.60		6%
Common Equity Tier 1 Capital Ratio ⁴	21.47%	21.29%	21.26%		0.18%
Tier 1 Capital Ratio ⁴	21.47%	21.29%	21.26%		0.18%
Total Capital Ratio ⁴	21.47%	21.29%	21.26%		0.18%
Leverage ratio ³	11.55%	11.74%	11.31%		(0.19%)
Credit Quality					
Impaired mortgage ratio (total) ^{2,5}	0.02%	0.10%	0.09%		(0.08%)
Impaired mortgage ratio (corporate) ^{2,5}	0.03%	0.22%	0.20%		(0.19%)
Mortgage Arrears ⁶					
Corporate	\$ 6,739	\$ 9,204	\$ 8,766	\$ (2,465)	(27%)
Securitized	13,979	9,554	8,803	4,425	46%
Total	\$ 20,718	\$ 18,758	\$ 17,569	\$ 1,960	10%
Common Share Information (end of period)					
Number of common shares outstanding	23,652	23,559	23,378		-
Book value per common share ²	\$ 12.94	\$ 12.82	\$ 12.70	\$ 0.12	1%
Common share price - close	\$ 17.90	\$ 17.61	\$ 17.84	\$ 0.29	2%
Market capitalization ²	\$ 423,371	\$ 414,874	\$ 417,064	\$ 8,497	2%

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

² Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.

³ Mortgages securitized through the market MBS program and CMB program for which derecognition has not been achieved are included in regulatory assets in the leverage ratio. For further information, refer to the "Capital Management" section of this MD&A.

⁴ These ratios are presented on the "all-in" basis, with certain regulatory capital deductions fully phased in.

⁵ Incorporates impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.

⁶ The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.

HIGHLIGHTS

Financial Performance

Q2 2018

- Net income of \$11.1 million in Q2 2018, an increase of \$2.2 million (24%) from \$8.9 million in Q2 2017.
- Earnings per share totalled \$0.47 per share in Q2 2018, up \$0.08 (21%) from \$0.39 per share in Q2 2017.
- Return on average shareholders' equity¹ was 14.54% in Q2 2018 compared to 12.37% in Q2 2017.
- Recognized a \$3.3 million unrealized gain on financial instruments (consisting of marketable securities and financial investments) in Q2 2018. IFRS 9, which was adopted effective January 1, 2018, requires unrealized gains and losses on equities to be recorded through net income. Prior period financial information was governed by IAS 39, which required unrealized gains and losses on equities to be recorded through other comprehensive income. Prior period financial information was not restated on adoption of IFRS 9.

Year to Date 2018

- For 2018 year to date, we earned net income of \$21.7 million, up \$2.5 million (13%) from \$19.2 million in 2017.
- Earnings per share were \$0.92 for 2018 year to date, up \$0.09 (11%) from \$0.83 in 2017.
- Return on average shareholders' equity¹ was 14.32% for 2018 year to date compared to 13.37% in 2017.

Corporate Activity

- Corporate assets, which totalled \$1.21 billion at June 30, 2018, increased by \$90 million (8%) from March 31, 2018.
- Corporate mortgage portfolio increased by \$60 million (7%) during Q2 2018 to \$919 million from \$859 million, which included increases of \$50 million in insured single family, \$25 million in construction loans and \$7 million in uninsured single family, partially offset by a decrease of \$24 million in commercial loans.
- Corporate mortgage originations increased to \$112 million in Q2 2018 from \$94 million in Q2 2017, including increases of \$20 million in insured single family and \$19 million in uninsured single family.

Dividend

- Consistent with the second quarter dividend, the Board of Directors (the "Board") declared a third quarter dividend of \$0.37 per share to be paid on September 28, 2018 to shareholders of record as of September 14, 2018.

Credit Quality

- Impaired total mortgage ratio^{1,2} decreased significantly to 0.02% at June 30, 2018 from 0.10% at March 31, 2018.
- Impaired corporate mortgage ratio^{1,2} decreased to 0.03% at June 30, 2018 from 0.22% at March 31, 2018.
- Total mortgage arrears^{1,3} were \$21 million at June 30, 2018, compared to \$19 million at March 31, 2018. The June 30, 2018 balance consists entirely of single family mortgages, \$3.8 million of which were uninsured.
- Net write-offs were 10.6 basis points of the average corporate portfolio in Q2 2018 compared to 4.7 basis points in Q2 2017.
- Average loan to value ratio ("LTV") of our uninsured single family portfolio based on an industry index of current real estate values was 56.9% at June 30, 2018 compared to 53.1% at March 31, 2018.

Capital

- Common Equity Tier 1, Tier 1 and Total Capital to risk-weighted assets ratios¹ were 21.47% at June 30, 2018 compared to 21.29% at March 31, 2018.
- Leverage ratio¹ was 11.55% at June 30, 2018 compared to 11.74% at March 31, 2018.
- Income tax asset capacity¹ was \$293 million at June 30, 2018 compared to \$356 million at March 31, 2018. This balance represents the additional amount of corporate assets in which we could invest within the rules of the *Income Tax Act (Canada)* (the "Tax Act") that govern leverage for mortgage investment corporations.

¹ Considered to be a "Non-IFRS Measure". For further details, refer to the "Non-IFRS Measures" section of this MD&A.

² Represents impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.

³ The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.

OUTLOOK

Regulatory Changes

Effective January 1, 2018, significant changes were implemented to Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* by OSFI. While creating uncertainty in terms of the number of borrowers that qualify for new mortgages, these new stress tests provide for an improvement in the quality of newly originated mortgages. We estimate that the uninsured stress test has impacted approximately 10-15% of mortgages that we underwrite based on the borrower's ability to service the higher mortgage rates used in the stress test, and will continue to have some impact on the proportion of mortgages that we approve.

Real Estate Conditions

Canadian residential real estate markets continue to have a mixed performance as regional markets adjust to both regulatory changes and local economic conditions. We expect Canadian housing market conditions to experience volatility and uncertainty in 2018 and continue to face headwinds as consumers face a rising interest rate environment, making mortgages less affordable.

We expect home sale levels to partially recover in Ontario in the second half of the year as buyers adjust to the multiple rule changes. We have seen significant increases in the number of days that resale home listings are on the market and notable decreases in sales volumes. We expect to see some level of weakness in resale markets as markets adjust to fewer buyers. Similar to the Greater Vancouver Area ("GVA") market in 2017, the Greater Toronto Area ("GTA") market has experienced lower sales in the first half of 2018 as a result of the announced mortgage rule changes, and we expect to see some level of recovery in the second half of 2018.

We expect the GVA to experience reduced sales activity in the second half of 2018 as buyers become less active in the market, allowing the supply of homes for sale to accumulate to levels higher than the last few years. Notwithstanding the above, there continues to be a lack of inventory in this market, which has and which we believe will continue to push prices upward.

The Prairie Provinces are expected to continue to demonstrate stabilization following the strengthening of oil prices. We expect to see more lending opportunities in this market as conditions continue to improve.

Given the recent increase in unsold homes in the resale market that we have seen, we expect to observe some weakness in construction markets in the near future.

Impact on MCAN

MCAN has historically repositioned itself during times of uncertainty to adapt its portfolio to changing market dynamics. At this time, we have decided to reposition our mortgage portfolio to focus more on single family mortgages and less on construction lending over future periods, given the uncertainty in the housing market, the economy and related risk factors.

Our construction lending activity, as discussed in the "Risk Governance and Management" section of this MD&A, is considered a higher risk lending activity and we believe that it is prudent to moderate lending activities in this business segment as we are currently seeing sales levels and property values weaken in the construction housing market. Comparatively, we believe that the single family business provides a more moderate risk profile as we enter into more uncertain times with respect to the housing market and the economy as a whole. Accordingly, we will focus on further growth in uninsured single family origination volumes in comparison to the volumes from the past two years.

To assist with our single family growth plans, we have been reviewing the launch of new single family products through XMC Mortgage Corporation ("XMC") and we have recommenced our program of acquiring uninsured single family mortgages from third parties. Through MCAP and other originators, we have accelerated discussions to acquire additional single family mortgages.

Given the competitive market conditions for single family lending market and the recent regulatory changes related to OSFI Guideline B-20, we believe that there will be some challenge in originating adequate volumes to grow the single family portfolio. Additionally, we expect to experience competitive mortgage rate pressures in our single family lending business as we compete with other lenders for market share. As a result of this rebalancing, we expect to observe a reduction in historical spread levels and economics in our mortgage portfolio. We expect to add additional resources and invest in new systems to ensure that there are sufficient processes and monitoring in place to support this growth and rebalancing. Collectively, we believe that this strategy may impact our net interest margins, while at the same time we believe that it will increase the strength of our balance sheet and improve our internal operating capabilities.

Our corporate assets have increased by 3% year to date, compared to our stated annual growth target of 10%. After experiencing a 5% decrease in the first quarter of the year, our corporate balance sheet achieved growth of 8% during the second quarter. We maintain our stated annual growth target for corporate assets of 10% per annum, as we believe that this target provides our

shareholders with a measure of the long term expected pace of annual growth for the Company. As market conditions change, we may choose to deviate from this target to exercise prudent risk management, or should an appropriate opportunity arise, we may choose to exceed it. We currently have \$293 million of available income tax asset capacity to take advantage of market opportunities.

As uncertainty in the current market evolves, we believe that our strong capital position and asset capacity can be deployed if and when opportunities arise. Overall, we believe that our strategy in the near term is prudent given the current state of the economy and housing markets.

RESULTS OF OPERATIONS

Table 3: Net Income

(in thousands except for per share amounts)						
For the Periods Ended June 30	Q2 2018 ¹	Q2 2017	Change (%)	YTD 2018 ¹	YTD 2017	Change (%)
Net Investment Income - Corporate Assets						
Mortgage interest	\$ 12,867	\$ 12,095	6%	\$ 24,867	\$ 23,650	5%
Equity income from MCAP Commercial LP	3,194	3,818	(16%)	6,633	5,710	16%
Financial investments and other loans	267	301	(11%)	630	592	6%
Marketable securities	867	1,094	(21%)	1,745	1,940	(10%)
Fees	1,321	911	45%	2,875	5,174	(44%)
Interest on cash and cash equivalents	208	141	48%	495	299	66%
Unrealized gain (loss) on financial instruments ^{1,3}	3,341	-	-	3,285	-	-
	22,065	18,360	20%	40,530	37,365	8%
Term deposit interest and expenses	5,643	5,136	10%	10,890	10,157	7%
Mortgage expenses	1,024	995	3%	1,975	1,954	1%
Interest on loans payable	96	4	2,300%	116	36	222%
Provision for credit losses ^{1,2}	239	46	420%	413	76	443%
	7,002	6,181	13%	13,394	12,223	10%
	15,063	12,179	24%	27,136	25,142	8%
Other Income - Corporate Assets						
Gain on sale of investment in MCAP Commercial LP	-	-	-	1,701	785	117%
Gain on dilution of investment in MCAP Commercial LP	-	-	-	-	91	(100%)
	-	-	-	1,701	876	94%
Net Investment Income - Securitization Assets						
Mortgage interest	6,375	7,021	(9%)	12,868	13,793	(7%)
Other securitization income	23	37	(38%)	95	73	30%
	6,398	7,058	(9%)	12,963	13,866	(7%)
Interest on financial liabilities from securitization	4,558	5,147	(11%)	9,239	10,158	(9%)
Mortgage expenses	534	537	(1%)	1,102	1,043	6%
Provision for credit losses ^{1,2}	(11)	-	-	4	-	-
	5,081	5,684	(11%)	10,345	11,201	(8%)
	1,317	1,374	(4%)	2,618	2,665	(2%)
Operating Expenses						
Salaries and benefits	3,179	2,589	23%	6,124	5,183	18%
General and administrative	1,963	2,027	(3%)	3,649	4,050	(10%)
	5,142	4,616	11%	9,773	9,233	6%
Net income before income taxes	11,238	8,937	26%	21,682	19,450	11%
Provision for (recovery of) income taxes	113	(1)	(11,400%)	(58)	247	(123%)
Net Income	\$ 11,125	\$ 8,938	25%	\$ 21,740	\$ 19,203	13%
Basic and diluted earnings per share	\$ 0.47	\$ 0.39	21%	\$ 0.92	\$ 0.83	11%
Dividends per share	\$ 0.37	\$ 0.32	16%	\$ 0.74	\$ 0.62	19%

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

² Under IFRS 9, the methodology for the calculation of mortgage allowances and provisions has changed from IAS 39, therefore provisions under IFRS 9 are not directly comparable to prior periods.

³ Under IFRS 9, fair value changes in certain reclassified financial assets are presented in the income statement and are therefore not directly comparable to prior periods. Under IAS 39, these fair value changes were recorded through other comprehensive income.

Net Investment Income - Corporate Assets

Mortgage interest income

Table 4: Interest Income and Average Rate by Mortgage Portfolio - Q2

For the Quarters Ended June 30 (in thousands except %)	2018			2017		
	Average Balance	Interest Income	Average Rate ¹	Average Balance	Interest Income	Average Rate ¹
Single family						
- Uninsured	\$ 203,052	\$ 2,356	4.65%	\$ 225,513	\$ 2,581	4.51%
- Insured	94,847	734	3.10%	81,653	742	3.63%
- Uninsured - completed inventory	12,065	159	5.29%	41,401	507	4.90%
Construction loans						
- Residential	440,870	7,076	6.44%	400,166	5,542	5.55%
- Non residential	5,291	77	5.87%	7,188	93	5.18%
Commercial loans						
- Multi family residential	74,034	1,014	5.43%	45,475	504	4.44%
- Other commercial	82,753	1,451	7.05%	112,564	2,126	7.58%
Mortgages - corporate portfolio	\$ 912,912	\$ 12,867	5.65%	\$ 913,960	\$ 12,095	5.28%
Term deposits	856,680	5,643	2.48%	872,198	5,136	2.21%
Spread of mortgages over term deposits			3.17%			3.07%
Mortgages - securitized portfolio	\$ 985,757	\$ 6,375	2.59%	\$ 1,057,298	\$ 7,021	2.67%
Financial liabilities from securitization	997,584	4,558	1.83%	1,071,719	5,147	1.93%
Spread of mortgages over liabilities			0.76%			0.74%

¹ Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Non-recurring items were immaterial for the quarters ended June 30, 2018 and June 30, 2017. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

The Bank of Canada announced two 0.25% increases in the overnight rate in the second half of 2017 and a third during Q1 2018. We expect these increases, in addition to a further 0.25% increase announced subsequent to quarter end, to have a positive impact on future mortgage interest income related to the floating rate component of our corporate mortgage portfolio. These rate increases contributed 0.68% and 0.42%, respectively, to the average interest rate for the construction and total corporate portfolios in Q2 2018, as approximately 85% and 50% of those respective portfolios were floating rate as at June 30, 2018 and repriced following the rate increases.

In Q2 2018 we also recognized additional corporate mortgage interest income from the acceleration of mortgage commitment fee amortization on the early payout of certain completed inventory, construction and commercial loans, which contributed 0.18% to the increase in the average interest rate from Q2 2017.

During Q2 2017 we earned \$0.3 million of non-recurring discount income on the payout of a construction loan. Excluding this discount income, the average yield on the corporate portfolio was 5.13% and the construction portfolio average yield was 5.21%. During Q2 2018 we did not earn any discount income.

Our construction portfolio grew steadily in Q2 2018, as we experienced seasonal growth in the second quarter. We generally target experienced builders in markets with favourable economic activity while ensuring that any new lending fits within our risk appetite and corporate strategy. Construction lending is based on specific loan covenants required to be satisfied prior to funding (e.g. pre-sales), which act as a risk mitigant given concerns about inflated valuations in certain real estate markets.

Our commercial loan portfolio levelled off during Q2 2018 after experiencing steady growth in the past few quarters. This portfolio provides a different risk profile from single family while providing appropriate risk-adjusted returns. The majority of the growth since 2017 has been in the multi family residential lending category, which carries a lower risk profile as it is secured by collateral such as apartment buildings.

During 2018, we have experienced a significant decrease in the completed inventory portfolio as certain loans paid out after the sale and closing of completed units. This portfolio balance can be volatile given the short-term nature of completed inventory

loans, which generally represent loans that have been transferred from the residential construction portfolio upon the substantial completion of housing units.

Our uninsured single family portfolio, while down from Q2 2017, has remained consistent for several quarters and increased slightly during Q2 2018. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market and have steadily increased origination volumes to maintain our portfolio balance. We funded \$11 million from external sources during Q2 2018.

Our combined insured and uninsured single family origination volumes increased by \$38 million from Q2 2017. During Q2 2018 we securitized insured single family mortgages through the NHA MBS program, however we retained the MBS on our corporate balance sheet for liquidity purposes instead of selling it to a third party.

The adoption of OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* effective January 1, 2018 has impacted the proportion of mortgages that we underwrite based on the borrower's ability to service the higher mortgage rates. These new stress tests provide for an improvement in the quality of newly originated mortgages.

Average mortgage portfolio yield is a non-IFRS measure. For a definition of this measure, refer to the "Non-IFRS Measures" section of this MD&A.

Equity income from MCAP

The decrease in equity income from MCAP from Q2 2017 was a result of lower net income from securitized mortgages, lower origination income and a higher origination fee expense, partially offset by lower operating expenses and higher hedge gains.

We recognize equity income from MCAP on a one-month lag such that our Q2 2018 equity income from MCAP is based on MCAP's net income for the quarter ended May 31, 2018. For further information on our equity investment in MCAP, refer to the "Equity investment in MCAP" sub-section of the "Financial Position" section of this MD&A.

Other net investment income

The change in the average term deposit balance is generally similar to that of the average corporate mortgage portfolio in that we use term deposits to fund our corporate assets. We issue term deposits that are eligible for Canada Deposit Insurance Corporation ("CDIC") deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor. For further details, refer to the "Liquidity Management" section of this MD&A.

Mortgage expenses consist primarily of mortgage servicing fees paid to external mortgage servicers.

Details of the provision for (recovery of) credit losses are discussed in the "Credit Quality" sub-section below.

For further information on corporate and securitization net investment income, refer to the "Net Interest Income" sub-section below.

Other Income - Corporate Assets

The Q2 2018 unrealized gain on financial instruments was comprised of \$1.3 million relating to marketable securities and \$2.0 million on our investment in the Crown Realty II Limited Partnership ("Crown LP"). Fair value changes in the investment in Crown LP are primarily driven by changes in the fair value of the properties held within Crown LP.

Net Investment Income - Securitization Assets

Net investment income from securitization assets relates to our participation in the market MBS program and CMB program, which involve the securitization of insured mortgages through the Canada Mortgage and Housing Corporation ("CMHC") NHA MBS program. In Q2 2018, our total securitization volumes were \$46 million (Q2 2017 - \$14 million). For further details on these programs, refer to the "Securitization Programs" section of this MD&A.

Market MBS Program

The average outstanding market MBS program mortgage balance decreased to \$842 million in Q2 2018 from \$921 million in Q2 2017, while the net spread increased to 0.79% from 0.75%. New market MBS and CMB program securitization volumes have been low since 2017.

CMB Program

The average outstanding CMB program mortgage balance increased to \$143 million in Q2 2018 from \$136 million in Q2 2017, while the net spread was unchanged at 0.61%.

Table 5: Interest Income and Average Rate by Mortgage Portfolio

For the Six Months Ended June 30	2018			2017		
	Average Balance	Interest Income	Average Rate ¹	Average Balance	Interest Income	Average Rate ¹
(in thousands except %)						
Single family						
- Uninsured	\$ 201,605	\$ 4,672	4.65%	\$ 234,547	\$ 5,366	4.51%
- Insured	80,504	1,269	3.16%	93,889	1,583	3.37%
- Uninsured - completed inventory	14,675	404	5.55%	31,335	811	5.22%
Construction loans						
- Residential	417,628	13,218	6.38%	394,804	10,714	5.46%
- Non residential	4,698	137	5.89%	7,522	198	5.31%
Commercial loans						
- Multi family residential	73,638	1,953	5.35%	40,169	892	4.47%
- Other commercial	88,147	3,214	7.34%	108,869	4,086	7.57%
Mortgages - corporate portfolio	\$ 880,895	\$ 24,867	5.68%	\$ 911,135	\$ 23,650	5.20%
Term deposits	847,250	10,890	2.43%	870,088	10,157	2.21%
Spread of mortgages over term deposits			3.25%			2.99%
Mortgages - securitized portfolio	\$ 1,000,459	\$ 12,868	2.58%	\$ 1,054,785	\$ 13,793	2.64%
Financial liabilities from securitization	1,010,581	9,239	1.83%	1,066,396	10,158	1.92%
Spread of mortgages over liabilities			0.75%			0.72%

¹ Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Non-recurring items were immaterial for the six months ended June 30, 2018 and June 30, 2017. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Net Interest Income

Presented in the following tables is an analysis of average rates and net interest income. Net interest income is the difference between interest earned on certain assets and the interest paid on liabilities to fund those assets. For further details, refer to the “Non-IFRS Measures” section of this MD&A.

Table 6: Net Interest Income - Q2

For the Quarters Ended June 30 (in thousands except %)	2018			2017		
	Average Balance ¹	Income / Expense	Average Rate ³	Average Balance ¹	Income / Expense	Average Rate ³
Assets						
Cash and cash equivalents	\$ 72,074	\$ 208	1.16%	\$ 74,568	\$ 141	0.76%
Mortgages - corporate	912,912	12,867	5.65%	913,960	12,095	5.28%
Other loans	2,505	34	5.44%	3,745	47	5.05%
Corporate interest earning assets	987,491	13,109	5.32%	992,273	12,283	4.98%
Cash held in trust	17,095	57	1.34%	18,833	11	0.23%
Mortgages - securitized	985,757	6,375	2.59%	1,057,298	7,021	2.67%
Securitization interest earning assets	1,002,852	6,432	2.57%	1,076,131	7,032	2.63%
Total interest earning assets	\$ 1,990,343	\$ 19,541	3.94%	\$ 2,068,404	\$ 19,315	3.76%
Liabilities						
Term deposits	\$ 856,680	\$ 5,643	2.48%	\$ 872,198	\$ 5,136	2.21%
Loans payable	9,187	96	4.19%	385	4	3.13%
Corporate liabilities	865,867	5,739	2.51%	872,583	5,140	2.21%
Securitization liabilities	997,584	4,558	1.83%	1,071,719	5,147	1.93%
Total interest bearing liabilities	\$ 1,863,451	\$ 10,297	2.21%	\$ 1,944,302	\$ 10,287	2.07%
Net Interest Income²		\$ 9,244			\$ 9,028	

¹ The average balances (excluding cash and cash equivalents, mortgages and term deposits) are calculated with reference to opening and closing monthly balances and as such may not be as precise as if daily balances were used. The average cash and cash equivalents, mortgage and term deposit balances are calculated using daily balances.

² Net interest income is equal to net investment income less equity income from MCAP, income from financial investments, marketable securities income, fees, unrealized gain/loss on financial instruments, other securitization income, mortgage expenses and provision for credit losses. Net interest income is a non-IFRS measure. Refer to the “Non-IFRS Measures” section of this MD&A for a definition of this measure.

³ Average rate is equal to income/expense divided by the average balance on an annualized basis. The average rate as presented may not necessarily be equal to “Income/Expense” divided by “Average Balance”, as non-recurring items such as discount income, one-time gains/losses, asset write-downs and fees not associated with the asset/liability yield are excluded from the calculation of the average rate. Non-recurring items were immaterial for the quarters ended June 30, 2018 and June 30, 2017. Average rate is considered to be a non-IFRS measure. Refer to the “Non-IFRS Measures” section of this MD&A for a definition of this measure.

Table 7: Net Interest Income - YTD

For the Six Months Ended June 30 (in thousands except %)	2018			2017		
	Average Balance ¹	Income / Expense	Average Rate ³	Average Balance ¹	Income / Expense	Average Rate ³
Assets						
Cash and cash equivalents	\$ 89,200	\$ 495	1.12%	\$ 77,768	\$ 289	0.75%
Mortgages - corporate	880,895	24,867	5.68%	911,135	23,650	5.20%
Other loans	2,526	68	5.43%	3,709	93	5.07%
Corporate interest earning assets	972,621	25,430	5.27%	992,612	24,032	4.88%
Cash held in trust	14,845	106	1.44%	15,905	21	0.27%
Mortgages - securitized	1,000,459	12,868	2.58%	1,054,785	13,793	2.64%
Securitization interest earning assets	1,015,304	12,974	2.58%	1,070,690	13,814	2.60%
Total interest earning assets	\$ 1,987,925	\$ 38,404	3.90%	\$ 2,063,302	\$ 37,846	3.70%
Liabilities						
Term deposits	\$ 847,250	\$ 10,890	2.43%	\$ 870,088	\$ 10,157	2.21%
Loans payable	5,564	116	4.20%	2,077	36	3.50%
Corporate liabilities	852,814	11,006	2.45%	872,165	10,193	2.21%
Securitization liabilities	1,010,581	9,239	1.83%	1,066,396	10,158	1.92%
Total interest bearing liabilities	\$ 1,863,395	\$ 20,245	2.17%	\$ 1,938,561	\$ 20,351	2.07%
Net Interest Income²		\$ 18,159			\$ 17,495	

¹ The average balances (excluding cash and cash equivalents, mortgages and term deposits) are calculated with reference to opening and closing monthly balances and as such may not be as precise as if daily balances were used. The average cash and cash equivalents, mortgage and term deposit balances are calculated using daily balances.

² Net interest income is equal to net investment income less equity income from MCAP, income from financial investments, marketable securities income, fees, unrealized gain/loss on financial instruments, other securitization income, mortgage expenses and provision for credit losses. Net interest income is a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

³ Average rate is equal to income/expense divided by the average balance on an annualized basis. The average rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income, one-time gains/losses, asset write-downs and fees not associated with the asset/liability yield are excluded from the calculation of the average rate. Non-recurring items were immaterial for the six months ended June 30, 2018 and June 30, 2017. Average rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Credit Quality

Table 8: Provisions for Credit Losses and Write-offs

(in thousands except basis points)						
For the Periods Ended June 30	Q2 2018	Q2 2017	Change (%)	YTD 2018	YTD 2017	Change (%)
Provision (recovery) on impaired corporate mortgages ¹						
Single family uninsured	\$ 90	\$ (65)	(239%)	\$ 154	\$ 29	431%
Provision (recovery) on performing corporate mortgages ²						
Single family insured	11	-	-	10	-	-
Single family uninsured	706	(66)	(1,170%)	738	(147)	(602%)
Single family uninsured - completed inventory	8	144	(94%)	(344)	182	(289%)
Construction						
Commercial	(52)	82	(163%)	86	163	(47%)
Multi family residential	(79)	58	(236%)	58	67	(13%)
Other commercial	(408)	(2)	20,300%	(237)	(112)	112%
	186	216	(14%)	311	153	103%
Other provisions (recoveries)	(37)	(105)	(65%)	(52)	(106)	(51%)
Corporate provision for credit losses	239	46	420%	413	76	443%
Provision (recovery) on performing securitized mortgages ²	(11)	-	-	4	-	-
Total provisions for credit losses, net	\$ 228	\$ 46	396%	\$ 417	\$ 76	449%
Corporate mortgage portfolio data:						
Provisions for credit losses, net	\$ 276	\$ 151	83%	\$ 465	\$ 182	156%
Net write offs	\$ 243	\$ 107	127%	\$ 256	\$ 377	(32%)
Net write offs (basis points)	10.6	4.7	127%	5.8	8.3	(30%)

¹ Represents impaired (stage 3) provision for credit losses on mortgages and mortgage commitments under IFRS 9 and individual provisions for credit losses under IAS 39.

² Represents performing (stage 1 and 2) provision for credit losses on mortgages and mortgage commitments under IFRS 9 and collective provisions for credit losses under IAS 39.

The significant increase in the general provision on the uninsured single family portfolio relates to an increased allowance taken on the Alberta and Saskatchewan geographical sub-segment of this portfolio during Q2 2018. The recovery of the general provision on the commercial portfolio was largely driven by a reduction in the portfolio balance.

Write-offs in all periods presented above relate entirely to uninsured single family mortgages, except for 2017 year to date which includes a \$220,000 construction loan.

Table 9: Operating Expenses

(in thousands)						
For the Periods Ended June 30	Q2 2018	Q2 2017	Change (%)	YTD 2018	YTD 2017	Change (%)
Salaries and benefits	\$ 3,179	\$ 2,589	23%	\$ 6,124	\$ 5,183	18%
General and administrative	1,963	2,027	(3%)	3,649	4,050	(10%)
	\$ 5,142	\$ 4,616	11%	\$ 9,773	\$ 9,233	6%

The increase in salaries and benefits is a result of an increase in the number of employees from 2017. Our headcount has increased since 2017 as we have continued to expand our risk management and corporate governance departments.

General and administrative expenses have decreased since 2017 as a result of expenditures associated with the development of systems and processes related to single family mortgage operations. In recent years, we have undertaken multiple projects to improve governance and mitigate risk, the volume of which was higher in 2017.

Provision for Income Taxes

Table 10: Income Taxes

(in thousands)							
For the Periods Ended June 30	Q2 2018	Q2 2017	Change (%)	YTD 2018	YTD 2017	Change (%)	
Current tax provision (recovery)	\$ 457	\$ -	-	\$ 457	\$ -	-	
Deferred tax provision (recovery)	(344)	(1)	34,300%	(515)	247	(309%)	
	\$ 113	\$ (1)	(11,400%)	\$ (58)	\$ 247	(124%)	

The current tax provision recorded during Q2 2018 relates to estimated current taxes payable in a subsidiary of MCAN as a result of taxable income earned from the sale of properties within the Crown LP investment. This current tax provision is largely offset by a corresponding recovery of deferred taxes from the investment in Crown LP.

As at June 30, 2018, we had \$8 million of losses available for carry-forward in the MCAN mortgage investment corporation ("MIC") parent company on a non-consolidated basis (March 31, 2018 - \$11 million). The benefit of these loss carry-forwards are not reflected in deferred taxes due to the fact that we have the ability to pay sufficient dividends in current and future years to ensure that we are not subject to income taxes in the MIC entity. For further information, refer to Notes 4 and 14 to the consolidated financial statements.

Taxable Income

The table below provides a reconciliation between net income for accounting purposes and taxable income. The adjustments below represent the difference between the individual components of net income for accounting and tax purposes. Taxable income is presented on a non-consolidated basis and does not incorporate taxable income from XMC and other subsidiaries as it does not directly impact MCAN's non-consolidated taxable income.

As a MIC, we typically pay out all of our taxable income to shareholders through dividends as our MIC status allows us to deduct dividends paid within 90 days of year end from taxable income. MCAN's dividend objective is to provide shareholders with a consistent and stable regular dividend, wherein dividend changes over time follow MCAN's long term growth. From quarter to quarter, timing differences between taxable income and accounting income are considered by the Board in the determination of the quarterly dividend.

Dividends that are deducted in the calculation of taxable income are not included in the table below.

Taxable income is considered to be a non-IFRS measure. For further details, refer to the "Non-IFRS Measures" section of this MD&A.

Table 11: Taxable Income Reconciliation ¹

(in thousands)	Q2 2018	Q2 2017	YTD 2018	YTD 2017
For the Periods Ended June 30				
Net income for accounting purposes	\$ 11,125	\$ 8,938	\$ 21,740	\$ 19,203
Adjustments:				
Deduct: Equity income from MCAP - accounting purposes	(3,194)	(3,818)	(6,633)	(5,710)
Add: MCAP taxable income	4,143	3,117	406	5,404
Provision for (recovery of) credit losses ²	167	190	312	109
Amortization of upfront securitization program costs ³	1,764	1,686	3,536	3,347
Securitization program mortgage origination costs ³	(698)	(489)	(1,017)	(1,212)
Unrealized gain on financial instruments ²	(1,304)	-	(729)	-
Equity income from subsidiaries ²	(1,411)	496	(1,803)	(1,396)
Deduct: Accounting gain on partial sale of MCAP ⁴	-	-	(1,701)	(785)
Add: Taxable gain on partial sale of MCAP ⁴	-	-	1,425	537
Gain on dilution of investment in MCAP ²	-	-	-	(91)
Other securitization program cash outflows	-	(67)	(269)	(649)
Other items	679	(165)	475	(23)
	\$ 11,271	\$ 9,888	\$ 15,742	\$ 18,734

¹ Taxable income is presented above on a non-consolidated basis for the MIC entity. The current year amounts presented above represent estimates as they are not finalized until the completion of our corporate tax filings.

² Not deductible/recognizable in the calculation of taxable income. Individual mortgage allowances are 90% deductible for tax purposes.

³ Deductible in full for tax purposes as mortgages securitized; capitalized and amortized for accounting purposes, however amortization is added back in calculation of taxable income.

⁴ For tax purposes, the accounting gain is excluded and only 50% of the taxable gain is included.

The increase in taxable income in Q2 2018 over Q2 2017 was generally consistent with the increase in accounting income, incorporating adjustments for unrealized gains on financial instruments, equity income from subsidiaries and taxable income from MCAP. For 2018 year to date, the significant decrease in taxable income was driven primarily by timing differences between accounting and taxable income in respect of a number of securitization transactions that MCAP completed during 2018. These timing differences are expected to reverse over the duration of the associated transactions.

In Q2 2018, we incurred \$0.7 million of origination costs on securitized mortgages (including market MBS held by MCAN) (Q2 2017 - \$0.5 million). These costs are deductible for income tax purposes in the period that the mortgages are securitized, while for accounting purposes they are capitalized and amortized over the term of the associated mortgages.

As at June 30, 2018, the unamortized origination fee balance was \$10.1 million (March 31, 2018 - \$10.8 million), which represents costs that are still to be expensed for non-consolidated accounting purposes but will be added back in the calculation of taxable income in future periods.

Table 12: Quarterly Net Income

(in thousands except per share amounts and %)				
For the Quarters Ended	June 30 2018	March 31 2018	Change from Prior Quarter (\$)	
				(%)
Net Investment Income - Corporate Assets				
Mortgage interest	\$ 12,867	\$ 12,000	\$ 867	7%
Equity income from MCAP Commercial LP	3,194	3,439	(245)	(7%)
Financial investments and other loans	1,321	1,554	(233)	(15%)
Marketable securities	867	878	(11)	(1%)
Fees	267	363	(96)	(26%)
Interest on cash and cash equivalents	208	287	(79)	(28%)
Unrealized gain (loss) on financial instruments	3,341	(56)	3,397	(6,066%)
	22,065	18,465	3,600	19%
Term deposit interest and expenses	5,643	5,247	396	8%
Mortgage expenses	1,024	951	73	8%
Interest on loans payable	96	20	76	380%
Provision for credit losses	239	174	65	37%
	7,002	6,392	610	10%
	15,063	12,073	2,990	25%
Other Income - Corporate Assets				
Gain on sale of investment in MCAP Commercial LP	-	1,701	(1,701)	(100%)
	-	1,701	(1,701)	(100%)
Net Investment Income - Securitization Assets				
Mortgage interest	6,375	6,493	(118)	(2%)
Other securitization income	23	72	(49)	(68%)
	6,398	6,565	(167)	(3%)
Interest on financial liabilities from securitization	4,558	4,681	(123)	(3%)
Mortgage expenses	534	568	(34)	(6%)
Provision for (recovery of) credit losses	(11)	15	(26)	(173%)
	5,081	5,264	(183)	(3%)
	1,317	1,301	16	1%
Operating Expenses				
Salaries and benefits	3,179	2,945	234	8%
General and administrative	1,963	1,686	277	16%
	5,142	4,631	511	11%
Net Income Before Income Taxes	11,238	10,444	794	8%
Provision for (recovery of) income taxes	113	(171)	284	(166%)
Net Income	\$ 11,125	\$ 10,615	\$ 510	5%
Basic and diluted earnings per share	\$ 0.47	\$ 0.45	\$ 0.02	4%
Dividends per share	\$ 0.37	\$ 0.37	\$ -	-

Q2 2018 vs. Q1 2018

Net Investment Income - Corporate Assets

Table 13: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

For the Quarters Ended (in thousands except %)	June 30, 2018			March 31, 2018		
	Average Balance	Interest Income	Average Rate ¹	Average Balance	Interest Income	Average Rate ¹
Single family						
- Uninsured	\$ 203,052	\$ 2,356	4.65%	\$ 200,142	\$ 2,315	4.65%
- Insured	94,847	734	3.10%	66,001	535	3.26%
- Uninsured - completed inventory	12,065	159	5.29%	17,314	245	5.73%
Construction loans						
- Residential	440,870	7,076	6.44%	394,128	6,140	6.32%
- Non residential	5,291	77	5.87%	4,098	60	5.91%
Commercial loans						
- Multi family residential	74,034	1,014	5.43%	73,238	951	5.27%
- Other commercial	82,753	1,451	7.05%	93,602	1,754	7.61%
Mortgages - corporate portfolio	\$ 912,912	\$ 12,867	5.65%	\$ 848,523	\$ 12,000	5.72%
Term deposits	856,680	5,643	2.48%	837,715	5,247	2.38%
Spread of mortgages over term deposits			3.17%			3.34%
Mortgages - securitized portfolio	\$ 985,757	\$ 6,375	2.59%	\$ 1,015,325	\$ 6,493	2.57%
Financial liabilities from securitization	997,584	4,558	1.83%	1,023,721	4,681	1.83%
Spread of mortgages over liabilities			0.76%			0.74%

¹ Average interest rate is equal to income/expense divided by the average balance on an annualized basis. The average interest rate as presented may not necessarily be equal to "Income/Expense" divided by "Average Balance", as non-recurring items such as discount income, deferred interest and prior period adjustments are excluded from the calculation of the average interest rate as applicable. Non-recurring items were immaterial for the quarters ended June 30, 2018 and March 31, 2018. Average interest rate is considered to be a non-IFRS measure. Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

Changes in the average balances for individual portfolios are consistent with the analysis in the "Mortgage Interest Income" sub-section of the "Net Investment Income - Corporate Assets" section of this MD&A.

Equity income from MCAP decreased slightly from Q1 2018 due to increased origination expense and provision for income taxes, partially offset by higher securitization net interest income and origination fee income. Equity income from MCAP is discussed further in the "Net Investment Income - Corporate Assets" section of this MD&A.

For a discussion of the Q2 2018 unrealized gain on financial instruments, refer to the "Other Income" sub-section of the "Results of Operations" section of this MD&A. In Q1 2018 there was minimal change to the asset fair values.

During Q1 2018 we sold 200,000 partnership units in MCAP at a price of \$22.60 per unit (compared to a net book value of \$14.10 per unit), recognizing a gain on sale of \$1.7 million.

For a discussion of operating expenses, refer to the "Operating Expenses" sub-section of the "Results of Operations" section of this MD&A.

For a discussion of current and deferred taxes, refer to the "Provision for Income Taxes" sub-section of the "Results of Operations" section of this MD&A.

Cash Flows

Operating activities used cash flows of \$9 million in 2018 and provided \$11 million in 2017. In 2018, we had higher net outflows related to mortgages and financial liabilities from securitization.

Investing activities provided cash flows of \$10 million in 2018 and provided \$4 million in 2017. In 2018, we had higher net inflows related to distributions from MCAP. In addition, we received proceeds from a partial sale of our equity investment in MCAP of \$4.5 million in 2018.

Financing activities used cash flows of \$21 million in 2018 and used \$18 million in 2017. In 2018, there was an increase in outflows from dividends paid.

FINANCIAL POSITION

Table 14: Assets

(in thousands except %)					
As at	June 30 2018 ¹	March 31 2018 ¹	December 31 2017	Change from Prior Quarter (\$) (%)	
Corporate Assets					
Cash and cash equivalents	\$ 96,985	\$ 62,463	\$ 117,571	\$ 34,522	55%
Marketable securities	58,534	61,429	62,518	(2,895)	(5%)
Mortgages	919,053	859,372	863,384	59,681	7%
Financial investments	70,191	73,446	68,190	(3,255)	(4%)
Other loans	2,426	2,655	2,612	(229)	(9%)
Equity investment in MCAP Commercial LP	57,954	56,398	59,189	1,556	3%
Foreclosed real estate	435	435	435	-	-
Deferred tax asset	3,005	2,874	2,672	131	5%
Other assets	3,495	2,734	5,800	761	28%
	1,212,078	1,121,806	1,182,371	90,272	8%
Securitization Assets					
Cash held in trust	25,740	15,073	13,441	10,667	71%
Mortgages	964,507	1,013,036	1,016,724	(48,529)	(5%)
Other assets	3,745	3,969	4,239	(224)	(6%)
	993,992	1,032,078	1,034,404	(38,086)	(4%)
	\$ 2,206,070	\$ 2,153,884	\$ 2,216,775	\$ 52,186	2%

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

Mortgages - Corporate & Securitized

Table 15: Mortgage Summary

(in thousands)					
As at	June 30 2018	March 31 2018	December 31 2017	Change from Prior Quarter (\$) (%)	
Corporate portfolio:					
Single family mortgages					
- Uninsured	\$ 203,897	\$ 196,624	\$ 198,354	\$ 7,273	4%
- Insured	125,330	75,698	80,377	49,632	66%
- Uninsured - completed inventory	9,314	7,410	51,190	1,904	26%
Construction loans					
- Residential	429,855	404,987	386,562	24,868	6%
- Non-residential	5,496	5,014	4,840	482	10%
Commercial loans					
- Multi family residential	73,830	73,026	64,655	804	1%
- Other commercial	71,331	96,613	77,406	(25,282)	(26%)
	919,053	859,372	863,384	59,681	7%
Securitized portfolio:					
Single family insured - Market MBS program	821,807	867,149	867,406	(45,342)	(5%)
Single family insured - CMB program	142,700	145,887	149,318	(3,187)	(2%)
	964,507	1,013,036	1,016,724	(48,529)	(5%)
	\$ 1,883,560	\$ 1,872,408	\$ 1,880,108	\$ 11,152	1%

Corporate and Securitized Mortgage Portfolio Analysis

Q2 2018 Summary

Our construction portfolio continued to grow steadily in Q2 2018, in line with the seasonal nature of the portfolio. We generally target experienced builders in markets with favourable economic activity while ensuring that any new lending fits within our risk appetite and corporate strategy. Construction lending is based on specific loan covenants required to be satisfied prior to funding (e.g. pre-sales), which act as a risk mitigant given concerns about inflated valuations in certain real estate markets.

During Q2 2018 we experienced a levelling off of our commercial loan portfolio, which provides a different risk profile from single family while providing appropriate risk-adjusted returns. Within this portfolio we have focused on the lower-risk segments, such as loans secured by apartment buildings, which we believe represent good lending opportunities in a slowing single family market as they are counter-cyclical to home sales.

The uninsured single family portfolio balance has remained steady over the last several quarters. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market. We have recommenced external acquisition programs for uninsured single family mortgages from MCAP and another third party origination source to earn attractive risk-adjusted returns and deploy excess balance sheet capacity.

The adoption of OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* effective January 1, 2018 has impacted the proportion of mortgages that we underwrite based on the borrower's ability to service the higher mortgage rates. These new stress tests provide for an improvement in the quality of newly originated mortgages.

Our insured single family portfolio increased significantly during Q2 2018. Origination volumes increased from the prior quarter, and additionally we issued \$46 million of market MBS that we retained on our corporate balance sheet to strengthen our liquidity position amidst current uncertainty in housing markets. These mortgages remain in the insured single family corporate mortgage classification since the transaction associated with the retention of MBS fails mortgage derecognition criteria under IFRS. The impact of multiple changes to mortgage regulations enacted within the last two years have made this market segment more competitive and have also led to reduced securitization economics.

Figure 1: Total Corporate and Securitized Mortgage Portfolio (in thousands)

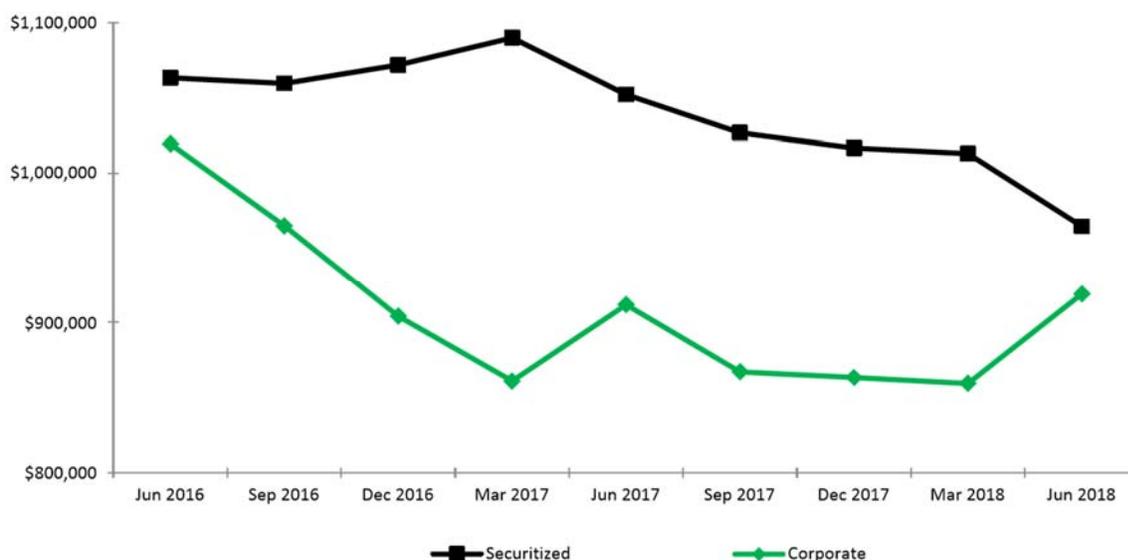
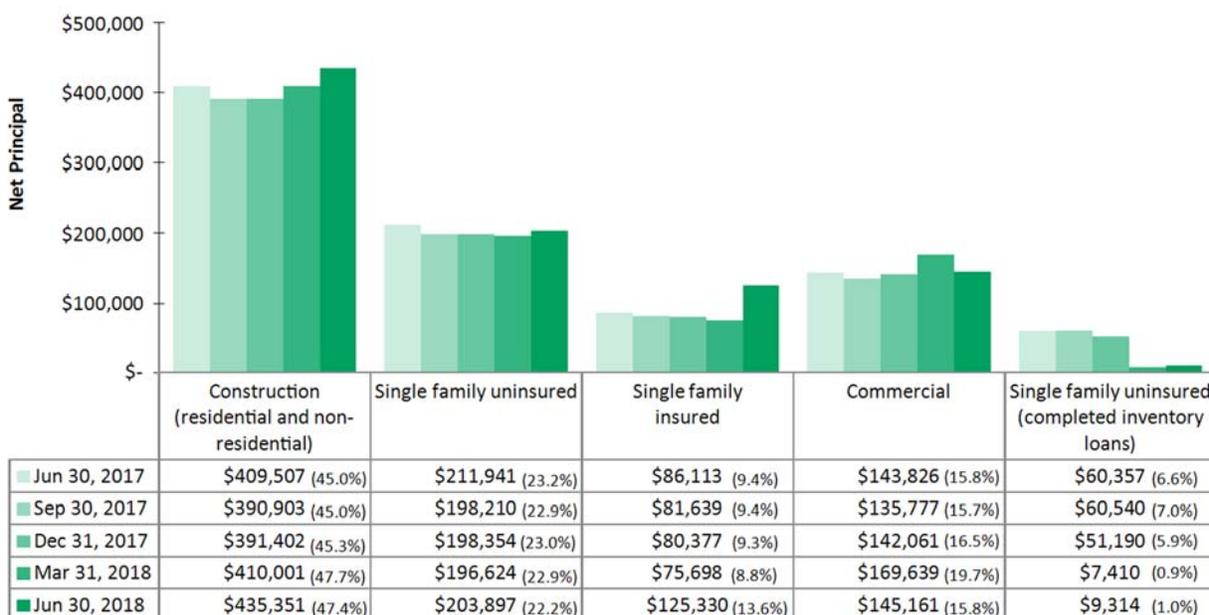
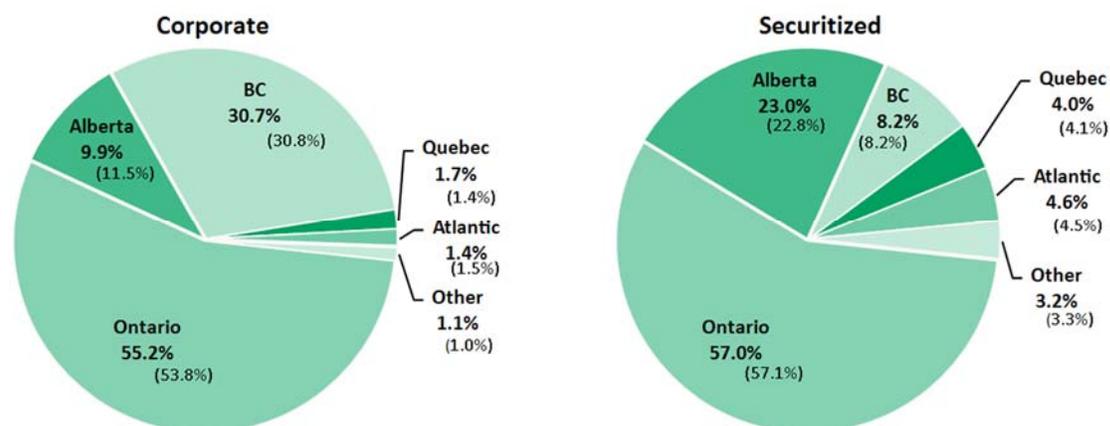


Figure 2: Corporate Mortgage Portfolio Composition by Product Type (in thousands)



Note: Amounts in parentheses represent the percentage of the corporate portfolio represented by the individual mortgage portfolio. Commercial consists of commercial - multi family residential and commercial - other.

Figure 3: Mortgage Portfolio Geographic Distribution as at June 30, 2018 (March 31, 2018)



Arrears and Impaired Mortgages

Table 16: Arrears and Impaired Mortgages

(in thousands except %)	IFRS 9 June 30 2018	IFRS 9 March 31 2018	Change (%)	IAS 39 December 31 2017
As at				
Impaired mortgages ²				
Corporate				
Single family - uninsured	\$ 292	\$ 1,873	(84%)	\$ 1,696
Single family - insured	1,939	1,945	(0%)	832
	2,231	3,818	(42%)	2,528
Securitized	1,458	966	51%	-
Total impaired mortgages	\$ 3,689	\$ 4,784	(23%)	\$ 2,528
Impaired mortgage ratio (total) ¹	0.02%	0.10%	(0.08%)	0.09%
Impaired mortgage ratio (corporate) ¹	0.03%	0.22%	(0.19%)	0.20%
Mortgage arrears ⁵				
Corporate				
Single family - uninsured	\$ 3,813	\$ 6,978	(45%)	\$ 5,912
Single family - insured	2,926	2,226	32%	2,854
Total corporate mortgage arrears ¹	6,739	9,204	(27%)	8,766
Total securitized mortgage arrears ¹	13,979	9,554	46%	8,803
Total mortgage arrears ¹	\$ 20,718	\$ 18,758	10%	\$ 17,569
Allowance for credit losses				
Corporate				
Allowance on performing mortgages ³	\$ 5,040	\$ 4,865	4%	\$ 4,748
Allowance on impaired mortgages ⁴	31	173	(82%)	62
	5,071	5,038	1%	4,810
Securitized - allowance on performing mortgages ³	21	32	(34%)	-
Total allowance for credit losses	\$ 5,092	\$ 5,070	0%	\$ 4,810

¹ Refer to the "Non-IFRS Measures" section of this MD&A for a definition of this measure.

² Represents impaired (stage 3) mortgages under IFRS 9 and impaired mortgages under IAS 39.

³ Represents performing (stage 1 and 2) allowances for credit losses on mortgages and mortgage commitments under IFRS 9 and collective allowances for credit losses under IAS 39.

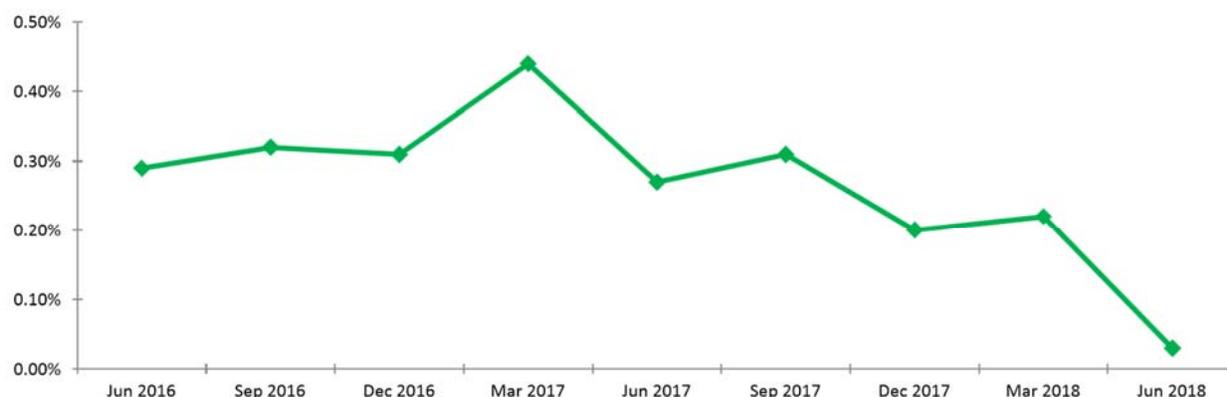
⁴ Represents impaired (stage 3) allowances for credit losses on mortgages and mortgage commitments under IFRS 9 and individual allowances for credit losses under IAS 39.

⁵ The calculation of mortgage arrears was not impacted by the adoption of IFRS 9 as it represents mortgages that are at least one day past due.

In 2017, a land developer in Western Canada filed for protection under the Companies' Creditors Arrangement Act ("CCAA"). We hold \$5.3 million of outstanding mortgages from the borrower legal entity that are not in arrears as at June 30, 2018, and we do not believe that we would incur a loss of principal or interest based on the value of the underlying collateral. During Q2 2018, the issues with the developer were resolved.

The majority of the increase in securitized mortgage arrears as at June 30, 2018 occurred in the 1-30 day category. Although we monitor our arrears position closely, the majority of arrears mortgages in this category are resolved and do not migrate to arrears categories over 30 days.

Figure 4: Impaired Corporate Mortgage Ratio



The ratio as presented above incorporates impaired (stage 3) mortgages under IFRS 9 for data presented after January 1, 2018. Data prior to this time incorporates impaired mortgages under IAS 39. Refer to the "Non-IFRS Measures" section of this MD&A for a full definition of impaired mortgage ratios.

Other Mortgage Information

Table 17: Mortgage Originations

(in thousands)	Q2 2018	Q2 2017	Q1 2018	YTD 2018	YTD 2017
For the Periods Ended June 30					
Single family - insured	\$ 28,013	\$ 7,754	\$ 12,992	\$ 41,005	\$ 17,817
Single family - uninsured	24,963	6,166	12,171	37,134	12,726
Single family - uninsured completed inventory	6,678	-	-	6,678	-
Residential construction	52,601	47,564	37,977	90,578	87,232
Non-residential construction	-	-	2,646	2,646	-
Commercial	-	32,639	44,819	44,819	35,869
	\$ 112,255	\$ 94,123	\$ 110,605	\$ 222,860	\$ 153,644

New uninsured single family origination volumes have increased modestly since mid-2017, which has stabilized the portfolio balance in recent quarters. While we have maintained a conservative underwriting approach in recent quarters given home valuations in certain single family markets, we continue to monitor our underwriting criteria in the context of the lending market.

We participate in acquisition programs for uninsured single family mortgages with MCAP and another third party origination source. Q2 2018 acquisition volumes of \$11 million are included in the table above. We will seek to identify additional sources for uninsured single family mortgage origination consistent with our risk and quality standards, given the attractive risk-adjusted returns and our excess balance sheet capacity.

The increase in insured single family originations during 2018 has enabled us to grow our insured single family portfolio (via the retention of market MBS on our corporate balance sheet) and strengthen our liquidity position.

The adoption of OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* effective January 1, 2018 has impacted the proportion of mortgages that we underwrite based on the borrower's ability to service the higher mortgage rates. These new stress tests provide for an improvement in the quality of newly originated mortgages.

Construction, commercial and completed inventory originations represent first advances on newly originated loans, i.e. they exclude additional fundings on existing loans in the portfolio or reclassifications between portfolios.

Table 18: Average Loan to Value (LTV) Ratio for Uninsured Single Family Mortgage Originations

(in thousands except %)								
For the Periods Ended June 30	Q2 2018	Average LTV	YTD 2018	Average LTV	Q2 2017	Average LTV	YTD 2017	Average LTV
Ontario	\$ 17,990	69.6%	\$ 25,632	68.8%	\$ 6,021	68.7%	\$ 12,189	69.2%
Alberta	7,175	62.1%	7,402	62.5%	145	34.5%	145	34.5%
British Columbia	5,910	70.8%	9,183	68.6%	-	-	225	50.6%
Other	566	68.7%	1,595	70.8%	-	-	167	66.8%
	\$ 31,641	68.1%	\$ 43,812	67.8%	\$ 6,166	67.9%	\$ 12,726	68.5%

Table 19: Average Mortgage Loan to Value (LTV) Ratios

As at	June 30 2018	March 31 2018	December 31 2017
Corporate portfolio:			
Single family mortgages			
- Uninsured	67.6%	67.3%	67.5%
- Uninsured completed inventory	57.6%	57.6%	64.2%
- Insured	80.8%	79.6%	78.1%
Construction loans			
- Residential	60.6%	61.4%	61.6%
- Non-residential	52.0%	52.6%	47.0%
Commercial loans			
- Multi family residential	67.9%	68.8%	67.9%
- Other commercial	65.3%	63.0%	64.6%
	65.8%	65.0%	65.3%
Securitized portfolio:			
Single family insured - Market MBS Program	85.4%	85.3%	85.8%
Single family insured - CMB Program	82.1%	82.1%	82.0%
	84.9%	84.9%	85.3%
	75.5%	75.7%	76.0%

Based on past experience and relative to the specifics of the then prevailing economic conditions, we would expect to observe an increase in overall mortgage default and arrears rates in the event of an economic downturn as realization periods on collateral become longer and borrowers adjust to the new economic conditions and changing real estate values. This would also result in a corresponding increase in our allowance for credit losses. An economic downturn, for example, could include changes to employment and unemployment rates, income levels and consumer spending which would have the above noted impact on our single family mortgage portfolio. MCAN utilizes a number of risk assessment and mitigation strategies to lessen the potential impact for loss on single family mortgages. In addition, MCAN's corporate uninsured single family mortgage portfolio (which includes completed inventory loans) is also secured with an average LTV at origination of 67.2% as at June 30, 2018 (March 31, 2018 - 66.9%). Based on an industry index that incorporates current real estate values, the ratios would be 56.9% and 53.1%, respectively.

Note: The LTV ratios in the above table represent the LTV at origination, not as at the reporting dates.

Mortgage renewal rights

Through our XMC origination platform, we retain the renewal rights to internally originated single family mortgages that are held as corporate or securitized mortgages or have been sold to third parties and derecognized from the balance sheet. At renewal, we may be able to renew these mortgages by offering clients attractive renewal options, thereby contributing to future revenues.

As at June 30, 2018, we had the renewal rights to \$936 million of single family mortgages (March 31, 2018 - \$923 million). The majority of these renewal rights relate to mortgages held on the consolidated balance sheet as corporate or securitized mortgages, while \$8 million relates to off-balance sheet mortgages sold to third parties on a whole loan basis (March 31, 2018 - \$27 million).

Other items

The Canadian mortgage industry continues to experience falsification of supporting documents provided to lenders in the mortgage underwriting process, and we have observed this activity in our own underwriting processes. We have enhanced and continue to enhance our underwriting processes, and we maintain a rigorous due diligence process.

To date, the impact of this document falsification has not had a material impact on MCAN or its financial position or performance. We do not expect to experience any material impact to our financial position or performance in the future relating to such document falsification.

Additional Information on Residential Mortgages and Home Equity Lines of Credit (“HELOCs”)

In accordance with OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures*, additional information is provided on the composition of MCAN’s single family mortgage portfolio by insurance status and province, as well as amortization periods and LTV by province. LTV is calculated as the ratio of the outstanding loan balance on an amortized cost basis to the value of the underlying collateral at the time of origination.

Insured mortgages include mortgages insured by CMHC or other approved insurers at origination and mortgages that are portfolio insured after origination.

The HELOC balances displayed below relate to insured single family mortgages that have been acquired by MCAN. We do not originate HELOCs.

Table 20: Single Family Mortgages by Province as at June 30, 2018

(in thousands except %)

	Corporate						Securitized		Total	
	Insured	%	Uninsured	%	HELOCs	%	Insured	%	Total	%
Ontario	\$ 77,540	61.9%	\$ 130,376	61.1%	\$ 101	76.5%	\$ 549,428	56.9%	\$ 757,445	58.0%
Alberta	23,279	18.6%	37,429	17.6%	31	23.5%	221,684	23.0%	282,423	21.7%
British Columbia	7,010	5.6%	28,155	13.2%	-	-	79,009	8.2%	114,174	8.8%
Quebec	7,375	5.9%	4,698	2.2%	-	-	38,337	4.0%	50,410	3.9%
Atlantic Provinces	7,246	5.8%	5,920	2.8%	-	-	43,894	4.6%	57,060	4.4%
Other	2,748	2.2%	6,633	3.1%	-	-	32,155	3.3%	41,536	3.2%
Total	\$ 125,198	100.0%	\$ 213,211	100.0%	\$ 132	100.0%	\$ 964,507	100.0%	\$ 1,303,048	100.0%

Table 21: Single Family Mortgages by Province as at March 31, 2018

(in thousands except %)

	Corporate						Securitized		Total	
	Insured	%	Uninsured	%	HELOCs	%	Insured	%	Total	%
Ontario	\$ 42,479	56.2%	\$ 124,260	60.9%	\$ 95	65.5%	\$ 578,407	57.1%	\$ 745,241	57.6%
Alberta	16,386	21.7%	36,914	18.1%	47	32.4%	230,691	22.8%	284,038	22.0%
British Columbia	3,492	4.6%	25,315	12.4%	3	2.1%	82,961	8.2%	111,771	8.6%
Quebec	4,759	6.3%	4,746	2.3%	-	-	41,638	4.1%	51,143	4.0%
Atlantic Provinces	6,201	8.2%	6,340	3.1%	-	-	45,924	4.5%	58,465	4.5%
Other	2,236	3.0%	6,459	3.2%	-	-	33,415	3.3%	42,110	3.3%
Total	\$ 75,553	100.0%	\$ 204,034	100.0%	\$ 145	100.0%	\$ 1,013,036	100.0%	\$ 1,292,768	100.0%

Table 22: Single Family Mortgages by Amortization Period as at June 30, 2018

(in thousands except %)	Up to 20 Years	>20 to 25 Years	>25 to 30 Years	>30 to 35 Years	>35 to 40 Years	Total
Corporate	\$ 67,494 19.9%	\$ 97,926 28.9%	\$ 171,311 50.7%	\$ 1,810 0.5%	\$ -	\$ 338,541 100.0%
Securitized	\$ 216,195 22.4%	\$ 468,607 48.6%	\$ 218,197 22.6%	\$ 61,508 6.4%	\$ -	\$ 964,507 100.0%
Total	\$ 283,689 21.8%	\$ 566,533 43.5%	\$ 389,508 29.8%	\$ 63,318 4.9%	\$ -	\$ 1,303,048 100.0%

Table 23: Single Family Mortgages by Amortization Period as at March 31, 2018

(in thousands except %)	Up to 20 Years	>20 to 25 Years	>25 to 30 Years	>30 to 35 Years	>35 to 40 Years	Total
Corporate	\$ 49,974 17.9%	\$ 69,085 24.7%	\$ 158,814 56.7%	\$ 1,859 0.7%	\$ -	\$ 279,732 100.0%
Securitized	\$ 218,868 21.6%	\$ 495,987 49.0%	\$ 227,991 22.5%	\$ 69,850 6.9%	\$ 340	\$ 1,013,036 100.0%
Total	\$ 268,842 20.8%	\$ 565,072 43.7%	\$ 386,805 30.0%	\$ 71,709 5.5%	\$ 340	\$ 1,292,768 100.0%

Other Corporate Assets

Cash and cash equivalents

Cash and cash equivalents, which include cash balances with banks and overnight term deposits, increased by \$35 million in Q2 2018. Cash and cash equivalents provide liquidity to meet maturing term deposit and new mortgage funding commitments and are considered to be Tier 1 liquid assets. For further information, refer to the "Liquidity Management" section of this MD&A.

Marketable securities

Marketable securities, consisting of corporate bonds and real estate investment trusts ("REITs"), decreased by \$3 million in Q2 2018. Marketable securities provide additional liquidity at yields in excess of cash and cash equivalents and are considered to be Tier 2 liquid assets. For further information, refer to the "Liquidity Management" section of this MD&A.

We recorded an increase to the unrealized gain on marketable securities of \$1.3 million through net income in Q2 2018 such that the unrealized gain as at June 30, 2018 was \$2.5 million.

Financial investments

We hold a \$41 million (March 31, 2018 - \$41 million) investment in the KingSett High Yield Fund ("KSHYF"), in which we have an 8.0% equity interest (March 31, 2018 - 8.0%). Our Q2 2018 return was 10.5% (Q2 2017 - 10.4%). As at June 30, 2018, our total remaining commitment to the KSHYF was \$22 million (March 31, 2018 - \$22 million), consisting of \$1 million of unfunded capital advances and \$21 million that supports credit facilities throughout the life of the KSHYF.

We also hold a \$29 million (March 31, 2018 - \$32 million) investment in Crown LP, in which we have a 14.1% equity interest (March 31, 2018 - 14.1%). In Q2 2018, we recorded an increase to the unrealized gain on the investment in Crown LP of \$2.0 million through net income such that the unrealized gain as at June 30, 2018 was \$14 million.

During Q2 2018, Crown LP sold the last remaining property in its opportunity fund and paid a distribution of \$5.1 million which reduced the carrying value of our investment in Crown LP. The remaining properties held by Crown LP are held in its core fund, which represents commercial office buildings that are expected to provide stable cash flows over a longer term time horizon.

Equity investment in MCAP

We hold a 13.83% equity interest in MCAP (March 31, 2018 - 13.83%), which represents 4.0 million units held by MCAN (March 31, 2018 - 4.0 million) of the 28.9 million total outstanding MCAP partnership units (March 31, 2018 - 28.9 million).

The investment had a net book value of \$58 million as at June 30, 2018 (March 31, 2018 - \$56 million).

The Limited Partner's At-Risk Amount ("LP ARA"), which represents the cost base of the equity investment in MCAP for income tax purposes, was \$36 million as at June 30, 2018 (March 31, 2018 - \$33 million). For further information on the LP ARA, refer to the "Non-IFRS Measures" section of this MD&A.

MCAP is an originator and servicer of mortgages for third party investors in Canada. MCAP's origination volumes were \$4.2 billion in Q2 2018 (Q2 2017 - \$3.3 billion). MCAP had \$68.7 billion of assets under administration as at May 31, 2018 (February 28, 2018 - \$66.8 billion).

Subsequent to quarter end, MCAP announced the retirement of its Chief Executive Officer, Derek Norton, and announced the appointment of Mark Aldridge as MCAP's new Chief Executive Officer.

Amongst the interparty rights in the MCAP partnership agreement, the majority partner in MCAP has the right to acquire MCAN's entire partnership interest in MCAP at "fair market value", which would be determined by an independent valuator agreed upon by both parties.

Securitization Assets

Securitization assets consist primarily of single family insured mortgages securitized through the market MBS program and CMB program. For further information, refer to the "Securitization Programs" section of this MD&A.

Table 24: Liabilities and Shareholders' Equity

(in thousands)						
As at	June 30 2018 ¹	March 31 2018 ¹	December 31 2017	Change from Prior Quarter		
				(\$)	(%)	
Corporate Liabilities						
Term deposits	\$ 912,223	\$ 823,604	\$ 884,460	\$ 88,619	11%	
Loans payable	-	3,020	-	(3,020)	(100%)	
Current tax liabilities	457	-	-	457	-	
Deferred tax liabilities	3,390	3,603	3,572	(213)	(6%)	
Other liabilities	7,135	6,315	16,067	820	13%	
	923,205	836,542	904,099	86,663	10%	
Securitization Liabilities						
Financial liabilities from securitization	976,769	1,015,296	1,015,699	(38,527)	(4%)	
	976,769	1,015,296	1,015,699	(38,527)	(4%)	
	1,899,974	1,851,838	1,919,798	48,136	3%	
Shareholders' Equity						
Share capital	219,456	217,817	214,664	1,639	1%	
Contributed surplus	510	510	510	-	-	
Retained earnings	86,130	83,719	65,365	2,411	3%	
Accumulated other comprehensive income	-	-	16,438	-	-	
	306,096	302,046	296,977	4,050	1%	
	\$ 2,206,070	\$ 2,153,884	\$ 2,216,775	\$ 52,186	2%	

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

To fund our corporate operations, we issue term deposits that are eligible for CDIC deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor. The role of term deposits in managing liquidity risk is discussed in the "Liquidity and Funding Risk" sub-section of the "Risk Governance and Management" section of this MD&A.

Financial liabilities from securitization relate to our participation in the market MBS program and CMB program, where we have sold MBS to third parties but have not derecognized the related mortgages from our balance sheet. For further information on the market MBS program and CMB program, refer to the “Securitization Programs” section of this MD&A.

Share capital activity for Q2 2018 reflects new common shares issued through the Dividend Reinvestment Plan (“DRIP”). The DRIP participation rate for the June 30, 2018 dividend was 19% (March 31, 2018 - 20%). For further information, refer to Note 16 to the consolidated financial statements.

Retained earnings activity for Q2 2018 consists of net income of \$11.1 million less dividends of \$7.4 million.

SELECTED QUARTERLY FINANCIAL DATA

Table 25: Selected Quarterly Financial Data

(in thousands except for per share amounts and %)	Q2/18 ²	Q1/18 ²	Q4/17	Q3/17	Q2/17	Q1/17	Q4/16	Q3/16
Net investment income - corporate assets ²	\$ 15,063	\$ 12,073	\$ 14,359	\$ 12,913	\$ 12,179	\$ 12,963	\$ 11,684	\$ 12,396
Other income - corporate assets	-	1,701	-	-	-	876	-	-
Net investment income - securitization assets ²	1,317	1,301	1,416	1,534	1,374	1,291	1,519	1,594
	16,380	15,075	15,775	14,447	13,553	15,130	13,203	13,990
Operating expenses	5,142	4,631	5,302	4,686	4,616	4,617	4,471	4,323
Net income before income taxes	11,238	10,444	10,473	9,761	8,937	10,513	8,732	9,667
Provision for (recovery of) income taxes	113	(171)	(334)	(157)	(1)	248	(268)	(108)
Net income	\$ 11,125	\$ 10,615	\$ 10,807	\$ 9,918	\$ 8,938	\$ 10,265	\$ 9,000	\$ 9,775
Basic and diluted earnings per share	\$ 0.47	\$ 0.45	\$ 0.47	\$ 0.42	\$ 0.39	\$ 0.44	\$ 0.39	\$ 0.43
Dividends per share	\$ 0.37	\$ 0.37	\$ 0.37	\$ 0.32	\$ 0.32	\$ 0.30	\$ 0.30	\$ 0.29
Return on average shareholders' equity ¹	14.54%	14.10%	14.63%	13.63%	12.37%	14.37%	12.94%	14.08%
Average mortgage portfolio yield - corporate ¹	5.65%	5.72%	5.56%	5.25%	5.28%	5.12%	4.99%	5.14%
Average term deposit interest rate ¹	2.48%	2.38%	2.29%	2.25%	2.21%	2.20%	2.20%	2.22%
Average mortgage portfolio balance - corporate (\$ million)	\$ 913	\$ 849	\$ 866	\$ 908	\$ 914	\$ 908	\$ 954	\$ 1,008
Average mortgage portfolio yield - securitized ¹	2.59%	2.57%	2.57%	2.63%	2.67%	2.61%	2.74%	2.74%
Average financial liability from securitization rate ¹	1.83%	1.83%	1.81%	1.83%	1.93%	1.90%	2.01%	2.01%
Average mortgage portfolio balance - securitized (\$ million)	\$ 986	\$ 1,015	\$ 1,002	\$ 1,028	\$ 1,057	\$ 1,052	\$ 1,032	\$ 1,032

¹ Refer to the “Non-IFRS Measures” section of this MD&A for a definition of these measures.

² Provisions for credit losses are included in both net investment income from corporate and securitization assets. Effective Q1 2018, we prospectively adopted IFRS 9 and did not restate prior period information. Under IFRS 9, the methodology for the calculation of mortgage allowances and provisions has changed from IAS 39, therefore provisions under IFRS 9 are not directly comparable to prior periods. Additionally, under IFRS 9 fair value changes in certain reclassified financial assets are presented in the income statement and are therefore not directly comparable to prior periods. Under IAS 39, these fair value changes were recorded through other comprehensive income.

Net investment income from corporate and securitization assets is largely driven by changes in the average mortgage portfolio balance and interest rate. Additionally, corporate net investment income was impacted by significant distribution income from Crown LP in Q1 2017 and substantial equity income from MCAP in Q2 2017 and Q4 2017. Operating expenses increased in Q4 2017 as a result of non-recurring professional fee accruals.

Corporate mortgage interest yields have increased since Q3 2017 as a result of increases to the overnight rate by the Bank of Canada given that the majority of the corporate portfolio is floating rate and repriced following the rate increases.

The securitized mortgage portfolio has gradually decreased since Q2 2017 as a result of a reduction in securitization volumes.

Since the adoption of IFRS 9 effective January 1, 2018, we have experienced increased volatility in net income as a result of the recognition of unrealized gains on certain financial instruments through net income. This volatility was especially prominent in Q2 2018, generating a positive impact to net income of \$3.3 million. Prior to the adoption of IFRS 9, these unrealized gains were recognized through accumulated other comprehensive income.

SECURITIZATION PROGRAMS

We are an NHA MBS issuer, which involves the securitization of insured mortgages to create MBS. We issue MBS through our internal market MBS program and the Canada Housing Trust (“CHT”) CMB program.

Market MBS Program

During Q2 2018, we securitized \$46 million of MBS through the market MBS program (Q2 2017 - \$14 million). We retained the MBS securitized in Q2 2018 on our corporate balance sheet to strengthen our corporate liquidity position, however in Q2 2017 we sold the MBS to a third party.

As noted above, we may issue market MBS through the NHA MBS program and retain the underlying MBS security for liquidity purposes instead of selling it to a third party. As at June 30, 2018, we held \$73 million of retained MBS on our balance sheet (March 31, 2018 - \$28 million), which is included in the insured single family classification within corporate mortgages.

CAPITAL MANAGEMENT

Our primary capital management objectives are to maintain sufficient capital for regulatory purposes and to earn acceptable and sustainable risk-weighted returns for our shareholders. Through our risk management and corporate governance framework, we assess current and projected economic, housing market, interest rate and credit conditions to determine appropriate levels of capital. We typically pay out all taxable income by way of dividends subject to final review and declaration by the Board. Capital growth is achieved through retained earnings, the DRIP, rights offerings and public share offerings. Our capital management is driven by the guidelines set out by the Tax Act and OSFI.

Income Tax Capital

As a MIC under the Tax Act, we are limited to an income tax liabilities to capital ratio of 5:1 (or an income tax assets to capital ratio of 6:1), based on our non-consolidated balance sheet in the MIC entity measured at its tax value. Securitization assets and liabilities (less accrued interest) are both excluded from the calculation of the income tax assets to capital ratio.

We manage our income tax assets to a level of 5.75 times income tax capital on a non-consolidated tax basis to provide a prudent cushion between the maximum permitted assets and total actual assets. Income tax asset capacity represents additional asset growth available to yield a 5.75 income tax assets to income tax capital ratio.

Table 26: Income Tax Capital ¹

(in thousands except ratios)	June 30 2018 ²	March 31 2018 ²	December 31 2017
As at			
Income tax assets ¹			
Consolidated assets	\$ 2,206,070	\$ 2,153,884	\$ 2,216,775
Adjustment for assets in subsidiaries	5,390	6,403	5,435
Non-consolidated assets in MIC entity	2,211,460	2,160,287	2,222,210
Add: mortgage allowances	5,061	4,883	4,750
Less: securitization assets ³	(988,051)	(1,028,356)	(1,030,020)
Less: equity investments in MCAP and subsidiaries	(48,616)	(48,061)	(42,411)
Other adjustments	(8,139)	(7,286)	(7,475)
	<u>\$ 1,171,715</u>	<u>\$ 1,081,467</u>	<u>\$ 1,147,054</u>
Income tax liabilities ¹			
Consolidated liabilities	\$ 1,899,974	\$ 1,851,838	\$ 1,919,798
Adjustment for liabilities in subsidiaries	(7,588)	(6,488)	(7,852)
Non-consolidated liabilities in MIC entity	1,892,386	1,845,350	1,911,946
Less: securitization liabilities ³	(975,384)	(1,013,854)	(1,014,258)
	<u>\$ 917,002</u>	<u>\$ 831,496</u>	<u>\$ 897,688</u>
Income tax capital ¹	<u>\$ 254,713</u>	<u>\$ 249,971</u>	<u>\$ 249,366</u>
Income tax asset capacity ¹	<u>\$ 292,883</u>	<u>\$ 355,867</u>	<u>\$ 286,801</u>
Income tax capital ratios ¹			
Income tax assets to capital ratio	4.60	4.33	4.60
Income tax liabilities to capital ratio	3.60	3.33	3.60

¹ Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.

² Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

³ The majority of securitization assets and liabilities per balance sheet are excluded from income tax assets, liabilities and capital to the extent that they are held in the MIC entity.

Regulatory Capital

As a Loan Company under the *Trust and Loan Companies Act* (the "Trust Act"), OSFI oversees the adequacy of our capital. For this purpose, OSFI has imposed minimum capital-to-regulatory (or risk-weighted) assets ratios and a minimum leverage ratio which is calculated on a different basis from the income tax assets to capital ratio discussed in the "Income Tax Capital" subsection.

Subsequent to quarter end, OSFI released a discussion paper in regards to the proposed implementation of final Basel III reforms in Canada. The reforms were published by the Basel Committee on Banking Supervision ("BCBS") in December 2017 and seek to enhance credibility in the calculation of risk-weighted assets and improve the comparability and transparency of the capital ratios of OSFI-regulated financial institutions. These proposed reforms could significantly impact the risk-weighting of the Company's construction and commercial mortgage portfolios. We are currently investigating the impact of these proposed reforms and the associated potential for higher capital requirements on real estate lending in Canada.

Subsequent to quarter end we increased our internal target minimum CET 1, Tier 1 and Total Capital ratios from 18% to 20%. We maintain prudent capital planning practices to ensure that we are adequately capitalized and continue to satisfy minimum standards and internal targets.

Table 27: Regulatory Capital

(in thousands except %)	June 30 2018 ¹	March 31 2018 ¹	December 31 2017
As at			
Regulatory Ratios (OSFI)			
Share capital	\$ 219,456	\$ 217,817	\$ 214,664
Contributed surplus	510	510	510
Retained earnings	86,130	83,719	65,365
Accumulated other comprehensive income	-	-	16,438
Deduction for equity investment in MCAP (Transitional adjustment) ²	n/a	n/a	(23,593)
Common Equity Tier 1, Tier 1 and Total Capital (Transitional) ^{2,3}	n/a	n/a	\$ 273,384
Deduction for equity investment in MCAP (All-in adjustment) ²	(27,344)	(26,193)	(5,898)
Common Equity Tier 1, Tier 1 and Total Capital (All-in) ^{2,3}	\$ 278,752	\$ 275,853	\$ 267,486
Total Exposures/Regulatory Assets ³			
Consolidated assets	\$ 2,206,070	\$ 2,153,884	\$ 2,216,775
Less: deductions from all-in Tier 1 Capital ²	(27,344)	(26,193)	(29,491)
Other adjustments ⁴	2,222	1,530	2,915
Total On-Balance Sheet Exposures	2,180,948	2,129,221	2,190,199
Mortgage and investment funding commitments	423,043	397,790	317,687
Less: conversion to credit equivalent amount (50%)	(211,522)	(198,895)	(158,844)
Letters of credit	42,236	44,178	32,164
Less: conversion to credit equivalent amount (50%)	(21,118)	(22,089)	(16,082)
Total Off-Balance Sheet Items	232,639	220,984	174,925
Total Exposures/Regulatory Assets	\$ 2,413,587	\$ 2,350,205	\$ 2,365,124
Leverage ratio ³	11.55%	11.74%	11.31%
Risk weighted assets (all-in) ^{2,3}	\$ 1,298,367	\$ 1,295,953	\$ 1,258,171
Risk weighted assets (transitional) ^{2,3}	n/a	n/a	\$ 1,269,967
Regulatory Capital Ratios ³			
Common Equity Tier 1 capital to risk-weighted assets ratio (all-in)	21.47%	21.29%	21.26%
Tier 1 capital to risk-weighted assets ratio (all-in)	21.47%	21.29%	21.26%
Total capital to risk-weighted assets ratio (all-in)	21.47%	21.29%	21.26%
Common Equity Tier 1 capital to risk-weighted assets ratio (transitional)	n/a	n/a	21.53%
Tier 1 capital to risk-weighted assets ratio (transitional)	n/a	n/a	21.53%
Total capital to risk-weighted assets ratio (transitional)	n/a	n/a	21.53%

¹ Effective January 1, 2018 we adopted IFRS 9, Financial Instruments. Results from periods prior to January 1, 2018 are reported in accordance with IAS 39, Financial Instruments: Recognition & Measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

² The deduction for the equity investment in MCAP on an all-in basis is equal to the equity investment balance less 10% of the Company's shareholders' equity. As of January 1, 2018, the deduction was fully deductible whereas in 2017, the deduction on the transitional basis was equal to 80% of the all-in adjustment.

³ Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.

⁴ Certain items, such as negative cash balances, are excluded from total exposures but included in consolidated assets.

Table 28: Regulatory Risk-Weighted Assets

(in thousands except %)	June 30, 2018			March 31, 2018		
	Per Balance Sheet	Average Rate	Risk Weighted Assets	Per Balance Sheet	Average Rate	Risk Weighted Assets
As at						
On-Balance Sheet Assets						
Cash and cash equivalents	\$ 96,985	20%	\$ 19,841	\$ 62,463	20%	\$ 12,799
Cash held in trust	25,740	20%	5,148	15,073	20%	3,015
Marketable securities	58,534	100%	58,534	61,429	100%	61,429
Mortgages - corporate	919,053	72%	665,771	859,372	77%	658,403
Mortgages - securitized	964,507	3%	29,089	1,013,036	3%	31,111
Financial investments	70,191	229%	161,033	73,446	245%	179,620
Other loans	2,426	100%	2,426	2,655	100%	2,655
Equity investment in MCAP	57,954	53%	30,609	56,398	54%	30,205
Foreclosed real estate	435	100%	435	435	100%	435
Deferred tax asset	3,005	100%	3,005	2,874	100%	2,874
Other assets	7,240	100%	7,240	6,703	100%	6,703
			<u>983,131</u>			<u>989,249</u>
Off-Balance Sheet Items						
Letters of credit	42,236	50%	21,118	44,178	50%	22,089
Commitments	423,043	44%	185,130	397,790	44%	176,040
			<u>206,248</u>			<u>198,129</u>
Charge for operational risk			<u>108,988</u>			<u>108,575</u>
Risk-Weighted Assets (all-in)			<u>\$ 1,298,367</u>			<u>\$ 1,295,953</u>

LIQUIDITY MANAGEMENT

Our liquidity management process includes a Liquidity Risk Management Framework that incorporates multi scenario stress testing. Results of the stress testing are reported to management on a monthly basis and to the Board on a quarterly basis.

We fund our corporate operations by issuing term deposits that are eligible for CDIC deposit insurance. We do not accept deposits that can be cashed prior to maturity or paid on demand except in the event of the death of a depositor.

For further information on how we manage liquidity risk, refer to the "Liquidity and Funding Risk" sub-section of the "Risk Governance & Management" section of this MD&A. For information on our credit facilities refer to Note 24 to the consolidated financial statements.

OSFI's Liquidity Adequacy Requirements ("LAR") guideline establishes three minimum standards based on the Basel III framework with national supervisory discretion applied to certain treatments: the Liquidity Coverage Ratio ("LCR") and Net Cumulative Cash Flow ("NCCF") metric, which are both currently in effect, and the Net Stable Funding Ratio ("NSFR"), which is effective January 1, 2020.

As at June 30, 2018, we were in compliance with the LCR and NCCF. Based on our current financial and liquidity position, we believe that we will be able to comply with the NSFR requirements once enacted. These requirements are supplemented by additional supervisory monitoring metrics including the liquidity monitoring tools and the intraday liquidity monitoring tools as considered in the Basel III framework.

The following table shows the composition of our internal liquidity ratios. These internal ratios include assumptions relating to the value of liquid assets such as the ability to sell these assets in a stressed market scenario. We manage our Tier 1 & 2 and Total liquid assets to a minimum of 60% and 100% of term deposit liabilities maturing within 100 days, respectively, and a maximum of 150% for both ratios.

As at June 30, 2018 our liquidity ratios increased significantly compared to the prior quarter. During Q2 2018 we specifically targeted growth in our liquid asset position by way of issuance of market MBS that we retained on our corporate balance sheet. Additionally, we raised our corporate cash balances to strengthen our position amidst current uncertainty in housing markets.

Table 29: Liquidity Ratios

(in thousands except %)	June 30 2018	March 31 2018	December 31 2017
As at			
Tier 1 liquid assets ¹			
Cash and cash equivalents	\$ 96,985	\$ 62,463	\$ 117,571
Tier 2 liquid assets ¹			
Marketable securities	58,534	61,429	62,518
Less: marketable securities adjustment ²	(13,952)	(14,002)	(14,391)
Market MBS retained by MCAN ³	73,123	28,040	28,597
	<u>117,705</u>	<u>75,467</u>	<u>76,724</u>
Tier 3 liquid assets ¹			
Single family insured mortgages ⁴	51,849	47,310	51,711
Less: single family insured mortgages adjustment ⁴	(19,008)	(16,619)	(17,713)
	<u>32,841</u>	<u>30,691</u>	<u>33,998</u>
Total liquid assets ¹	\$ 247,531	\$ 168,621	\$ 228,293
100 day term deposit maturities	\$ 53,398	\$ 158,910	\$ 103,632
Liquidity ratios ¹			
Tier 1 & 2 liquid assets to 100 day term deposit maturities	402%	87%	187%
Total liquid assets to 100 day term deposit maturities	464%	106%	220%

¹ Refer to the "Non-IFRS Measures" section of this MD&A for a definition of these measures.

² Adjusted to reflect estimated impact to fair market value in a stressed scenario. Corporate bonds are reduced as follows: BBB- or higher (30%); below BBB- (45%). REITs are reduced as follows: constituent in TSX/S&P Composite Index (20%); not a constituent in TSX/S&P Composite Index (40%).

³ Included in corporate mortgages - insured single family. For further information, refer to the "Securitization Programs" section of this MD&A.

⁴ Single family insured mortgages exclude mortgages pledged as collateral and second mortgages not insured by CMHC. The adjustment reflects lower liquidity than Tier 1 and Tier 2 liquidity, as follows: CMHC insured (25%), CMHC insured second mortgages (50%), privately insured (50%).

Our sources and uses of liquidity are outlined in the table below. We manage our net liquidity surplus/deficit by raising term deposits as mentioned above. For further information on our off-balance sheet commitment associated with our investment in the KSHYF, refer to the "Off-Balance Sheet Arrangements" section of this MD&A.

Table 30: Liquidity Analysis

(in thousands)	Within 3 Months	3 Months To 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	June 30 2018	March 31 2018
Sources of liquidity							
Cash and cash equivalents	\$ 96,985	\$ -	\$ -	\$ -	\$ -	\$ 96,985	\$ 62,463
Marketable securities	58,506	-	-	-	28	58,534	61,429
Mortgages - corporate	164,484	402,413	289,323	56,845	5,988	919,053	859,372
Financial investments	-	-	41,033	-	29,158	70,191	73,446
Other loans	1,088	175	1,163	-	-	2,426	2,655
	321,063	402,588	331,519	56,845	35,174	1,147,189	1,059,365
Uses of liquidity							
Term deposits	52,499	303,624	460,146	95,954	-	912,223	823,604
Loans payable	-	-	-	-	-	-	3,020
Other liabilities	7,135	-	-	-	-	7,135	6,315
	59,634	303,624	460,146	95,954	-	919,358	832,939
Net liquidity surplus (deficit)	\$ 261,429	\$ 98,964	\$ (128,627)	\$ (39,109)	\$ 35,174	\$ 227,831	\$ 226,426
Off-Balance Sheet							
Unfunded mortgage commitments	\$ 93,705	\$ 125,383	\$ 181,522	\$ -	\$ -	\$ 400,610	\$ 375,357
Commitment - KSHYF	-	-	22,433	-	-	22,433	22,433
	\$ 93,705	\$ 125,383	\$ 203,955	\$ -	\$ -	\$ 423,043	\$ 397,790

Note: The above table excludes securitized assets and liabilities and pledged assets as their use is restricted to securitization program operations.

RISK GOVERNANCE AND MANAGEMENT

We are exposed to a number of risks, including credit risk, liquidity and funding risk, operational risk, strategic and business risk, reputational risk, interest rate risk, market risk and cyber risk, that can adversely affect our ability to achieve our business objectives or execute our business strategies, and which may result in a loss of earnings, capital and/or damage to our reputation. We mitigate these risks through prudent credit limits, established lending policies and procedures, effective monitoring and reporting, investment diversification and by the diligent management of assets and liabilities.

We operate in changing regulatory and economic environments. As a result, we believe that our management team and the Board are particularly diligent in their consideration of all identified and emerging risks. Our goal is not to eliminate risk, as this would result in significantly reduced earnings, but rather to be proactive in our assessment and management of risk, as a means to gain a strategic advantage and ultimately enhance shareholder value.

The risks that have been identified may not be the only risks that we face. Other risks of which we are not aware or which we currently deem to be immaterial may surface in future periods and have a material adverse impact on our business, results from operations and financial condition.

The shaded areas of this MD&A represent a discussion of risk factors and risk management policies and procedures relating to credit, liquidity, interest rate and market risks as required under IFRS 7, *Financial Instruments: Disclosures*. The relevant MD&A sections are identified by shading within boxes and the content forms an integral part of the consolidated financial statements.

For a detailed discussion of risks that the Company is exposed to, refer to the "Risk Governance and Management" section of the 2017 Annual MD&A.

Liquidity and Funding Risk

Liquidity and funding risk is the risk that cash inflows, supplemented by assets readily convertible to cash, will be insufficient to honour all cash outflow commitments (both on and off-balance sheet) as they come due. The failure of borrowers to make regular mortgage payments increases the uncertainties associated with liquidity management, notwithstanding that we may eventually collect the amounts outstanding, which may result in a loss of earnings or capital, or have an otherwise adverse effect on our financial condition and results of operations.

For information on the contractual maturities of certain obligations of the Company, refer to notes 13, 15 and 23 to the consolidated financial statements.

Reputational Risk

Reputational risk is the negative consequence of the occurrence of other risks and can occur from an activity undertaken by the Company, its affiliated companies, or its representatives. The loss of reputation can greatly affect shareholder value through reduced public confidence, a loss of business, legal action, or increased regulatory oversight. Reputation refers to the perception of the enterprise by various stakeholders. Typically, key stakeholder groups include investors, customers, depositors, employees, suppliers and regulators. Perceptions may be impacted by various events including financial performance, specific adverse occurrences from events such as cyber security issues, unfavourable media coverage, and changes or actions of the corporation's leadership. Failure to effectively manage reputation risk can result in reduced market capitalization, loss of client loyalty, reduced access to deposit funding and the inability to achieve our strategic objectives.

Strategic and Business Risk

Strategic and business risk is the risk of loss due to fluctuations in the external business environment, the failure of management to adjust its strategies, business model and business activities for external events, business results, changes in the competitive environment or the inability of the business to change its cost levels in response to those changes.

Operational Risk

Operational risk is the potential for loss resulting from people, inadequate or failed internal processes, systems, or from external events. The risk of loss from people includes internal or external fraud, non-adherence to internal procedures/values/objectives or unethical behaviour. The largest components of this risk for MCAN have been separately identified as outsourcing risk and cyber risk. The remaining risks arise from the small size and entrepreneurial nature of MCAN, and the legacy systems used within it. The exposure to financial misreporting, inaccurate financial models, fraud, breaches in privacy, information security, attraction and retention of employees, and business continuity and recovery are included within operational risk.

Outsourcing Risk

Within operational risk, outsourcing risk is the risk incurred when we contract out a business function to a service provider instead of performing the function ourselves, and the service provider performs at a lower standard than we would have under similar circumstances. We outsource the majority of our mortgage and loan origination, servicing and collections to MCAP and other third parties.

Risk of Accuracy and Completeness of Borrower Information

Within operational risk, in the single family mortgage underwriting process, we rely on information provided by potential borrowers and other third parties, including mortgage brokers. We may also rely on the representations of potential borrowers and third parties as to the accuracy and completeness of that information. Our financial position and performance may be negatively impacted if this information is intentionally misleading or does not fairly represent the financial condition of the potential borrower and is not detected by our internal controls.

Cyber Risk

We collect and store confidential and personal information to the extent needed for operational purposes. Unauthorized access to the Company's computer systems could result in the theft or publication of confidential information or the deletion or modification of records or could otherwise cause interruptions in the Company's operations. In addition, despite the Company's implementation of security measures, its systems are vulnerable to damages from computer viruses, natural disasters, unauthorized access, cyber-attack and other similar disruptions. Any such system failure, accident or security breach could disrupt the Company's delivery of services and make the Company's applications unavailable or cause similar disruptions to the Company's operations. If a person penetrates the Company's network security or otherwise misappropriates sensitive data, we could be subject to liability or our business could be interrupted, and any of these developments could have a material adverse effect on the Company's business, results of operations and financial condition.

Credit Risk

Credit risk is the risk of financial loss resulting from the failure of a counterparty, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from our mortgage and lending activities. Fluctuations in real estate values may increase the risk of default and may also reduce the net realizable value of the collateral property to the Company. These risks may result in defaults and credit losses, which may result in a loss of earnings. Credit losses occur when a counter

party fails to meet its obligations to the Company and the value realized on the sale of the underlying security deteriorates below the carrying amount of the exposure.

Interest Rate Risk

Interest rate risk is the potential impact of changes in interest rates on our earnings and capital. Interest rate risk arises when our assets and liabilities, both on and off-balance sheet, have mismatched repricing dates. Changes in interest rates where we have mismatched repricing dates may have an adverse effect on our financial condition and results of operations. In addition, interest rate risk may arise when changes in the underlying interest rates on assets do not match changes in the interest rates on liabilities. This potential mismatch may have an adverse effect on our financial condition and results of operations.

Our exposure to interest rate risk is discussed further in Note 25 to the consolidated financial statements.

Market Risk

Market risk is the exposure to adverse changes in the value of financial assets. Our market risk factors include price risk on marketable securities, interest rates, real estate values and commodity prices, among others. Any changes in these market risk factors may negatively affect the value of our financial assets, which may have an adverse effect on our financial condition and results of operations. We do not undertake trading activities as part of our regular operations, and therefore are not exposed to risks associated with activities such as market making, arbitrage or proprietary trading.

Risk Management

For a detailed discussion of how we manage the risks noted above, refer to the “Risk Governance and Management” section of the 2017 Annual MD&A.

Credit Risk - Impairment Assessment Under IFRS 9

The analysis of MCAN’s IFRS 9 impairment assessment and measurement approach discussed below should be read in conjunction with Note 4 to the consolidated financial statements.

Probability of Default

The probability of default (“PD”) is driven by historical arrears performance, and incorporates the rate at which mortgages move from performing status to defaulted status. Key macroeconomic variables, borrower Beacon scores and internal mortgage risk ratings (where applicable) are also used in calculating this rate. Where historical arrears performance is limited or not available, the Company uses external arrears/default data for similar loans and mortgages.

Exposure at default

The exposure at default (“EAD”) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the borrower’s ability to increase its exposure while approaching default and potential early repayments.

To calculate the EAD for a Stage 1 loan, the Company assesses the possible default events within 12 months for the calculation of the 12 month ECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the EAD is considered for events over the lifetime of the instruments.

The Company determines EADs by determining the period of exposure and modelling the change in loan exposures over time. Except for some revolving credit facilities, the maximum period over which ECL is measured is the maximum contractual period. For revolving credit facilities that include both a loan component and an undrawn commitment component, assessment is made with respect to whether the Company’s exposure to credit losses is not limited to the contractual notice period. Once the period of exposure is determined, EAD is modelled based on loan terms, prepayment assumptions, commitment drawing patterns and other relevant forward-looking information.

Loss given default

Loss given default (“LGD”) is modelled using a common LGD methodology that incorporates specific relevant data where appropriate. The LGD estimation takes into account all relevant and forward-looking information including but not limited to expected EAD, forecast of future collateral valuations including expected sales costs and discounts, debt structure and cross-collateralisation, and varies with macroeconomic scenarios.

The Company segments its corporate mortgage portfolio into individual lines of business, outlined in Note 8. The segmentation is based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and other transaction characteristics as applicable.

Additional data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each mortgage. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in collateral values including property prices for mortgages, regional housing price indexes or other factors that are indicative of losses in the group. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 IFRS 9 segment of each mortgage. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

Grouping financial assets measured on a collective basis

The Company calculates ECLs either on a collective or individual basis for the corporate mortgage portfolio based on the line of business (per Note 8). ECLs are calculated on an individual basis for all mortgages in Stage 3 and are calculated on a collective basis for all mortgages in Stage 1 and Stage 2.

Analysis of inputs into the ECL model under multiple economic scenarios

An overview of the approach to estimating ECLs is set out in Notes 4 and 5. As part of the model input process, macroeconomic data are obtained from third party sources (e.g. rating agencies, bank economic forecasts), and its Risk Management department verifies the quality of data and assumptions in the Company's ECL models including determining the weights attributable to the multiple scenarios.

DESCRIPTION OF CAPITAL STRUCTURE

Our authorized share capital consists of an unlimited number of common shares with no par value. At June 30, 2018, there were 23,651,814 common shares outstanding (March 31, 2018 - 23,559,145). As at August 9, 2018, there were 23,651,814 common shares outstanding.

During Q2 2018, we issued 92,669 new common shares under the DRIP (Q2 2017 - 79,334), which provides MCAN with a reliable source of new capital and existing shareholders an opportunity to acquire additional shares at a discount to market value. Under the DRIP, dividends paid to shareholders are automatically reinvested in common shares issued out of treasury at the weighted average trading price for the five days preceding such issue less a discount of 2%.

For additional information related to share capital, refer to Note 16 to the consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

We have contractual obligations relating to an operating lease, in addition to outstanding commitments for future fundings of corporate mortgages and our investment in the KSHYF. We are obligated to advance additional fundings on the investment at any time subject to capital calls by the KSHYF.

We outsource the majority of our mortgage servicing and continue to pay servicing expenses as long as the mortgages remain on our balance sheet.

Table 31: Contractual Obligations

(in thousands)	Less than one year	One to three years	Three to five years	Over five years	June 30 2018	March 31 2018
Mortgage funding commitments	\$ 219,088	\$ 181,522	\$ -	\$ -	\$ 400,610	\$ 375,357
Commitment - KSHYF	-	22,433	-	-	22,433	22,433
Operating lease	852	1,761	1,769	3,943	8,325	8,538
	\$ 219,940	\$ 205,716	\$ 1,769	\$ 3,943	\$ 431,368	\$ 406,328

We retain mortgage servicing obligations relating to securitized mortgages where balance sheet derecognition has been achieved. For further information, refer to Note 11 to the consolidated financial statements.

We provide letters of credit, which are not reflected on the consolidated balance sheet, for the purpose of supporting developer obligations to municipalities in conjunction with residential construction loans. For further information, refer to Note 24 to the consolidated financial statements.

As at June 30, 2018, of our total single family mortgage renewal rights of \$936 million (March 31, 2018 - \$923 million), \$8 million related to off-balance sheet mortgages sold to third parties on a whole loan basis (March 31, 2018 - \$27 million).

MCAP is actively defending a claim arising from a power of sale process with respect to a defaulted land development loan previously funded by MCAN. The plaintiff has claimed improvident sale and has claimed damages of approximately \$6 million. MCAP was awarded a judgment for approximately \$500,000 against the same plaintiff in related proceedings. We may be subject to the indemnification of MCAP for certain liabilities that may be incurred as part of the proceedings under a mortgage servicing agreement between the two parties. Based on, among other things, the current status of the proceedings, we do not expect to incur any material liability arising out of this indemnification obligation to MCAP and accordingly have not recorded a provision.

DIVIDENDS

Consistent with the prior quarter, the Board declared a third quarter dividend of \$0.37 per share, to be paid on September 28, 2018 to shareholders of record as of September 14, 2018.

TRANSACTIONS WITH RELATED PARTIES

Related party transactions for the quarters ended June 30, 2018 and June 30, 2017 and related party balances as at June 30, 2018 are discussed in Note 22 to the consolidated financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The majority of our consolidated balance sheet consists of financial instruments, and the majority of net income is derived from the related income, expenses, gains and losses. Financial instruments include cash and cash equivalents, cash held in trust, marketable securities, mortgages, financial investments, other loans, financial liabilities from securitization, term deposits and loans payable, which are discussed throughout this MD&A.

The use of financial instruments exposes us to interest rate, credit, liquidity and market risk. A discussion of these risks and how these risks are managed is found in the "Risk Governance and Management" section of this MD&A.

Information on the financial statement classification and amounts of income, expenses, gains and losses associated with the instruments are located in the "Results from Operations" and "Financial Position" sections of this MD&A. Information on the determination of the fair value of financial instruments is located in the "Critical Accounting Estimates and Judgments" section of this MD&A.

PEOPLE

As at June 30, 2018, we had 75 employees (March 31, 2018 - 76).

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the Company's financial statements requires management to make judgments, estimations and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. Estimates are considered carefully and reviewed at an appropriate level within MCAN. We believe that our estimates of the value of our assets and liabilities are appropriate. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Critical Accounting Estimates

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated financial statements cannot be derived from active markets, they are determined using a variety of valuation techniques that may include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, estimates are required to establish fair values. These estimates include considerations of liquidity and model inputs such as discount rates, prepayment rates and default rate assumptions for certain investments.

Allowances for credit losses

The allowance for credit losses reduces the carrying value of mortgage assets by an estimate of the principal amounts that borrowers may not repay in the future. In assessing the estimated realizable value of assets, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. A number of factors can affect the amount that we ultimately collect, including the quality of our own underwriting process and credit criteria, the diversification of the portfolio, the underlying security relating to the loans and the overall economic environment. Allowances on impaired mortgages include all of the accumulated provisions for losses to reduce the assets to their estimated realizable value. Allowances depend on asset class, as different classes have varying underlying risks. Future changes in circumstances could materially affect net realizable values and lead to an increase or decrease the allowance for credit losses.

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Company's ECL calculations are model outputs with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Company's criteria for assessing if there has been a significant increase in credit risk which results in allowances being measured on a lifetime versus 12 month ECL basis;
- The segmentation of financial assets for the purposes of assessing ECL on a collective basis;
- Development of ECL models, including the various formulas and the choice of inputs; and
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs.

We review our ECL models on a quarterly basis. We continue to monitor asset performance and current economic conditions, focusing on any regionally specific issues to assess the adequacy of the current provisioning policies.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the consolidated financial statements. To reflect this, we may make temporary qualitative adjustments or overlays using expert credit judgment when such differences are material.

Mortgage prepayment rates

In calculating the rate at which borrowers prepay their mortgages, the Company makes estimates based on its historical experience. These assumptions impact the timing of revenue recognition and the amortization of mortgage premiums using the EIM.

Taxes

Uncertainties exist with respect to the interpretation of complex tax regulations, changes in tax laws and the amount and timing of future taxable income in the subsidiaries of the Company. Differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to the tax treatment of income and expenses already recorded in the subsidiaries of the Company.

The Company establishes provisions, based on reasonable estimates, for possible consequences of audits by relevant tax authorities. The amount of such provisions is based on various factors, such as experience of previous tax audits and interpretations of tax regulations by the responsible tax authority. As the Company assesses the probability of litigation and subsequent cash outflow with respect to taxes as remote, no contingent liability has been recognized.

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable income will be available against which the losses can be used in the subsidiaries of the Company. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized in the subsidiaries of the Company, based upon the likely timing and the level of future taxable income together with future tax planning strategies.

Impairment of financial assets

As applicable, the Company reviews financial assets at each consolidated financial statement date to assess whether an impairment loss should be recorded. In particular, estimates by management are required in the calculation of the amount and timing of future cash flows associated with these assets when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the fair value of the asset.

Critical Accounting Judgments**Going concern**

The Company's management has made an assessment of the Company's ability to continue as a going concern and is satisfied that the Company has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Company's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Significant influence

In determining whether it has significant influence over an entity, the Company makes certain judgments based on the applicable accounting standards. These judgments form the basis for the Company's policies in accounting for its equity investments.

Taxes

As a MIC under the Tax Act, the Company is able to deduct from income for tax purposes dividends paid within 90 days of year-end. The Company intends to maintain its status as a MIC and intends to pay sufficient dividends in current and future years to ensure that it is not subject to income taxes in the MIC entity on a non-consolidated basis. Accordingly, the Company does not record a provision for current and deferred taxes within the MIC entity; however provisions are recorded as applicable in all subsidiaries of MCAN.

STANDARDS ISSUED BUT NOT YET EFFECTIVE

Standards issued but not yet effective include IFRS 16, *Leases*, IFRS 2, *Share-based Payment Transactions* and IFRIC 23, *Uncertainty over Income Tax Treatments*. For further information on these standards, refer to Note 4 to the consolidated financial statements.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

As at June 30, 2018, the CEO and CFO of MCAN, along with the assistance of the Company's disclosure committee comprised of members of senior management, have designed disclosure controls and procedures to provide reasonable assurance that (i) material information relating to MCAN is made known to the CEO and CFO and (ii) information required to be disclosed by us in reports we file or submit is recorded, processed, summarized and reported within the time periods specified in securities legislation, and have designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

There were no changes in our internal controls over financial reporting that occurred during the interim period ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

We adopted IFRS 9 effective January 1, 2018 and have updated and modified certain internal controls over financial reporting as a result of the new accounting standard.

All internal control systems, no matter how well designed, have inherent limitations. As a result, even systems determined to be effective may not prevent or detect misstatements on a timely basis, as systems can provide only reasonable assurance that the objectives of the control system are met. In addition, projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may change.

Notice required under National Instrument 51-102, “Continuous Disclosure Obligations,” Part 4.3 (3) (a).

The accompanying consolidated interim financial statements of MCAN have not been reviewed by an auditor.

The Company is in compliance with the interim Management’s Discussion and Analysis of Operations requirements set out by National Instrument 51-102.

NON IFRS MEASURES

We prepare our consolidated financial statements in accordance with IFRS. We use a number of financial measures to assess our performance. Some of these measures are not calculated in accordance with IFRS, are not defined by IFRS, and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. The non-IFRS measures used in this MD&A are defined as follows:

Return on Average Shareholders' Equity

Return on average shareholders' equity is a profitability measure that presents the annualized net income available to shareholders as a percentage of the capital deployed to earn the income. We calculate return on average shareholders' equity as a monthly average using all components of shareholders' equity.

Taxable Income Measures

Taxable Income Measures include taxable income and taxable income per share. Taxable income represents MCAN's net income on a non-consolidated basis calculated under the provisions of the Tax Act applicable to a MIC. Taxable income is calculated as an estimate until we complete our annual tax returns subsequent to year end, at which point it is finalized.

Average Interest Rate

The average interest rate is a profitability measure that presents the average annualized yield of an asset or liability. Average mortgage portfolio yield (corporate or securitized), term deposit average interest rate, financial liabilities from securitization average interest rate, spread of mortgages over term deposits and spread of securitized assets over liabilities are examples of average interest rates. The average asset/liability balance that is incorporated into the average interest rate calculation is calculated on either a daily or monthly basis depending on the nature of the asset/liability. Please refer to the applicable tables containing average balances for further details.

Net Interest Income

Net interest income is a profitability measure that reflects net interest income earned only from interest-bearing assets and liabilities.

Impaired Mortgage Ratios

The impaired mortgage ratios represent the ratio of impaired uninsured mortgages to both corporate and total (corporate and securitized) mortgage principal.

Mortgage Arrears

Mortgage arrears measures include total corporate mortgage arrears, total securitized mortgage arrears and total mortgage arrears. These measures represent the amount of mortgages from the corporate portfolio, securitized portfolio and the sum of the two, respectively, that are at least one day past due.

Common Equity Tier 1, Tier 1 and Total Capital, Total Exposures, Regulatory Assets, Leverage Ratio, Assets to Capital Multiple and Risk Weighted Assets

These measures provided in this MD&A are in accordance with guidelines issued by OSFI and are located on Table 27 of this MD&A and Note 26 to the consolidated financial statements.

Tier 1, Tier 2, Tier 3 and Total Liquid Assets and Liquidity Ratios

Tier 1, Tier 2, Tier 3 and Total Liquid Assets are internal metrics that quantify the balance sheet assets (or components of assets) that comprise various liquidity levels. Liquidity ratios represent the ratio of select tiers of liquid assets to term deposits maturing within 100 days.

Income Tax Capital Measures

Income tax assets, income tax liabilities and income tax capital represent assets, liabilities and capital as calculated on a non-consolidated basis using the provisions of the Tax Act applicable to a MIC. The calculation of the income tax assets to capital ratio and income tax liabilities to capital ratio are based on these amounts. Income tax asset capacity represents additional income tax asset growth available to yield a 5.75 income tax assets to capital ratio, which is our target ratio.

Market Capitalization

Market capitalization is calculated as the number of common shares outstanding multiplied by the closing common share price as of that date.

Book Value per Common Share

Book value per common share is calculated as total shareholders' equity divided by the number of common shares outstanding.

Limited Partner's At-Risk Amount

The value of our equity investment in MCAP for income tax purposes is referred to as the Limited Partner's At-Risk Amount ("LP ARA"), which represents the cost base of the limited partner's investment in the partnership. The LP ARA is increased (decreased) by the partner's share of partnership income (loss) on a tax basis, increased by the amount of capital contributions into the partnership and reduced by distributions received from the partnership.