



Quarterly Report 2018 Q1

A STRATEGIC INVESTOR IN CANADIAN MORTGAGES



DESCRIPTION OF BUSINESS

MCAN Mortgage Corporation ("MCAN") is a public company listed on the Toronto Stock Exchange ("TSX") under the symbol MKP and is a reporting issuer in all provinces and territories in Canada. MCAN is a Loan Company under the *Trust and Loan Companies Act* (Canada) (the "Trust Act") and also qualifies as a mortgage investment corporation ("MIC") under the *Income Tax Act* (Canada) (the "Tax Act").

Our objective is to generate a reliable stream of income by investing our funds in a diversified portfolio of mortgages (including single family residential, residential construction, non-residential construction and commercial loans), as well as other types of loans and investments, real estate and securitization investments. We employ leverage by issuing term deposits eligible for Canada Deposit Insurance Corporation ("CDIC") deposit insurance up to a maximum of five times capital (on a non-consolidated basis in the MIC entity) as limited by the provisions of the Tax Act applicable to a MIC. Our term deposits are sourced through a network of independent financial agents.

As a MIC, we are entitled to deduct from income for tax purposes 50% of capital gains dividends and 100% of non-capital gains dividends that we pay to shareholders. Such dividends are taxed in the hands of our shareholders as capital gains dividends and interest income, respectively, to the extent that they are held in a non-registered plan. Dividends paid to foreign investors outside of Canada may be subject to withholding taxes.

MCAN's wholly-owned subsidiary, XMC Mortgage Corporation ("XMC") (formerly Xceed Mortgage Corporation), is an originator of residential first-charge mortgage products across Canada. As such, XMC operates primarily in one industry segment through its sales team and mortgage brokers.

TABLE OF CONTENTS

PRESIDENT AND CEO'S MESSAGE TO SHAREHOLDERS.....	3
MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS.....	5
CONSOLIDATED FINANCIAL STATEMENTS.....	51
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.....	55
DIRECTORS AND EXECUTIVE OFFICERS.....	89
CORPORATE INFORMATION	90

MESSAGE TO SHAREHOLDERS

MCAN Mortgage Corporation (“MCAN”, the “Company” or “we”) reported net income for the first quarter of 2018 of \$10.6 million compared to \$10.3 million earned in the first quarter of 2017.

Earnings per share totalled \$0.45 for the first quarter of 2018 compared to \$0.44 in the first quarter of 2017. First quarter 2018 return on average shareholders’ equity was 14.10% compared to 14.37% in the prior year.

The Board of Directors (the “Board”) declared a quarterly dividend of \$0.37 per share on May 8, 2018 to be paid on June 29, 2018.

Effective January 1, 2018, we prospectively adopted IFRS 9, *Financial Instruments*. IFRS 9 has resulted in changes to MCAN’s accounting policies for the impairment of financial assets and the recognition, classification and measurement of financial assets and liabilities. We have not restated comparative financial information for 2017.

Corporate Assets

Corporate assets totalled \$1.12 billion at March 31, 2018, a decrease of \$61 million from December 31, 2017. The corporate mortgage portfolio decreased by \$4 million during the first quarter of 2018 to \$859 million from \$863 million, which included decreases of \$44 million in completed inventory loans, \$5 million in insured single family and \$2 million in uninsured single family, and increases of \$19 million in construction loans and \$28 million in commercial loans.

Mortgage arrears totalled \$19 million at March 31, 2018, compared to \$18 million at December 31, 2017. The March 31, 2018 balance consists entirely of single family mortgages, \$7.0 million of which were uninsured.

The impaired total mortgage ratio increased to 0.10% at March 31, 2018 from 0.09% as at December 31, 2017, while the impaired corporate mortgage ratio increased to 0.22% from 0.20% during the same period. We remain vigilant and continue to use underwriting and credit standards and default management practices which we believe are conservative and appropriate in the context of the current market.

Equity income from our investment in MCAP Commercial LP (“MCAP”) increased to \$3.4 million in the first quarter of 2018 from \$1.9 million in the prior year. MCAP earned higher income from non-securitized mortgages from a larger average portfolio, increased hedge gains and decreased income tax expense in the first quarter of 2018. MCAP’s Q1 2018 origination volumes were \$3.1 billion (Q1 2017 - \$3.0 billion). MCAP had \$66.8 billion of assets under administration as at February 28, 2018 (November 30, 2017 - \$65.9 billion).

Additionally, we recognized a \$1.7 million gain on the sale of a portion of our partnership units in MCAP, which reduced our ownership interest from 14.41% to 13.83%.

Securitization Assets

During the first quarter of 2018, we securitized \$28 million of insured single family mortgages through the National Housing Act (“NHA”) mortgage-backed securities (“MBS”) program (Q1 2017 - \$48 million). Changes to mortgage regulations have reduced volumes in the market and have led to tightened securitization spreads. These changes have led to a reduction in securitization volumes and a reduction in the associated securitization economics. We have reduced our securitization volumes to a level where we are primarily securitizing mortgages that we have renewed. We will continue to securitize mortgages to the extent that it is profitable.

Business Activities

There has been an unprecedented number of rule changes affecting residential mortgage lending in the past year by the federal and provincial governments. These have impacted mortgage affordability and demand for housing, as already observed in the first quarter of 2018. OSFI implemented significant changes to Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* as of January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower’s contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada’s benchmark rate and the borrower contractual rate. We expect that the uninsured stress test will continue to have some impact on the proportion of mortgages that we approve based on the borrower’s ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Housing markets experienced lower housing sales activity levels in Q1 2018, with both the Greater Toronto Area (“GTA”) and the Greater Vancouver Area (“GVA”) recording lower resale and new home sales levels. GTA residential home sales dropped 39.5% in March 2018 compared to March 2017, with sale volumes down 17.6% from the 10-year March average. GVA residential home sales dropped 29.7% in March 2018 compared to March 2017, with sale volumes 23% below the 10-year March average. The GTA

saw home price weakness experiencing a 14.3% drop in resale prices in March 2018 compared to March 2017. The GVA experienced a 16.1% increase in home prices in March 2018 compared to March 2017. The GVA experienced price weakness in 2017 and now is seeing recovery a year after provincial regulations and taxes came into effect in 2017.

We have observed evidence of a buyer's market in the first quarter, with fewer examples of multiple bidders on homes creating high price inflation in the Toronto and Vancouver markets that we observed in 2016 and 2017. Several suburban markets in the GTA saw significant price weakness. Given the weakness in sales levels experienced in the quarter in Canada's two largest housing markets, and increased volatility in home prices, we maintained our conservative underwriting and credit standards.

MCAN is a diversified lender to housing markets, and temporarily adjusted its corporate mortgage portfolio composition in 2017 by opportunistically deploying capital into other business lines such as commercial and construction lending to compensate for the shortfall in the single family business given the uncertainties in that market. We believe that certain lower-risk segments of the commercial mortgage market, such as loans secured by apartment buildings, represent good lending opportunities in a slowing single family market as they are counter-cyclical to home sales.

MCAN has considerable experience in commercial and construction lending. New home construction markets remain in balance due to lot supply constraints. We continue to see new project lending opportunities supported by strong presales and experienced builders and developers.

Our corporate assets decreased by 5% in the first quarter of 2018, compared to our stated annual growth target of 10%. 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. The combination of the current weakness in home values in Canada's two major markets and a tighter marketplace has led to a moderation in our single family volumes.

We believe that we are well positioned to adapt to the uncertainty of the upcoming year, with a sound liquidity position and available income tax asset capacity of \$356 million.



William Jandrisits
President and Chief Executive Officer

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 March 31, 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 May 8, 2018.

Effective January 1, 2018, MCAN prospectively adopted IFRS 9, *Financial Instruments* and did not restate prior period information. Accordingly, financial information for the quarter ended March 31, 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.

TABLE OF CONTENTS - MD&A

A CAUTION ABOUT FORWARD-LOOKING INFORMATION AND STATEMENTS	6
SELECTED FINANCIAL INFORMATION	8
HIGHLIGHTS	10
OUTLOOK	11
RESULTS OF OPERATIONS	13
FINANCIAL POSITION	23
SELECTED QUARTERLY FINANCIAL DATA	34
SECURITIZATION PROGRAMS	35
CAPITAL MANAGEMENT	37
LIQUIDITY MANAGEMENT	41
RISK GOVERNANCE AND MANAGEMENT	42
DESCRIPTION OF CAPITAL STRUCTURE	45
OFF-BALANCE SHEET ARRANGEMENTS	45
DIVIDENDS	46
TRANSACTIONS WITH RELATED PARTIES	46
FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS	46
PEOPLE	46
CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS	47
CHANGES IN ACCOUNTING POLICIES	48
STANDARDS ISSUED BUT NOT YET EFFECTIVE	48
DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING	49
NON-IFRS MEASURES	50

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 %)				
For the Quarters Ended March 31	2018 ¹	2017	Change from 2017	
			(\$)	(%)
Income Statement Highlights				
Net investment income - corporate assets	\$ 12,073	\$ 12,963	\$ (890)	(6.9%)
Net investment income - securitization assets	1,301	1,291	10	0.8%
	13,374	14,254	(880)	(6.2%)
Other income	1,701	876	825	94.2%
Operating expenses	4,631	4,617	14	0.3%
Net income before income taxes	10,444	10,513	(69)	(0.7%)
Provision for (recovery of) income taxes	(171)	248	(419)	(169.0%)
Net income	\$ 10,615	\$ 10,265	\$ 350	3.4%
Basic and diluted earnings per share	\$ 0.45	\$ 0.44	\$ 0.01	2.3%
Dividends per share	\$ 0.37	\$ 0.30	\$ 0.07	23.3%
Next quarter's dividend per share	\$ 0.37			
Return on average shareholders' equity ²	14.10%	14.37%		(0.27%)
Taxable income per share ^{2,4}	\$ 0.19	\$ 0.38	\$ (0.19)	(50.0%)
Yields				
Average mortgage portfolio yield - corporate ³	5.72%	5.14%		0.58%
Term deposit average interest rate ³	2.38%	2.20%		0.18%
Spread of mortgages over term deposits	3.34%	2.94%		0.40%
Average mortgage portfolio yield - securitized ³	2.57%	2.61%		(0.04%)
Financial liabilities from securitization				
- average interest rate ³	1.83%	1.90%		(0.07%)
Spread of mortgages over liabilities	0.74%	0.71%		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 %)	March 31 2018 ¹	December 31 2017	Change from Prior Quarter	
			(\$)	(%)
Balance Sheet Highlights				
Assets				
Corporate	\$ 1,121,806	\$ 1,182,371	\$ (60,565)	(5%)
Securitization	1,032,078	1,034,404	(2,326)	-
Total assets	\$ 2,153,884	\$ 2,216,775	\$ (62,891)	(3%)
Mortgages - corporate	\$ 859,372	\$ 863,384	\$ (4,012)	-
Mortgages - securitized	\$ 1,013,036	\$ 1,016,724	\$ (3,688)	-
Liabilities				
Corporate	\$ 836,542	\$ 904,099	\$ (67,557)	(7%)
Securitization	1,015,296	1,015,699	(403)	-
Total liabilities	\$ 1,851,838	\$ 1,919,798	\$ (67,960)	(4%)
Shareholders' equity	\$ 302,046	\$ 296,977	\$ 5,069	2%
Capital Ratios ²				
Income Tax Assets to Capital Ratio	4.33	4.60		(6%)
Common Equity Tier 1 Capital Ratio ⁴	21.29%	21.26%		0.03%
Tier 1 Capital Ratio ⁴	21.29%	21.26%		0.03%
Total Capital Ratio ⁴	21.29%	21.26%		0.03%
Leverage ratio ³	11.74%	11.31%		0.43%
Credit Quality				
Impaired mortgage ratio (total) ²	0.10%	0.09%		0.01%
Impaired mortgage ratio (corporate) ²	0.22%	0.20%		0.02%
Mortgage Arrears ⁶				
Corporate	\$ 9,204	\$ 8,766	\$ 438	5%
Securitized	9,554	8,803	751	9%
Total	\$ 18,758	\$ 17,569	\$ 1,189	7%
Common Share Information (end of period)				
Number of common shares outstanding	23,559	23,378		1%
Book value per common share ²	\$ 12.82	\$ 12.70	\$ 0.12	1%
Common share price - close	\$ 17.61	\$ 17.84	\$ (0.23)	(1%)
Market capitalization ²	\$ 414,874	\$ 417,064	\$ (2,190)	(1%)

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 Represents 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

Income Statement

- We earned net income of \$10.6 million compared to net income of \$10.3 million earned in Q1 2017.
- Earnings per share totalled \$0.45 per share in Q1 2018, up from \$0.44 per share in Q1 2017.
- Return on average shareholders' equity¹ was 14.10% in Q1 2018 compared to 14.37% in Q1 2017.
- Our equity investment in MCAP Commercial LP ("MCAP") continued to provide solid equity income of \$3.4 million, up from \$1.9 million in Q1 2017.
- We recognized a \$1.7 million gain on the sale of a portion of our partnership units in MCAP, which reduced our ownership interest from 14.41% to 13.83%.
- Income from financial investments and other loans decreased to \$1.6 million in Q1 2018 from \$4.3 million in Q1 2017 due to a significant non-recurring income distribution received from Crown Realty II Limited Partnership ("Crown LP") in Q1 2017.
- We prospectively adopted IFRS 9 effective January 1, 2018 and did not restate prior period financial information, which is governed by IAS 39. IFRS 9 impacts the calculation of our provision for credit losses and requires us to record unrealized gains and losses on marketable securities and financial investments through the consolidated income statement.

Corporate Activity

- Corporate assets, which totalled \$1.12 billion at March 31, 2018, decreased by \$61 million from December 31, 2017.
- The corporate mortgage portfolio decreased by \$4 million during Q1 2018 to \$859 million from \$863 million, which included decreases of \$44 million in uninsured completed inventory, \$5 million in insured single family and \$2 million in uninsured single family, partially offset by increases of \$19 million in construction loans and \$28 million in commercial loans.
- Corporate mortgage originations increased significantly to \$111 million in Q1 2018 from \$60 million in Q1 2017, primarily driven by increased commercial mortgage originations.
- Financial investments increased by \$5 million (8%) during Q1 2018 to \$73 million from \$68 million.
- Cash and cash equivalents decreased to \$62 million from \$118 million during Q1 2018 to a level more in line with our internal liquidity targets.

Dividend

- Consistent with the first quarter dividend, the Board of Directors (the "Board") declared a second quarter dividend of \$0.37 per share to be paid on June 29, 2018 to shareholders of record as of June 15, 2018.

Credit Quality

- The impaired total mortgage ratio^{1,2} increased to 0.10% at March 31, 2018 from 0.09% at December 31, 2017.
- The impaired corporate mortgage ratio^{1,2} increased to 0.22% at March 31, 2018 from 0.20% at December 31, 2017.
- Total mortgage arrears^{1,3} were \$19 million at March 31, 2018, compared to \$18 million at December 31, 2017. The March 31, 2018 balance consists entirely of single family mortgages, \$7.0 million of which were uninsured.
- Net write-offs were 0.6 basis points of the average corporate portfolio in Q1 2018 compared to 11.9 basis points in Q1 2017.
- The average loan to value ratio ("LTV") of our uninsured single family portfolio based on an industry index of current real estate values was 53.1% at March 31, 2018 compared to 52.6% at December 31, 2017.

Capital

- Our Common Equity Tier 1, Tier 1 and Total Capital to risk-weighted assets ratios¹ were 21.29% at March 31, 2018 compared to 21.26% at December 31, 2017.
- Our leverage ratio¹ was 11.74% at March 31, 2018 compared to 11.31% at December 31, 2017.
- Income tax asset capacity¹ was \$356 million at March 31, 2018 compared to \$287 million at December 31, 2017. 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

The revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test will continue to have some impact on the proportion of mortgages that we approve and will have the largest impact on market origination activity.

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.

We expect home sale levels to slow considerably in Ontario as buyers react to the uncertainty caused by the multiple rule changes, with significant increases in the number of days that 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 and more available listings. We expect that the negative impact of the announced changes will impact the Greater Toronto Area ("GTA") market for the first half of 2018, similar to what occurred in the Greater Vancouver Area ("GVA") market in 2017.

We expect the GVA to see reduced sales activity in 2018 but we expect price inflation to return as demand is expected to outpace supply. There continues to be a lack of inventory in this market, which has and will continue to push prices upward.

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

Impact on MCAN

Currently, there is a significant degree of uncertainty surrounding the future performance of the mortgage market. We believe that the mortgage market will require at least two quarters to adjust to the new underwriting rules of Guideline B-20 and other new regulations. While we continue to see significantly reduced home sales and weakening prices, we will continue to moderate our origination volumes.

We expect to see some offset by way of stronger activity from the renewal of our own mortgages that are not subject to the same stress tests as newly originated mortgages. We also expect to see an increase in the level of activity from the prime mortgage market to the alternative market that fits within our XMC-originated mortgage products. In late 2017 we commenced new acquisition programs for single family mortgages from MCAP and another third party originator and we will continue examining additional opportunities in 2018.

MCAN is a diversified lender to housing markets, and temporarily adjusted its corporate mortgage portfolio composition in 2017 by opportunistically deploying capital into other business lines such as commercial and construction lending to compensate for the shortfall in the single family business given the uncertainties in that market. We believe that certain lower-risk segments of the commercial mortgage market, such as loans secured by apartment buildings, represent good lending opportunities in a slowing single family market.

Our disciplined approach to investment in mortgages resulted in MCAN not aggressively growing its uninsured single family mortgage portfolio when the GTA and GVA markets were at record high home prices. We believe that this conservative approach and the moderation of originations amidst market volatility will reduce our exposure to loss in the event of a market correction.

MCAN has considerable experience in commercial and construction lending, and has strategic lending relationships with MCAP and KingSett Capital that provide MCAN with access to origination and risk-managed participation in commercial and construction lending opportunities. We will continue to leverage our strategic business relationships to earn appropriate risk adjusted returns.

Our corporate assets decreased by 5% in the first quarter of 2018 compared to our stated annual growth target of 10%. While we maintain our stated annual growth target for corporate assets of 10% per annum, 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. The combination of the current weakness in home values in Canada's two major markets and a tighter marketplace has led to a moderation in our single family volumes.

We expect our equity investments in MCAP, Crown LP and the KingSett High Yield Fund (“KSHYF”) to positively contribute to our earnings in 2018. In the first quarter we recognized a \$1.7 million gain on the partial sale of our investment in MCAP, which reduced our ownership interest from 14.41% to 13.83%. The growth of the KSHYF since Q2 2017 has advanced our investment level and is expected to continue to have a positive impact on future income from this investment. In the first quarter of 2018 we funded an additional \$5 million of our capital commitment relating to our investment in the KSHYF.

With low impaired mortgage ratios and arrears, we believe that MCAN’s balance sheet is well positioned in the current market. In addition, with over 50% of our consolidated balance sheet represented by insured mortgages, we believe that our asset composition provides a sound risk adjusted return to our shareholders. As the uncertainty in the current market evolves, we believe that our strong capital position and asset capacity can be deployed if and when opportunities arise.

RESULTS OF OPERATIONS

Table 3: Net Income - For the Quarters Ended March 31

(in thousands except for per share amounts and %)	2018 ¹	2017	Change from 2017	
			(\$)	(%)
Net Investment Income - Corporate Assets				
Mortgage interest	\$ 12,000	\$ 11,555	\$ 445	4%
Equity income from MCAP Commercial LP	3,439	1,892	1,547	82%
Financial investments and other loans	1,554	4,263	(2,709)	(64%)
Marketable securities	878	846	32	4%
Fees	363	291	72	25%
Interest on cash and cash equivalents	287	158	129	82%
Unrealized gain (loss) on financial instruments ^{1,3}	(56)	-	(56)	-
	18,465	19,005	(540)	(3%)
Term deposit interest and expenses	5,247	5,021	226	5%
Mortgage expenses	951	959	(8)	(1%)
Interest on loans payable	20	32	(12)	(38%)
Provision for credit losses ^{1,2}	174	30	144	480%
	6,392	6,042	350	6%
	12,073	12,963	(890)	(7%)
Other Income - Corporate Assets				
Gain on sale of investment in MCAP Commercial LP	1,701	785	916	117%
Gain on dilution of investment in MCAP Commercial LP	-	91	(91)	(100%)
	1,701	876	825	94%
Net Investment Income - Securitization Assets				
Mortgage interest	6,493	6,772	(279)	(4%)
Other securitization income	72	36	36	100%
	6,565	6,808	(243)	(4%)
Interest on financial liabilities from securitization	4,681	5,011	(330)	(7%)
Mortgage expenses	568	506	62	12%
Provision for credit losses ^{1,2}	15	-	15	-
	5,264	5,517	(253)	(5%)
	1,301	1,291	10	1%
Operating Expenses				
Salaries and benefits	2,945	2,594	351	14%
General and administrative	1,686	2,023	(337)	(17%)
	4,631	4,617	14	0%
Net Income Before Income Taxes	10,444	10,513	(69)	(1%)
Provision for (recovery of) income taxes	(171)	248	(419)	(169%)
Net Income	\$ 10,615	\$ 10,265	\$ 350	3%
Basic and diluted earnings per share	\$ 0.45	\$ 0.44	\$ 0.01	2%
Dividends per share	\$ 0.37	\$ 0.30	\$ 0.07	23%

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.

Net Investment Income - Corporate Assets

Mortgage interest income

Table 4: Interest Income and Average Rate by Mortgage Portfolio - Q1

For the Quarters Ended March 31	2018			2017		
	Average Balance	Interest Income	Average Rate ¹	Average Balance	Interest Income	Average Rate ¹
(in thousands except %)						
Single family						
- Uninsured	\$ 200,142	\$ 2,315	4.65%	\$ 243,682	\$ 2,785	4.58%
- Insured	66,001	535	3.26%	106,261	842	3.17%
- Uninsured - completed inventory	17,314	245	5.73%	21,157	305	5.84%
Construction loans						
- Residential	394,128	6,140	6.32%	389,383	5,170	5.39%
- Non residential	4,098	60	5.91%	7,860	105	5.44%
Commercial loans						
- Multi family residential	73,238	951	5.27%	34,805	388	4.50%
- Other commercial	93,602	1,754	7.61%	105,131	1,960	7.57%
Mortgages - corporate portfolio	\$ 848,523	\$ 12,000	5.72%	\$ 908,279	\$ 11,555	5.14%
Term deposits	837,715	5,247	2.38%	867,954	5,021	2.20%
Spread of mortgages over term deposits			3.34%			2.94%
Mortgages - securitized portfolio	\$ 1,015,325	\$ 6,493	2.57%	\$ 1,052,243	\$ 6,772	2.61%
Financial liabilities from securitization	1,023,721	4,681	1.83%	1,061,015	5,011	1.90%
Spread of mortgages over liabilities			0.74%			0.71%

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 March 31, 2018 and March 31, 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 which had and are expected to continue to have a positive impact on mortgage interest income related to the floating rate component of our corporate mortgage portfolio. These rate increases contributed 0.69% and 0.43%, respectively, to the average interest rate for the construction and total corporate portfolios in Q1 2018, as approximately 98% and 60% of those respective portfolios are floating rate and repriced following the rate increases.

Additionally, in Q1 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 to the increase in the average interest rate from Q1 2017.

We continued to steadily grow our construction portfolio in Q1 2018, consistent with the seasonal growth experienced in Q1 2017 and prior years. Over the past two quarters, we have increased our commitment pipeline in this portfolio with a view to deploying excess asset capacity after temporarily curtailing new commitments in mid-2017 due to liquidity issues in the market. While we continue to target experienced builders in markets with favourable economic activity, we ensure that new lending fits within our risk appetite. 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.

We have also experienced steady growth in our commercial loan portfolio, which provides a different risk profile from single family while providing appropriate risk-adjusted returns. The majority of the growth since Q1 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 Q1 2018, we 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 Q1 2017, has remained consistent for 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 and have steadily increased origination volumes to maintain our portfolio balance. We funded \$5.4 million from external sources during Q1 2018.

Revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Our insured single family origination and securitization volumes have remained low since 2017. The impact of multiple changes to mortgage regulations enacted within the last two years have made that market segment more competitive and have also led reduced securitization economics.

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 increase in equity income from MCAP from Q1 2017 was a result of higher income from non-securitized mortgages from a larger average portfolio, increased hedge gains and a decrease in income tax expense.

We recognize equity income from MCAP on a one-month lag such that our Q1 2018 equity income from MCAP is based on MCAP's net income for the quarter ended February 28, 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 decrease in income from financial investments and other loans is primarily due to \$3.5 million of distribution income recognized from Crown LP in Q1 2017, compared to \$0.3 million in Q1 2018. The decrease is due to the fact that we received a significant non-recurring income distribution in Q1 2017, while the Q1 2018 distribution represented a regular distribution of operating income by Crown LP.

Income from financial investments and other loans also includes \$1.2 million of income from our investment in the KSHYF (Q1 2017 - \$0.8 million). For further information on both of these investments, refer to the "Other Corporate Assets" sub-section of the "Financial Position" section of this MD&A.

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

In 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.

In Q1 2017, we sold 100,000 partnership units in MCAP at a price of \$19.47 per unit (compared to a net book value of \$11.62 per unit), recognizing a gain on sale of \$0.8 million. MCAP also issued additional class B units to other partners of MCAP during 2017 which diluted our equity interest. Since the new units were issued at a price in excess of our carrying value per unit, we recorded a dilution gain of \$0.1 million.

The Q1 2018 unrealized loss on financial instruments consisted of an unrealized loss of \$0.6 million on marketable securities and an unrealized gain of \$0.5 million on financial investments. Unrealized gains and losses on marketable securities and financial

investments are now recorded through the consolidated income statement as a result of the adoption of IFRS 9 effective January 1, 2018. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

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 Q1 2018, our total securitization volumes were \$28 million (Q1 2017 - \$48 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 \$869 million in Q1 2018 from \$949 million in Q1 2017, while the net spread increased to 0.76% from 0.71% as a result of higher net penalty income. As noted earlier, new securitization volumes have been low since 2017.

CMB Program

The average outstanding CMB program mortgage balance increased to \$147 million in Q1 2018 from \$103 million in Q1 2017, while the net spread decreased to 0.62% from 0.73%. Historically, the CMB program spread is higher than the market MBS program spread due to a lower funding cost. However, the tightening of spreads in CMB issuances from 2017 has made the CMB program net spread lower than that from the market MBS program.

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 5: Net Interest Income - Q1

For the Quarters Ended March 31 (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	\$ 104,452	\$ 287	1.11%	\$ 78,200	\$ 158	0.82%
Marketable securities	61,660	878	5.77%	56,293	846	6.09%
Mortgages - corporate	848,523	12,000	5.72%	908,279	11,555	5.14%
Financial investments	39,108	1,238	12.84%	24,332	763	12.72%
Other loans	2,546	34	5.42%	3,673	46	5.08%
Corporate interest earning assets	1,056,289	14,437	5.54%	1,070,777	13,368	5.06%
Cash held in trust	12,596	49	1.58%	12,977	10	0.31%
Mortgages - securitized	1,015,325	6,493	2.57%	1,052,243	6,772	2.61%
Securitization interest earning assets	1,027,921	6,542	2.58%	1,065,220	6,782	2.58%
Total interest earning assets	2,084,210	20,979	4.08%	2,135,997	20,150	3.83%
Non interest earning assets	91,977	282	-	91,035	3,454	-
Total assets	\$ 2,176,187	\$ 21,261	3.96%	\$ 2,227,032	\$ 23,604	4.30%
Liabilities and shareholders' equity						
Term deposits	\$ 837,715	\$ 5,247	2.38%	\$ 867,954	\$ 5,021	2.20%
Loans payable	1,900	20	4.27%	3,789	32	3.43%
Corporate liabilities	839,615	5,267	2.39%	871,743	5,053	2.21%
Securitization liabilities	1,023,721	4,681	1.83%	1,061,015	5,011	1.90%
Total interest bearing liabilities	1,863,336	9,948	2.13%	1,932,758	10,064	2.06%
Non interest bearing liabilities	11,735	-	-	8,613	-	-
Shareholders' equity	301,116	-	-	285,661	-	-
Total liabilities and shareholders' equity	\$ 2,176,187	\$ 9,948	1.85%	\$ 2,227,032	\$ 10,064	1.83%
Net Interest Income²		\$ 11,313			\$ 13,540	

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, 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 March 31, 2018 and March 31, 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

We prospectively adopted IFRS 9 effective January 1, 2018. Prior period information has not been restated. Under IFRS 9, we segregate the provision for credit losses between impaired mortgages and performing mortgages. The provision for credit losses on impaired mortgages under IFRS 9 replaces the individual provision under IAS 39, while the provision on performing mortgages under IFRS 9 replaces the collective provision under IAS 39. For further information on provisions for credit losses under IFRS 9, refer to Note 4 to the consolidated financial statements.

Table 6: Provisions for Credit Losses and Write-offs

(in thousands except basis points)				
	IFRS 9	IAS 39	Change from 2017	
For the Quarters Ended March 31	2018	2017	(\$)	(%)
Provision (recovery) on impaired corporate mortgages ¹				
Single family uninsured	\$ 64	\$ 94	\$ (30)	(32%)
Provision (recovery) on performing corporate mortgages ²				
Single family insured	(1)	-	(1)	-
Single family uninsured	32	(81)	113	(140%)
Single family uninsured - completed inventory	(352)	38	(390)	(1026%)
Construction	138	81	57	70%
Commercial				
Multi family residential	137	9	128	1422%
Other commercial	171	(110)	281	(255%)
	125	(63)	188	(298%)
Other provisions (recoveries)	(15)	(1)	(14)	1400%
Corporate provision for credit losses	174	30	144	480%
Provision (recovery) on performing securitized mortgages ²	15	-	15	-
Total provision for (recovery of) credit losses	\$ 189	\$ 30	\$ 159	530%
Corporate mortgage portfolio data:				
Provision for (recovery of) credit losses	\$ 189	\$ 31	\$ 158	510%
Net write offs	\$ 13	\$ 270	\$ (257)	(95%)
Net write offs (basis points)	0.6	11.9	(11.3)	(95%)

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.

Write-offs in Q1 2017 include \$220,000 relating to capitalized legal fees on a construction loan for which an individual allowance had already been recorded. The remainder of the Q1 2017 balance and the entire Q1 2018 balance consist of write-offs of uninsured single family mortgages for which an individual allowance had already been recorded. Accordingly, these write-offs had no impact on net income.

Operating Expenses

Table 7: Operating Expenses

(in thousands)					
For the Quarters Ended March 31	2018		2017		Change from 2017
					(\$) (%)
Salaries and benefits	\$	2,945	\$	2,594	\$ 351 14%
General and administrative		1,686		2,023	(337) (17%)
	\$	4,631	\$	4,617	\$ 14 0%

The increase in salaries and benefits is a result of an increase in the number of employees from Q1 2017. Our headcount has increased since 2017 as we have continued to expand our risk management and corporate governance departments.

General and administrative expenses were higher in Q1 2017 due to expenditures associated with the development of systems and processes related to single family mortgage operations. At that time, we were undertaking multiple projects to improve governance and mitigate risk.

Provision for Income Taxes

Table 8: Income Taxes

(in thousands)					
For the Quarters Ended March 31	2018		2017		Change from 2017
					(\$) (%)
Deferred tax provision (recovery)	\$	(171)	\$	248	\$ (419) \$ (169%)
	\$	(171)	\$	248	\$ (419) \$ (169%)

Deferred tax provisions (recoveries) are generally due to taxable income (losses) recognized at the subsidiary level.

As at March 31, 2018, we had \$11 million of losses available for carry-forward in the MCAN mortgage investment corporation ("MIC") parent company on a non-consolidated basis (December 31, 2017 - \$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. Tax activity for fiscal 2017 has not been reflected in the loss carry-forward balance as our 2017 tax position has not been officially finalized. 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.

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 9: Taxable Income Reconciliation ¹

(in thousands)		
For the Quarters Ended March 31	2018	2017
Net income for accounting purposes	\$ 10,615	\$ 10,265
Adjustments:		
Deduct: Equity income from MCAP - accounting purposes	(3,439)	(1,892)
Add: MCAP taxable income (loss)	(3,737)	2,287
Deduct: Accounting gain on partial sale of MCAP ⁴	(1,701)	(785)
Add: Taxable gain on partial sale of MCAP ⁴	1,425	536
Provision for (recovery of) credit losses ²	145	(81)
Amortization of upfront securitization program costs ³	1,772	1,661
Securitization program mortgage origination costs ³	(319)	(723)
Unrealized loss on financial instruments ²	575	-
Equity income from subsidiaries ²	(392)	(1,892)
Other securitization program cash outflows	(269)	(582)
Gain on dilution of investment in MCAP ²	-	(91)
Other items	(204)	143
Taxable Income	\$ 4,471	\$ 8,846

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 significant decrease in taxable income in Q1 2018 was driven primarily by timing differences between accounting and taxable income in respect of a number of securitization transactions that MCAP completed during Q1 2018. These timing differences are expected to reverse over the duration of the associated transactions.

The key differences between taxable income and pre-tax net income for accounting purposes include differences between equity income from MCAP and XMC for accounting and tax purposes and the treatment of securitization program origination costs, securitization gains and losses, unrealized gains (losses) on marketable securities, capital gains income, collective provisions for credit losses and the amortization of upfront securitization program costs for tax purposes.

We originate and purchase insured mortgages that are securitized through the market MBS program and CMB program and sold to third parties or retained on our balance sheet (for further details on these programs, refer to the "Securitization Programs" section of this MD&A). The purchase of mortgages involves the payment of an up-front origination fee that is deductible for income tax purposes in the period that the mortgages are securitized, while for accounting purposes this fee is capitalized and amortized over the term of the associated mortgages. In Q1 2018, we incurred \$0.3 million of origination costs on securitized mortgages, including market MBS held by MCAN (Q1 2017 - \$0.7 million). As at March 31, 2018, the unamortized origination fee balance was \$10.8 million (December 31, 2017 - \$11.9 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.

MCAN's MIC status allows it to deduct dividends paid within 90 days of year end from taxable income. Dividends that are deducted in the calculation of taxable income are not included in the table above.

As a MIC, we typically pay out all of our taxable income to shareholders through dividends. 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.

Table 10: Quarterly Net Income

(in thousands except per share amounts and %)				
For the Quarters Ended	March 31 2018	December 31 2017	Change from Prior Quarter (\$) (%)	
Net Investment Income - Corporate Assets				
Mortgage interest	\$ 12,000	\$ 12,109	\$ (109)	(1%)
Equity income from MCAP Commercial LP	3,439	5,457	(2,018)	(37%)
Financial investments and other loans	1,554	1,517	37	2%
Marketable securities	878	854	24	3%
Fees	363	321	42	13%
Interest on cash and cash equivalents	287	320	(33)	(10%)
Unrealized gain (loss) on financial instruments ^{1,3}	(56)	-	(56)	-
	18,465	20,578	(2,113)	(10%)
Term deposit interest and expenses	5,247	5,233	14	0%
Mortgage expenses	951	951	-	-
Interest on loans payable	20	2	18	900%
Provision for credit losses ^{1,2}	174	33	141	427%
	6,392	6,219	173	3%
	12,073	14,359	(2,286)	(16%)
Other Income - Corporate Assets				
Gain on sale of investment in MCAP Commercial LP	1,701	-	1,701	-
	1,701	-	1,701	-
Net Investment Income - Securitization Assets				
Mortgage interest	6,493	6,449	44	1%
Other securitization income	72	82	(10)	(12%)
	6,565	6,531	34	1%
Interest on financial liabilities from securitization	4,681	4,594	87	2%
Mortgage expenses	568	521	47	9%
Provision for credit losses ^{1,2}	15	-	15	-
	5,264	5,115	149	3%
	1,301	1,416	(115)	(8%)
Operating Expenses				
Salaries and benefits	2,945	2,595	350	13%
General and administrative	1,686	2,707	(1,021)	(38%)
	4,631	5,302	(671)	(13%)
Net Income Before Income Taxes	10,444	10,473	(29)	(0%)
Provision for (recovery of) income taxes	(171)	(334)	163	(49%)
Net Income	\$ 10,615	\$ 10,807	\$ (192)	(2%)
Basic and diluted earnings per share	\$ 0.45	\$ 0.47	\$ (0.02)	(4%)
Dividends per share	\$ 0.37	\$ 0.37	\$ -	-

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.

Q1 2018 vs. Q4 2017

Net Investment Income - Corporate Assets

Table 11: Interest Income and Average Rate by Mortgage Portfolio (Corporate)

For the Quarters Ended (in thousands except %)	March 31, 2018			December 31, 2017		
	Average Balance	Interest Income	Average Rate ¹	Average Balance	Interest Income	Average Rate ¹
Single family						
- Uninsured	\$ 200,142	\$ 2,315	4.65%	\$ 200,797	\$ 2,366	4.72%
- Insured	66,001	535	3.26%	84,468	696	3.30%
- Uninsured - completed inventory	17,314	245	5.73%	51,826	885	6.78%
Construction loans						
- Residential	394,128	6,140	6.32%	376,059	5,570	5.88%
- Non residential	4,098	60	5.91%	6,995	100	5.69%
Commercial loans						
- Multi family residential	73,238	951	5.27%	56,684	701	4.91%
- Other commercial	93,602	1,754	7.61%	89,136	1,791	7.98%
Mortgages - corporate portfolio	\$ 848,523	\$ 12,000	5.72%	\$ 865,965	\$ 12,109	5.56%
Term deposits	837,715	5,247	2.38%	847,523	5,233	2.29%
Spread of mortgages over term deposits			3.34%			3.27%
Mortgages - securitized portfolio	\$ 1,015,325	\$ 6,493	2.57%	\$ 1,001,708	\$ 6,449	2.57%
Financial liabilities from securitization	1,023,721	4,681	1.83%	1,012,852	4,594	1.81%
Spread of mortgages over liabilities			0.74%			0.76%

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 March 31, 2018 and December 31, 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 0.25% increase in the overnight rate by the Bank of Canada during Q1 2018 contributed approximately 0.20% and 0.13%, respectively, to the average interest rate for the construction and total corporate portfolios in Q1 2018 compared to Q4 2017, as approximately 98% and 60% of those respective portfolios are floating rate and repriced following the rate increases.

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 in Q4 2017 was significantly higher than usual due to higher origination fee income, higher net interest income on securitized mortgages and a lower income tax expense, partially offset by lower financial instrument gains. Equity income from MCAP and the gain on sale of MCAP from Q1 2018 are discussed in the "Net Investment Income - Corporate Assets" section of this MD&A.

Net Investment Income - Securitization Assets

The net spread of securitized mortgages over liabilities was comparable to Q4 2017, as the current quarter securitization had a minimal impact on net spread.

Operating Expenses and Income Taxes

Salaries and benefits were lower in Q4 2017 as a result of a lower variable compensation expense driven by the finalization of year-end accruals. General and administrative expenses were higher in Q4 2017 as a result of non-recurring professional fee accruals.

For a discussion of deferred tax activity, 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 \$52 million in Q1 2018 and used \$8 million in Q1 2017. In Q1 2018, we had higher net outflows related to term deposits and financial liabilities from securitization, and lower inflows from mortgages.

Investing activities provided cash flows of \$8 million in Q1 2018 and provided \$3 million in Q1 2017. In Q1 2018, we received proceeds from a partial sale of our equity investment in MCAP of \$4.5 million.

Financing activities used cash flows of \$11 million in Q1 2018 and used \$12 million in Q1 2017. In Q1 2018, there was an increase in outflows from dividends paid.

FINANCIAL POSITION

Table 12: Assets

(in thousands except %)	March 31 2018 ¹	December 31 2017	Change from Prior Quarter	
As at			(\$)	(%)
Corporate Assets				
Cash and cash equivalents	\$ 62,463	\$ 117,571	\$ (55,108)	(47%)
Marketable securities	61,429	62,518	(1,089)	(2%)
Mortgages	859,372	863,384	(4,012)	-
Financial investments	73,446	68,190	5,256	8%
Other loans	2,655	2,612	43	2%
Equity investment in MCAP Commercial LP	56,398	59,189	(2,791)	(5%)
Foreclosed real estate	435	435	-	-
Deferred tax asset	2,874	2,672	202	8%
Other assets	2,734	5,800	(3,066)	(53%)
	1,121,806	1,182,371	(60,565)	(5%)
Securitization Assets				
Cash held in trust	15,073	13,441	1,632	12%
Mortgages	1,013,036	1,016,724	(3,688)	-
Other assets	3,969	4,239	(270)	(6%)
	1,032,078	1,034,404	(2,326)	-
	\$ 2,153,884	\$ 2,216,775	\$ (62,891)	(3%)

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 13: Mortgage Summary

(in thousands)	March 31	December 31	Change from 2017	
As at	2018	2017	(\$)	(%)
Corporate portfolio:				
Single family mortgages				
- Uninsured	\$ 196,624	\$ 198,354	\$ (1,730)	(1%)
- Insured	75,698	80,377	(4,679)	(6%)
- Uninsured - completed inventory	7,410	51,190	(43,780)	(86%)
Construction loans				
- Residential	404,987	386,562	18,425	5%
- Non-residential	5,014	4,840	174	4%
Commercial loans				
- Multi family residential	73,026	64,655	8,371	13%
- Other commercial	96,613	77,406	19,207	25%
	859,372	863,384	(4,012)	-
Securitized portfolio:				
Single family insured - Market MBS program	867,149	867,406	(257)	-
Single family insured - CMB program	145,887	149,318	(3,431)	(2%)
	1,013,036	1,016,724	(3,688)	-
	\$ 1,872,408	\$ 1,880,108	\$ (7,700)	-

Corporate and Securitized Mortgage Portfolio Analysis

Q1 2018 Summary

During Q1 2018 we experienced multiple changes in individual mortgage lines of business. Over the past two quarters, the construction portfolio has grown steadily as we have increased our commitment pipeline with a view to deploying our excess asset capacity. While we continue to target experienced builders in markets with favourable economic activity, we ensure that new lending fits within our risk appetite. 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.

We have also experienced growth in our commercial loan portfolio, which provides a different risk profile from single family while providing appropriate risk-adjusted returns. We believe that certain lower-risk segments of the commercial mortgage market, such as loans secured by apartment buildings, represent good lending opportunities in a slowing single family market as they are counter-cyclical to home sales.

During the quarter, we 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.

After a significant decrease since 2016, 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. In late 2017, we commenced new acquisition programs for uninsured single family mortgages from MCAP and another third party origination source. We have targeted additional sources for uninsured single family mortgage origination given the attractive risk-adjusted returns and our excess balance sheet capacity.

OSFI implemented significant changes to Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures*, effective January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower's contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to the quality of newly originated mortgages.

Our insured single family origination and securitization volumes have remained low since 2017. The impact of multiple changes to mortgage regulations enacted within the last two years have made that market segment more competitive and have also led reduced securitization economics.

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

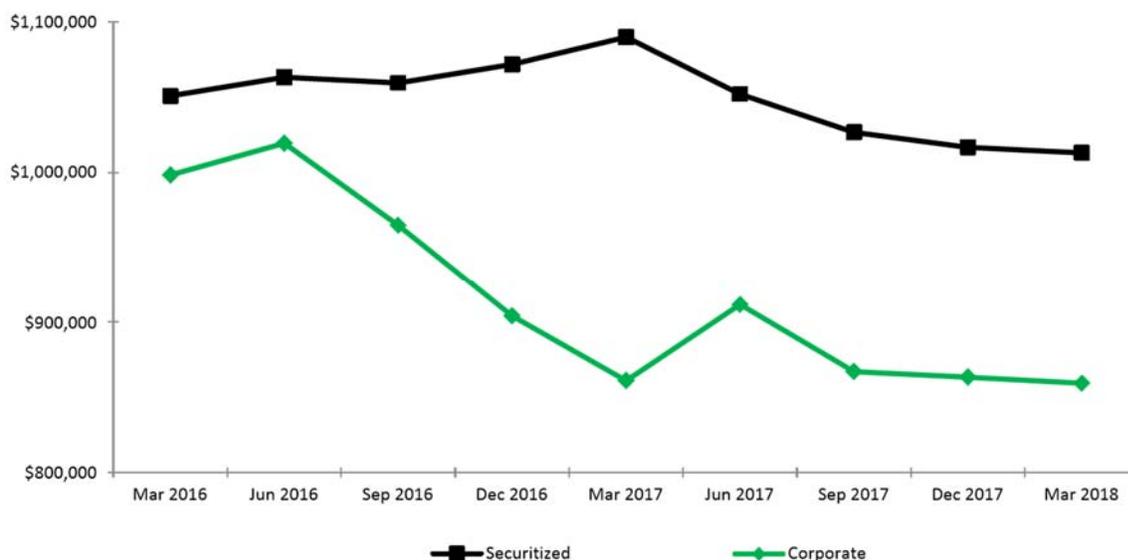
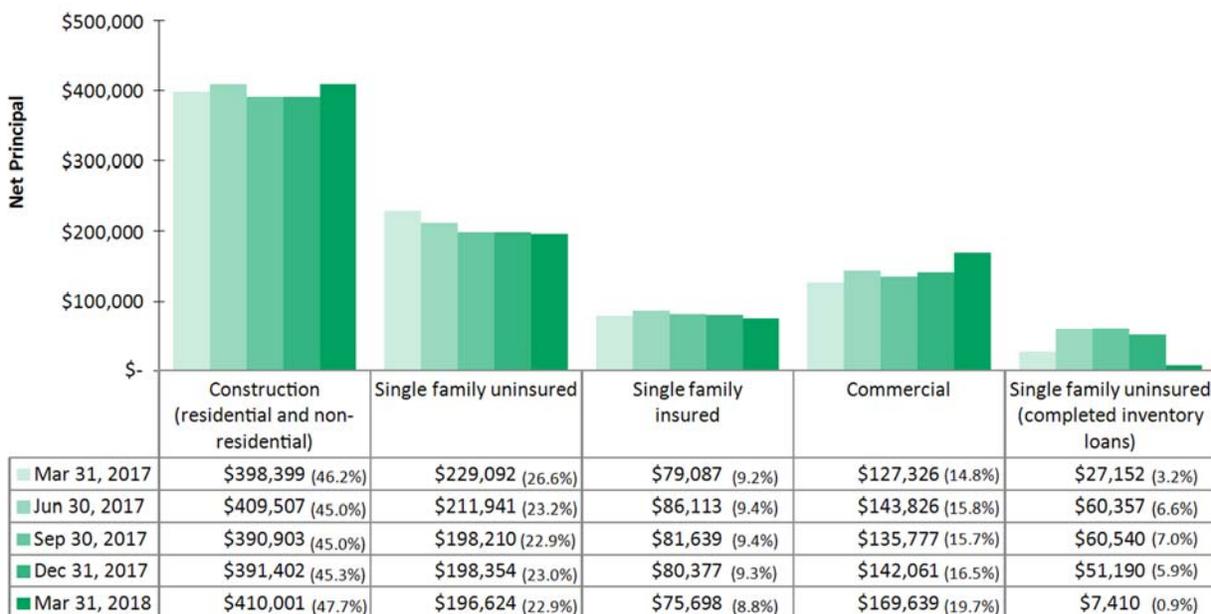
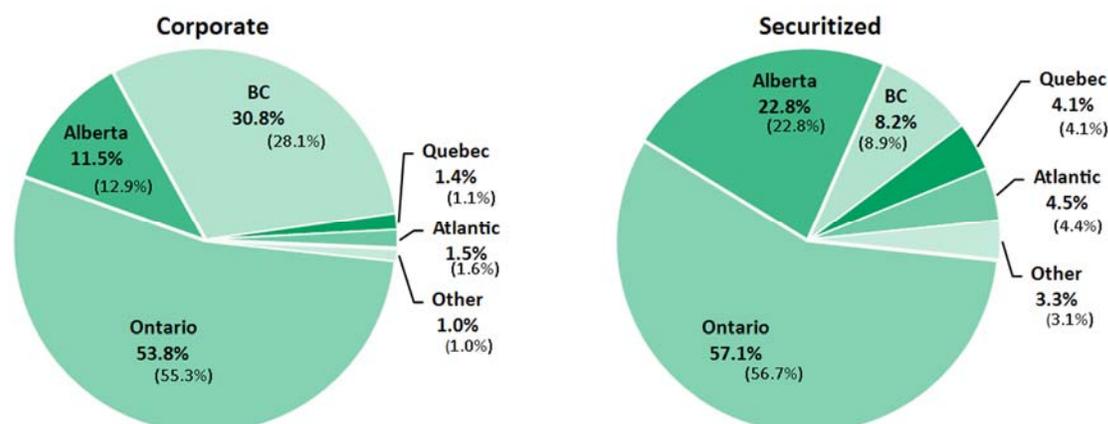


Figure 2: Corporate Mortgage Portfolio Composition by Product Type (in thousands)



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 March 31, 2018 (December 31, 2017)



Since 2017, we have focused on reducing our exposure to Alberta in the corporate mortgage portfolio while increasing exposure to Ontario and British Columbia.

Corporate Mortgages

Single family mortgages

We invest in insured and uninsured single family mortgages in Canada, primarily originated through XMC for our own corporate portfolio and for securitization activities. Uninsured mortgages may not exceed 80% of the value of the real estate securing such loans at the time of funding. For the purposes of this ratio, value is the appraised value of the property as determined by a qualified appraiser at the time of funding. Residential mortgages insured by CMHC or other private insurers may exceed this ratio. As noted in the Corporate Mortgage Summary, in late 2017 we commenced new acquisition programs for uninsured single family mortgages from third party sources, including MCAP.

For further information on MCAN-issued market MBS retained for liquidity purposes and included in corporate insured single family mortgages, refer to the "Securitization Programs" section of this MD&A.

Completed inventory loans

Completed inventory loans are credit facilities extended to developers to provide interim mortgage financing on residential units (condominium or freehold) that are close to completion. Qualification criteria for the completed inventory classification include no substantial remaining construction risk, commencement of occupancy permits, potential sale and closing with a purchaser within 3-4 months or units being at least at a drywall stage with completion of plumbing and electrical.

Construction loans

Residential construction loans are made to homebuilders to finance residential construction projects. These loans generally have a floating interest rate and loan terms of one to two years. Non-residential construction loans provide construction financing for retail shopping developments, office buildings and industrial developments.

Commercial loans

Commercial loans include multi family residential loans (e.g. loans secured by apartment buildings), and other commercial loans, which consist of commercial term mortgages (e.g. loans secured by retail/industrial buildings) and high ratio mortgage loans (e.g. loans that do not meet standard residential construction loan parameters).

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.

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 March 31, 2018, we had the renewal rights to \$923 million of single family mortgages (December 31, 2017 - \$931 million). The majority of these renewal rights relate to mortgages held on the consolidated balance sheet as corporate or securitized mortgages, while \$27 million relates to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2017 - \$42 million).

Arrears and Impaired Mortgages

The adoption of IFRS 9 effective January 1, 2018 has impacted the calculation of impaired mortgages, mortgage arrears and mortgage allowances for credit losses. Under IFRS 9, the impaired insured single family mortgage balance has increased as the calculation now includes all mortgages over 90 days in arrears. Under IAS 39, the calculation consisted only of mortgages over 365 days in arrears.

Further details are included in the footnotes below the following table.

Table 14: Arrears and Impaired Mortgages

(in thousands except %)	IFRS 9 March 31 2018	IAS 39 December 31 2017	Change from Prior Quarter	
As at			(\$)	(%)
Impaired mortgages ²				
Corporate				
Single family - uninsured	\$ 1,873	\$ 1,696	\$ 177	10.4%
Single family - insured	1,945	832	1,113	133.8%
	3,818	2,528	1,290	51.0%
Securitized	966	-	966	-
Total impaired mortgages	\$ 4,784	\$ 2,528	\$ 2,256	89.2%
Impaired mortgage ratio (total) ¹	0.10%	0.09%		0.01%
Impaired mortgage ratio (corporate) ¹	0.22%	0.20%		0.02%
Mortgage arrears ⁵				
Corporate				
Single family - uninsured	\$ 6,978	\$ 5,912	\$ 1,066	18.0%
Single family - insured	2,226	2,854	(628)	(22.0%)
Total corporate mortgage arrears ¹	9,204	8,766	438	5.0%
Total securitized mortgage arrears ¹	9,554	8,803	751	8.5%
Total mortgage arrears ¹	\$ 18,758	\$ 17,569	\$ 1,189	6.8%
Allowance for credit losses				
Corporate				
Allowance on performing mortgages ³	\$ 4,865	\$ 4,748	\$ 117	2.5%
Allowance on impaired mortgages ⁴	173	62	111	179.0%
	5,038	4,810	228	4.7%
Securitized - allowance on performing mortgages ³	32	-	32	-
Total allowance for credit losses	\$ 5,070	\$ 4,810	\$ 260	5.4%

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.

Economic volatility and continued weakness in commodity prices continue to affect housing markets in impacted provinces such as Alberta and Saskatchewan where job losses have impacted industry mortgage arrears. We continue to be diligent in monitoring the local housing markets in which we lend and closely monitor our mortgage portfolio for early indicators of potential performance concerns by maintaining a “watch list” for these loans, whether they are in arrears or not.

During 2017, a land developer in Western Canada filed for protection under the Companies’ Creditors Arrangement Act (“CCAA”). We held \$15.4 million of outstanding mortgages from the borrower legal entity that are not in arrears as at March 31, 2018. If the individual loans enter into arrears, we do not believe that we would incur a loss of principal or interest based on the value of the underlying collateral and accordingly have not recorded an individual allowance on either loan. Subsequent to quarter end, one of the mortgages, in the amount of \$10 million and classified as corporate - other commercial, paid out with no loss of principal or interest at which point \$5.4 million of outstanding loans remained.

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.

Table 15: Mortgage Originations

(in thousands)		
For the Quarters Ended March 31	2018	2017
Single family - insured	\$ 12,992	\$ 10,063
Single family - uninsured	12,415	6,561
Residential construction	37,977	39,668
Non-residential construction	2,646	-
Commercial	44,819	3,229
	\$ 110,849	\$ 59,521

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.

In late 2017, we commenced new acquisition programs for uninsured single family mortgages from MCAP and another third party origination source. Q1 2018 acquisition volumes of \$5.4 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.

Insured single family originations have remained low as a result of changes to mortgage regulations enacted within the last two years that have made that market segment more competitive and have led to reduced securitization economics.

Revised OSFI Guideline B-20, *Residential Mortgage Underwriting Practices and Procedures* came into effect on January 1, 2018. The B-20 guideline now requires a stress test on uninsured single family mortgage applications in the form of a 200 basis point increase to the borrower’s contractual rate. Insured single family mortgages are required to qualify at the greater of the Bank of

Canada's benchmark rate and the borrower contractual rate. We expect that the uninsured stress test may continue to have some impact on the proportion of mortgages that we approve based on the borrower's ability to service the higher mortgage rates. While creating uncertainty in terms of the volumes of borrowers that qualify for new mortgages, these new stress tests provide for an improvement to 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. Commercial originations increased significantly in Q1 2018 as a result of several significant new individual loan fundings during the quarter, relating primarily to loans secured by apartment buildings.

Table 16: Average Loan to Value (LTV) Ratio for Uninsured Single Family Mortgage Originations

(in thousands except for %)				
For the Quarters Ended March 31	2018	Average LTV	2017	Average LTV
Ontario	\$ 7,641	67.0%	\$ 6,169	69.8%
Alberta	472	77.6%	-	-
British Columbia	3,273	64.6%	225	50.6%
Other	1,029	72.0%	167	66.8%
	\$ 12,415	67.2%	\$ 6,561	69.0%

Table 17: Average Mortgage Loan to Value (LTV) Ratios

As at	March 31 2018	December 31 2017
Corporate portfolio:		
Single family mortgages		
- Uninsured	67.6%	67.5%
- Uninsured completed inventory	57.6%	64.2%
- Insured	79.6%	78.1%
Construction loans		
- Residential	60.0%	61.6%
- Non-residential	51.2%	47.0%
Commercial loans		
- Multi family residential	68.8%	67.9%
- Other commercial	62.8%	64.6%
	64.4%	65.3%
Securitized portfolio:		
Single family insured - Market MBS Program	85.4%	85.8%
Single family insured - CMB Program	82.1%	82.0%
	85.0%	85.3%
	75.5%	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 is also secured with an average LTV at origination of 67.2% as at March 31, 2018 (December 31, 2017 - 66.8%). Based on an industry index that incorporates current real estate values, the ratios would be 53.1% and 52.6%, respectively.

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

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

	Corporate						Securitized		Total	%
	Insured	%	Uninsured	%	HELOCs	%	Insured	%		
(in thousands except %)										
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 19: Single Family Mortgages by Province as at December 31, 2017

	Corporate						Securitized		Total	%
	Insured	%	Uninsured	%	HELOCs	%	Insured	%		
(in thousands except %)										
Ontario	\$ 47,391	59.1%	\$ 159,788	64.1%	\$ 114	67.5%	\$ 576,785	56.6%	\$ 784,078	58.2%
Alberta	14,932	18.6%	47,396	19.0%	48	28.4%	231,335	22.8%	293,711	21.8%
British Columbia	3,026	3.8%	25,169	10.1%	7	4.1%	90,174	8.9%	118,376	8.8%
Quebec	4,504	5.6%	4,853	1.9%	-	-	41,449	4.1%	50,806	3.8%
Atlantic Provinces	7,142	8.9%	6,539	2.6%	-	-	44,924	4.4%	58,605	4.4%
Other	3,213	4.0%	5,799	2.3%	-	-	32,057	3.2%	41,069	3.0%
Total	\$ 80,208	100.0%	\$ 249,544	100.0%	\$ 169	100.0%	\$ 1,016,724	100.0%	\$ 1,346,645	100.0%

Table 20: 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%

Table 21: Single Family Mortgages by Amortization Period as at December 31, 2017

(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	\$ 98,172 29.8%	\$ 69,868 21.2%	\$ 158,200 48.0%	\$ 3,681 1.0%	\$ - -	\$ 329,921 100.0%
Securitized	\$ 205,764 20.2%	\$ 502,032 49.4%	\$ 231,282 22.7%	\$ 77,305 7.7%	\$ 341 -	\$ 1,016,724 100.0%
Total	\$ 303,936 22.6%	\$ 571,900 42.5%	\$ 389,482 28.9%	\$ 80,986 6.0%	\$ 341 -	\$ 1,346,645 100.0%

Other Corporate Assets

Cash and cash equivalents

Cash and cash equivalents, which include cash balances with banks and overnight term deposits, decreased by \$55 million in Q1 2018 to arrive at a level more in line with our internal liquidity targets. 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 \$1 million in Q1 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 details, refer to the “Liquidity Management” section of this MD&A.

On the adoption of IFRS 9 effective January 1, 2018, we reclassified our marketable securities portfolio from available for sale (“AFS”) under IAS 39, with fair value changes recorded through accumulated other comprehensive income, to fair value reported through profit and loss (“FVPL”) under IFRS 9, with unrealized gains and losses recorded in net income. The carrying value of our marketable securities portfolio did not change upon the adoption of IFRS 9.

Financial investments

We hold a \$41 million (December 31, 2017 - \$36 million) investment in the KSHYF, in which we have an 8.0% equity interest (December 31, 2017 - 8.1%). KSHYF invests in mortgages secured by real estate with a focus on mezzanine, subordinate and bridge mortgages. We carry our investment in the KSHYF at fair value. As mortgage advances are made by the KSHYF, we advance our proportionate share. The KSHYF pays a base distribution of 9% per annum, and distributes any additional income earned on a quarterly basis. Our Q1 2018 return was 12.9% (Q1 2017 - 12.6%). Our total funding commitment is \$63 million, which consists of \$42 million of capital advances for the Fund and \$21 million that supports credit facilities throughout the life of the KSHYF. As at March 31, 2018, the unfunded commitment was \$22 million (December 31, 2017 - \$26 million).

We also hold a \$32 million (December 31, 2017 - \$32 million) investment in Crown LP, in which we have a 14.1% equity interest (December 31, 2017 - 14.1%). Crown LP invests primarily in commercial office buildings and separates them into its core fund, which consists of buildings expected to provide stable cash flows over a longer time horizon, and its opportunity fund, which consists of buildings with medium term capital appreciation. Its fair value is driven primarily by independent appraisals of the buildings. As property acquisitions are made by Crown LP, we advance our proportionate share to finance the acquisitions.

On the adoption of IFRS 9 effective January 1, 2018, we reclassified our investments in the KSHYF and Crown LP from AFS under IAS 39, with fair value changes recorded through accumulated other comprehensive income, to FVPL under IFRS 9, with unrealized gains and losses recorded in net income. We were unable to elect to continue to record changes in fair value through accumulated other comprehensive income, therefore they were reclassified as FVPL. The carrying value of financial investments did not change upon the adoption of IFRS 9.

Equity investment in MCAP

We hold a 13.83% equity interest in MCAP (December 31, 2017 - 14.41%), which represents 4.0 million units held by MCAN (December 31, 2017 - 4.2 million) of the 28.9 million total outstanding MCAP partnership units (December 31, 2017 - 29.1 million). The investment had a net book value of \$56 million as at March 31, 2018 (December 31, 2017 - \$59 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 \$33

million as at March 31, 2018 (December 31, 2017 - \$42 million). For further information on the LP ARA, refer to the “Non-IFRS Measures” section of this MD&A.

Our investment in MCAP creates a deduction from Total Capital under Basel III (refer to the “Capital Management” section of this MD&A), which has been fully phased in as of January 1, 2018. We have managed our investment in MCAP in line with our Risk Appetite Framework (“RAF”) and regulatory requirements in order to minimize this deduction from Total Capital under Basel III while optimizing the economic benefits of the investment.

MCAP is an originator and servicer of mortgages for third party investors in Canada. MCAP’s origination volumes were \$3.1 billion in Q1 2018 (Q1 2017 - \$3.0 billion). MCAP had \$66.8 billion of assets under administration as at February 28, 2018 (November 30, 2017 - \$65.9 billion).

Since MCAP’s fiscal year end is November 30, we record equity income from MCAP on a one-month lag. To the extent that MCAP has a material transaction during the one-month lag, we are required to reflect the transaction in the month in which it occurred.

We currently use the equity basis of accounting for our investment in MCAP as per International Accounting Standard (“IAS”) 28, *Investments in Associates and Joint Ventures*, as we have significant influence over MCAP through our entitlement to a position on MCAP’s Board of Directors. If we experience further dilution our influence may be diminished and we may no longer qualify for the equity basis of accounting. In that case, we would not recognize our pro-rata share of MCAP’s net income as equity income, but would instead recognize distributions received from MCAP as income and would carry the investment as FVPL or fair value through other comprehensive income (“FVOCI”).

As an “investment in associate” under IAS 28, the equity investment in MCAP is not directly in the scope of the classification and measurement principles of IFRS 9, which govern financial instruments. Since MCAP’s fiscal year end is November 30, MCAP will not officially adopt IFRS 9 until December 1, 2018. However, IAS 28 requires MCAN to consistently apply its accounting policies in accounting for investments in associates, and therefore the principles of IFRS 9 (including applicable policy choices by MCAN) have been reflected in equity income from MCAP and the carrying value of the equity investment based on MCAN’s internal analysis. Based on this analysis, the adoption of IFRS 9 effective January 1, 2018 did not impact the carrying value of our equity investment in MCAP.

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. During Q1 2018 we recognized \$28 million of new securitized mortgages on our balance sheet.

For further information, refer to the “Securitization Programs” section of this MD&A.

Table 22: Liabilities and Shareholders' Equity

(in thousands)	March 31 2018 ¹	December 31 2017	Change from 2017 (\$)		(%)
As at					
Corporate Liabilities					
Term deposits	\$ 823,604	\$ 884,460	\$ (60,856)		(7%)
Loans payable	3,020	-	3,020		-
Deferred tax liabilities	3,603	3,572	31		1%
Other liabilities	6,315	16,067	(9,752)		(61%)
	836,542	904,099	(67,557)		(7%)
Securitization Liabilities					
Financial liabilities from securitization	1,015,296	1,015,699	(403)		-
	1,015,296	1,015,699	(403)		-
	1,851,838	1,919,798	(67,960)		(4%)
Shareholders' Equity					
Share capital	217,817	214,664	3,153		1%
Contributed surplus	510	510	-		-
Retained earnings	83,719	65,365	18,354		28%
Accumulated other comprehensive income	-	16,438	(16,438)		(100%)
	302,046	296,977	5,069		2%
	\$ 2,153,884	\$ 2,216,775	\$ (62,891)		(3%)

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. Activity in Q1 2018 consisted of the creation of \$28 million of new liabilities from our participation in the market MBS program and CMB program less \$28 million of net repayments. 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 Q1 2018 reflects new common shares issued through the Dividend Reinvestment Plan ("DRIP") and the Executive Share Purchase Plan ("ESPP"). The DRIP participation rate for the March 31, 2018 dividend was 20% (March 31, 2017 - 15%). For further information, refer to Note 16 to the consolidated financial statements.

Retained earnings activity for Q1 2018 consists of net income of \$10.6 million and the IFRS 9 transition adjustment of \$16.4 million less dividends of \$8.7 million.

On the adoption of IFRS effective January 1, 2018, the accumulated other comprehensive income balance was reclassified to retained earnings.

The impact of the transition to IFRS 9 as at January 1, 2018 on retained earnings and accumulated other comprehensive income was as follows:

Retained earnings

Closing balance under IAS 39, December 31, 2017	\$ 65,365
Recognition of expected credit losses on corporate mortgages	(52)
Recognition of expected credit losses on securitized mortgages	(17)
Other adjustments - corporate mortgages	51
Reclassification of AFS financial investments to FVPL	13,125
Reclassification of AFS marketable securities to FVPL	3,313
Opening balance under IFRS 9, January 1, 2018	<u>\$ 81,785</u>

Accumulated other comprehensive income

Closing balance under IAS 39, December 31, 2017	\$ 16,438
Reclassification of AFS financial investments to FVPL	(13,125)
Reclassification of AFS marketable securities to FVPL	(3,313)
Opening balance under IFRS 9, January 1, 2018	<u>\$ -</u>

SELECTED QUARTERLY FINANCIAL DATA

Table 23: Selected Quarterly Financial Data

(in thousands except for per share amounts and %)	Q1/18 ²	Q4/17	Q3/17	Q2/17	Q1/17	Q4/16	Q3/16	Q2/16
Net investment income - corporate assets ²	\$ 12,073	\$ 14,359	\$ 12,913	\$ 12,178	\$ 12,963	\$ 11,684	\$ 12,396	\$ 16,996
Other income - corporate assets	1,701	-	-	-	876	-	-	-
Net investment income - securitization assets ²	1,301	1,416	1,534	1,372	1,291	1,519	1,594	1,421
	15,075	15,775	14,447	13,550	15,130	13,203	13,990	18,417
Operating expenses	4,631	5,302	4,686	4,613	4,617	4,471	4,323	4,650
Net income before income taxes	10,444	10,473	9,761	8,937	10,513	8,732	9,667	13,767
Provision for (recovery of) income taxes	(171)	(334)	(157)	(1)	248	(268)	(108)	131
Net income	<u>\$ 10,615</u>	<u>\$ 10,807</u>	<u>\$ 9,918</u>	<u>\$ 8,938</u>	<u>\$ 10,265</u>	<u>\$ 9,000</u>	<u>\$ 9,775</u>	<u>\$ 13,636</u>
Basic and diluted earnings per share	\$ 0.45	\$ 0.47	\$ 0.42	\$ 0.39	\$ 0.44	\$ 0.39	\$ 0.43	\$ 0.59
Dividends per share	\$ 0.37	\$ 0.37	\$ 0.32	\$ 0.32	\$ 0.30	\$ 0.30	\$ 0.29	\$ 0.29
Return on average shareholders' equity ¹	14.10%	14.63%	13.63%	12.37%	14.37%	12.94%	14.08%	20.10%
Average mortgage portfolio yield - corporate ¹	5.72%	5.56%	5.25%	5.28%	5.12%	4.99%	5.14%	5.21%
Average term deposit interest rate ¹	2.38%	2.29%	2.25%	2.21%	2.20%	2.20%	2.22%	2.22%
Average mortgage portfolio balance - corporate (\$ million)	\$ 849	\$ 866	\$ 908	\$ 914	\$ 908	\$ 954	\$ 1,008	\$ 1,017
Average mortgage portfolio yield - securitized ¹	2.57%	2.57%	2.63%	2.67%	2.61%	2.74%	2.74%	2.73%
Average financial liability from securitization rate ¹	1.83%	1.81%	1.83%	1.93%	1.90%	2.01%	2.01%	2.02%
Average mortgage portfolio balance - securitized (\$ million)	\$ 1,015	\$ 1,002	\$ 1,028	\$ 1,057	\$ 1,052	\$ 1,032	\$ 1,032	\$ 1,028

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.

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 Q2 2016 and Q1 2017 and substantial equity income from MCAP in Q2 2016, 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 Q1 2017 as a result of a reduction in securitization volumes.

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. In both programs, we leverage our regulatory asset capacity by originating or purchasing insured single family mortgages for securitization and sale to third parties, thus providing us with a reliable source of incremental income.

Pursuant to the NHA MBS program, MBS investors receive monthly cash flows consisting of interest and scheduled and unscheduled principal payments. CMHC makes principal and interest payments in the event of any MBS default by the issuer, thus fulfilling the Timely Payment obligation to investors. In instances where we have sold MBS, where applicable, these sales are executed for the purposes of transferring various economic exposures that result in accounting outcomes noted for each program below. Each of the programs noted below provide for many responsibilities that are linked to the issuer of these MBS instruments. We do not transfer program oversight or these specific responsibilities when selling MBS to other parties.

Market MBS Program

As part of the market MBS program, we may sell MBS to third parties and may also sell the interest-only strips to third parties. The MBS portion of the mortgage represents the core securitized mortgage principal and the right to receive coupon interest at a specified rate. The interest-only strips represent the right to receive excess cash flows after satisfying the MBS coupon interest payment and any other expenses such as mortgage servicing. As part of this program, we originate and purchase insured single family mortgages to sell as MBS.

During Q1 2018, we securitized \$28 million of MBS to third parties (Q1 2017 - \$6 million). This mortgage transaction, in addition to the majority of our previous market MBS securitizations, did not achieve derecognition for accounting purposes as we retained significant continuing involvement with the mortgages. As such, the associated mortgages remained on the balance sheet while a corresponding liability was incurred. The mortgage interest income and interest expense associated with the financial liability from securitization related to these mortgages are recognized on the accrual basis over the term of the mortgages.

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 March 31, 2018, we held \$28 million of retained MBS on our balance sheet (December 31, 2017 - \$29 million), which is included in the insured single family classification within corporate mortgages.

CMB Program

The CMB program involves the sale of MBS to CHT who in turn issues a non-amortizing bullet bond to external investors. The CMB program requires the reinvestment by the issuer of mortgage principal repayments received during their term into certain permitted assets. We have transferred the benefits and obligations associated with the principal reinvestment function to a third party such that we only earn spread income on the amortizing mortgage balance. The third party is responsible for sourcing assets in which to reinvest and any associated obligations. This transfer has no net ongoing financial impact on MCAN.

We did not securitize any insured single family mortgages through the CMB program during Q1 2018 (Q1 2017 - \$42 million). Similar to the market MBS program, we do not derecognize the securitized mortgages from the consolidated balance sheet when we retain significant continuing involvement with the assets such that the associated mortgages remain on the consolidated balance sheet while a corresponding liability is incurred. The mortgage interest income and interest on the financial liability from securitization associated with these mortgages are recognized on the accrual basis over the term of the mortgages.

Other Accounting Considerations

The primary risks associated with the market MBS program and CMB program are prepayment, liquidity and funding risk, including the obligation to fund 100% of any cash shortfall related to the Timely Payment (discussed below in the “Timely Payment” sub-section). Prepayment risk includes the acceleration of the amortization of mortgage premiums as a result of early payouts.

Any mortgages securitized through the market MBS program or CMB program for which derecognition is not achieved remain on the consolidated balance sheet as securitized assets and are also included in total exposures in the calculation of the leverage ratio. A corresponding liability is also recognized on the balance sheet for mortgage securitizations that fail derecognition. However, for income tax purposes, all mortgages securitized by MCAN have been evaluated as true mortgage sales and therefore are not included in income tax assets. For further details on total exposures, regulatory capital and income tax assets and capital, refer to the “Capital Management” and “Non-IFRS Measures” sections of this MD&A.

MCAN has capitalized certain mortgage acquisition costs. These costs are amortized using the effective interest rate method (“EIM”), which incorporates mortgage prepayment assumptions.

Timely Payment

Consistent with all issuers of MBS, we are required to remit scheduled mortgage principal and interest payments to CMHC, even if these mortgage payments have not been collected from mortgagors, to ensure that the Timely Payment of principal and interest to MBS investors is effected. Similarly, at the maturity of the MBS pools that have been issued by MCAN, any outstanding principal must be paid to CMHC. We maintain the Timely Payment obligation in our role as MBS issuer until the maturity of the security. If we fail to make a scheduled principal and interest payment to CMHC, CMHC may enforce the assignment of the mortgages included in all MBS pools in addition to other assets backing the MBS issued.

If mortgage payments have not been collected from mortgagors or mortgagors are unable to renew their mortgages at their scheduled maturities, we will be required to use our own financial resources to fund our pro-rata share of these obligations until mortgage arrears are collected or proceeds are received from the mortgage insurers following the sale of the mortgaged properties.

As part of our participation in the market MBS program and CMB program, we are required to fund 100% of any cash shortfall unless we have sold the interest-only strip, in which case the purchaser of the interest-only strip is obligated to fund 100% of any cash shortfall. If the interest-only strip purchaser is not able to provide funds to cover any cash shortfalls, we will be required to use our own financial resources to fund our 100% share of this obligation until mortgage arrears are collected or proceeds are received from the mortgage insurers following the sale of the mortgaged properties.

In the case of mortgage defaults, we are required to make scheduled principal and interest payments to investors as part of the Timely Payment and then place the mortgage/property through the insurance claims process to recover any losses. These defaults may result in cash flow timing mismatches that may marginally increase funding and liquidity risks.

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, public share offerings, rights offerings and the DRIP. 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.

The adoption of IFRS 9 effective January 1, 2018 had a minimal impact on our income tax assets and capital due to the fact that allowances on performing mortgages are excluded from both amounts. The reclassification of marketable securities and financial investments to FVPL had no impact on income tax assets and capital due to the fact that the tax values of these assets were not impacted by IFRS 9 reclassifications.

Table 24: Income Tax Capital ¹

(in thousands except ratios)	March 31 2018 ²	December 31 2017
As at		
Income tax assets ¹		
Consolidated assets	\$ 2,153,884	\$ 2,216,775
Adjustment for assets in subsidiaries	6,403	5,435
Non-consolidated assets in MIC entity	2,160,287	2,222,210
Add: mortgage allowances	4,883	4,750
Less: securitization assets ³	(1,028,356)	(1,030,020)
Less: equity investments in MCAP and subsidiaries	(48,061)	(42,411)
Other adjustments	(7,286)	(7,475)
	<u>\$ 1,081,467</u>	<u>\$ 1,147,054</u>
Income tax liabilities ¹		
Consolidated liabilities	\$ 1,851,838	\$ 1,919,798
Adjustment for liabilities in subsidiaries	(6,488)	(7,852)
Non-consolidated liabilities in MIC entity	1,845,350	1,911,946
Less: securitization liabilities ³	(1,013,854)	(1,014,258)
	<u>\$ 831,496</u>	<u>\$ 897,688</u>
Income tax capital ¹	\$ 249,971	\$ 249,366
Income tax asset capacity ¹	\$ 355,867	\$ 286,801
Income tax capital ratios ¹		
Income tax assets to capital ratio	4.33	4.60
Income tax liabilities to capital ratio	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.

Since the financial crisis, OSFI and the Basel Committee on Banking Supervision (“BCBS”) have taken measures to promote a more resilient banking sector and strengthen global capital standards. Changes from Basel III that impact MCAN through the Capital Adequacy Requirements (“CAR”) Guideline, Leverage Ratio and other items are listed below. We expect to be able to meet OSFI’s requirements and expectations without having a materially adverse effect on the Company’s business plan.

- OSFI requires all federally regulated financial institutions to meet the minimum Common Equity Tier 1 (“CET 1”), Total Tier 1 and Total Capital requirements set out therein. The minimum capital ratios are 4.5% for CET 1, 6% for Total Tier 1 and 8% for Total Capital (with the phase-in of certain regulatory adjustments and phase-out of non-qualifying capital instruments by 2022).
- The regulatory adjustments to be phased into the calculation of the capital ratios of a federally regulated financial institution include the deduction of certain significant investments in the capital of banking, financial and insurance entities above 10% of the institution’s CET 1 Capital (after certain prescribed regulatory adjustments), which incorporates an adjustment for the equity investment in MCAP into CET 1 capital. The adjustment factor was increased by 20% annually over the phase-in period such that as of January 1, 2018 this deduction was fully phased in. The “transitional” basis as presented in previous years reflects the component of the adjustment phased in as at that time.
- In 2016, OSFI implemented the requirement for all federally regulated financial institutions to maintain a capital conservation buffer. The buffer will be phased in over time and will reach its final level of 2.5% in 2019.
- In addition to the minimum capital requirements and capital conservation buffer to be maintained by all federally regulated institutions, OSFI expects all such institutions to attain target capital ratios equal to or greater than the 2019 minimum capital ratios and the 2019 capital conservation buffer well in advance of the phase-in period. Accordingly, OSFI expects all federally regulated institutions to have a minimum CET 1 ratio of 7% and a Total Tier 1 ratio of 8.5% and a Total Capital ratio of 10.5% (in each case, calculated on an “all in” basis giving effect to all regulatory adjustments that will be required by 2019 and including the 2019 capital conservation buffer). Failure to achieve such targets will serve as triggers for supervisory intervention.

OSFI began the phase-in of the Credit Valuation Adjustment (“CVA”) risk capital charge in 2014. The CVA risk capital charge applicable to CET 1 Capital is 80% in 2018. This will increase annually until it reaches 100% by 2019. The implementation of the CVA risk capital charge has had an insignificant impact on MCAN.

Our internal target minimum CET 1, Tier 1 and Total Capital ratios are 18%. We maintain prudent capital planning practices to ensure that we are adequately capitalized and continue to satisfy minimum standards and internal targets.

OSFI and the BCBS are finalizing consultations for an update to the regulatory capital framework for loans secured by residential real estate properties. The potential impact to MCAN will largely be in changes to the risk weighting of mortgages as calculated in the standardized approach and a new capital charge for insured mortgages.

The adoption of IFRS 9 effective January 1, 2018 did not have a material impact on our regulatory capital or ratios.

Table 25: Regulatory Capital

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

(in thousands except %)	March 31, 2018 ¹			December 31, 2017		
	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	\$ 62,463	20%	\$ 12,799	\$ 117,571	20%	\$ 24,097
Cash held in trust	15,073	20%	3,015	13,441	20%	2,688
Marketable securities	61,429	100%	61,429	62,518	100%	62,518
Mortgages - corporate	859,372	77%	658,403	863,384	76%	656,384
Mortgages - securitized	1,013,036	3%	31,111	1,016,724	3%	32,182
Financial investments	73,446	245%	179,620	68,190	251%	170,922
Other loans	2,655	100%	2,655	2,612	100%	2,612
Equity investment in MCAP (all-in) ²	56,398	54%	30,205	59,189	50%	29,697
Foreclosed real estate	435	100%	435	435	100%	435
Deferred tax asset	2,874	100%	2,874	2,672	100%	2,672
Other assets	6,703	100%	6,703	10,039	100%	10,039
			<u>989,249</u>			<u>994,246</u>
Off-Balance Sheet Items						
Letters of credit	44,178	50%	22,089	32,164	50%	16,082
Commitments	397,790	44%	176,040	317,687	45%	142,043
			<u>198,129</u>			<u>158,125</u>
Charge for operational risk			<u>108,575</u>			<u>105,800</u>
Risk-Weighted Assets (all-in)			\$ 1,295,953			1,258,171
Equity investment in MCAP (transitional adjustment) ²			n/a			<u>11,796</u>
Risk-Weighted Assets (transitional)			n/a			\$ 1,269,967

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 In calculating risk-weighted assets on the "all-in" basis, the capital deduction related to the investment in MCAP is risk weighted at 0%. In 2017, the component not deducted from capital was risk weighted at 100% and the difference between the all-in deduction and the transitional deduction was risk weighted at 200% in calculating risk-weighted assets on the transitional basis.

Other Capital Management Activity

In conjunction with the annual strategic planning and budgeting process, we complete an Internal Capital Adequacy Assessment Process ("ICAAP") in order to ensure that we have sufficient capital to support our business plan and risk appetite. The ICAAP assesses the capital necessary to support the various inherent risks that we face, including credit, liquidity, interest rate, market, geographic concentration and reputational risks. Our business plan is also stress-tested under various adverse scenarios to determine the impact on our results from operations and financial condition. The ICAAP is reviewed by both management and the Board and is submitted to OSFI annually. In addition, the Company performs stress testing on our internal forecasts for capital adequacy on a quarterly basis, and the results of such testing are reported to the Board.

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 Investment Committee of the Board (“ICB”) 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 March 31, 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.

Table 27: Liquidity Ratios

(in thousands except %)		
As at	March 31 2018	December 31 2017
Tier 1 liquid assets ¹		
Cash and cash equivalents	\$ 62,463	\$ 117,571
Tier 2 liquid assets ¹		
Marketable securities	61,429	62,518
Less: marketable securities adjustment ²	(14,002)	(14,391)
Market MBS retained by MCAN ³	28,040	28,597
	75,467	76,724
Tier 3 liquid assets ¹		
Single family insured mortgages ⁴	47,310	51,711
Less: single family insured mortgages adjustment ⁴	(16,619)	(17,713)
	30,691	33,998
Total liquid assets ¹	\$ 168,621	\$ 228,293
100 day term deposit maturities	\$ 158,910	\$ 103,632
Liquidity ratios ¹		
Tier 1 & 2 liquid assets to 100 day term deposit maturities	87%	187%
Total liquid assets to 100 day term deposit maturities	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 KingSett High Yield Fund, refer to the “Off-Balance Sheet Arrangements” section of this MD&A.

Table 28: Liquidity Analysis

(in thousands)	Within 3 Months	3 Months To 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	March 31 2018	December 31 2017
Sources of liquidity							
Cash and cash equivalents	\$ 62,463	\$ -	\$ -	\$ -	\$ -	\$ 62,463	\$ 117,571
Marketable securities	61,402	-	-	-	27	61,429	62,518
Mortgages - corporate	150,788	403,365	281,017	21,001	3,201	859,372	863,384
Financial investments	-	-	41,255	-	32,191	73,446	68,190
Other loans	1,108	232	1,315	-	-	2,655	2,612
	275,761	403,597	323,587	21,001	35,419	1,059,365	1,114,275
Uses of liquidity							
Term deposits	153,009	199,941	327,782	142,872	-	823,604	884,460
Loans payable	-	3,020	-	-	-	3,020	-
Other liabilities	6,315	-	-	-	-	6,315	16,067
	159,324	202,961	327,782	142,872	-	832,939	900,527
Net liquidity surplus (deficit)	\$ 116,437	\$ 200,636	\$ (4,195)	\$ (121,871)	\$ 35,419	\$ 226,426	\$ 213,748
Off-Balance Sheet							
Unfunded mortgage commitments	\$ 141,552	\$ 125,411	\$ 108,394	\$ -	\$ -	\$ 375,357	\$ 291,204
Commitment - KSHYF	-	-	22,433	-	-	22,433	26,483
	\$ 141,552	\$ 125,411	\$ 130,827	\$ -	\$ -	\$ 397,790	\$ 317,687

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 counterparty 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 March 31, 2018, there were 23,559,145 common shares outstanding (December 31, 2017 - 23,377,785). As at May 8, 2018, there were 23,559,145 common shares outstanding.

During Q1 2018, we issued 181,360 new common shares under the DRIP (Q1 2017 - 142,019), 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%.

In Q1 2018, we did not issue any common shares through the Executive Share Purchase Plan (Q1 2017 - 6,709).

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 29: Contractual Obligations

(in thousands)	Less than one year	One to three years	Three to five years	Over five years	March 31 2018	December 31 2017
Mortgage funding commitments	\$ 266,963	\$ 108,394	\$ -	\$ -	\$ 375,357	\$ 291,204
Commitment - KSHYF	-	22,433	-	-	22,433	26,483
Operating lease	852	1,753	1,769	4,164	8,538	8,652
	\$ 267,815	\$ 132,580	\$ 1,769	\$ 4,164	\$ 406,328	\$ 326,339

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 March 31, 2018, of our total single family mortgage renewal rights of \$923 million (December 31, 2017 - \$931 million), \$27 million related to off-balance sheet mortgages sold to third parties on a whole loan basis (December 31, 2017 - \$42 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 second quarter dividend of \$0.37 per share, to be paid on June 29, 2018 to shareholders of record as of June 15, 2018.

TRANSACTIONS WITH RELATED PARTIES

Related party transactions for the quarters ended March 31, 2018 and March 31, 2017 and related party balances as at March 31, 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 March 31, 2018, we had 76 employees (December 31, 2017 - 69).

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 and so allowances for financial assets should be measured on a lifetime ECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed 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 significantly 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.

CHANGES IN ACCOUNTING POLICY

We prospectively adopted IFRS 9, *Financial Instruments*, effective January 1, 2018 and did not restate prior period information. The most significant impacts of the adoption of IFRS 9 on MCAN's financial statements relate to impairment and classification and measurement. For further information on the adoption of IFRS 9, refer to Notes 4 and 6 to the consolidated financial statements.

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 March 31, 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 March 31, 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 has 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 25 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.

CONSOLIDATED BALANCE SHEETS
(Unaudited) (in thousands of Canadian dollars)

As at	Note	March 31 2018	December 31 2017
Assets			
Corporate Assets			
Cash and cash equivalents		\$ 62,463	\$ 117,571
Marketable securities	7	61,429	62,518
Mortgages	8	859,372	863,384
Financial investments	9	73,446	68,190
Other loans		2,655	2,612
Equity investment in MCAP Commercial LP	10	56,398	59,189
Foreclosed real estate		435	435
Deferred tax asset	14	2,874	2,672
Other assets		2,734	5,800
		1,121,806	1,182,371
Securitization Assets			
Cash held in trust		15,073	13,441
Mortgages	12	1,013,036	1,016,724
Other assets		3,969	4,239
		1,032,078	1,034,404
		\$ 2,153,884	\$ 2,216,775
Liabilities and Shareholders' Equity			
Liabilities			
Corporate Liabilities			
Term deposits	13	\$ 823,604	\$ 884,460
Loans payable	24	3,020	-
Deferred tax liabilities	14	3,603	3,572
Other liabilities		6,315	16,067
		836,542	904,099
Securitization Liabilities			
Financial liabilities from securitization	15	1,015,296	1,015,699
		1,015,296	1,015,699
		1,851,838	1,919,798
Shareholders' Equity			
Share capital	16	217,817	214,664
Contributed surplus		510	510
Retained earnings		83,719	65,365
Accumulated other comprehensive income	18	-	16,438
		302,046	296,977
		\$ 2,153,884	\$ 2,216,775

The accompanying notes and shaded areas of the "Risk Governance and Management" section of Management's Discussion and Analysis of Operations are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited) (in thousands of Canadian dollars except for per share amounts)

For the Quarters Ended March 31	Note	2018	2017
Net Investment Income - Corporate Assets			
Mortgage interest		\$ 12,000	\$ 11,555
Equity income from MCAP Commercial LP	10	3,439	1,892
Financial investments and other loans	9	1,554	4,263
Marketable securities		878	846
Fees		363	291
Interest on cash and cash equivalents		287	158
Unrealized gain (loss) on financial instruments	19	(56)	-
		18,465	19,005
Net Investment Income - Securitization Assets			
Term deposit interest and expenses		5,247	5,021
Mortgage expenses	20	951	959
Interest on loans payable		20	32
Provision for credit losses	21	174	30
		6,392	6,042
		12,073	12,963
Other Income - Corporate Assets			
Gain on sale of investment in MCAP Commercial LP	10	1,701	785
Gain on dilution of investment in MCAP Commercial LP	10	-	91
		1,701	876
Net Investment Income - Securitization Assets			
Mortgage interest		6,493	6,772
Other securitization income		72	36
		6,565	6,808
Net Investment Income - Other Assets			
Interest on financial liabilities from securitization		4,681	5,011
Mortgage expenses	20	568	506
Provision for credit losses	21	15	-
		5,264	5,517
		1,301	1,291
Operating Expenses			
Salaries and benefits		2,945	2,594
General and administrative		1,686	2,023
		4,631	4,617
Net Income Before Income Taxes			
		10,444	10,513
Provision for (recovery of) income taxes			
Deferred	14	(171)	248
		(171)	248
Net Income		\$ 10,615	\$ 10,265
Basic and diluted earnings per share			
		\$ 0.45	\$ 0.44
Dividends per share			
		\$ 0.37	\$ 0.30
Weighted average number of basic and diluted shares ('000's)			
		23,464	23,150

The accompanying notes and shaded areas of the "Risk Factors" and "Risk Management" sections of Management's Discussion and Analysis of Operations are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited) (in thousands of Canadian dollars)

For the Periods Ended March 31	2018	2017
Net income	\$ 10,615	\$ 10,265
Other comprehensive income (loss)		
Change in unrealized gain on available for sale marketable securities	-	1,179
Change in unrealized gain on available for sale financial investments	-	338
Transfer of income distribution from available for sale financial investments to net income	-	(308)
Transfer of unrealized gains on available for sale financial investments to net income	-	(3,146)
Less: deferred taxes	-	412
	-	(1,525)
Comprehensive income	\$ 10,615	\$ 8,740

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited) (in thousands of Canadian dollars)

For the Quarters Ended March 31	Note	2018	2017
Share capital			
Balance, beginning of year		\$ 214,664	\$ 210,239
Share capital issued	16	3,153	2,140
Balance, end of year		217,817	212,379
Contributed surplus			
Balance, beginning of year		510	510
Changes to contributed surplus		-	-
Balance, end of year		510	510
Retained earnings			
Balance, beginning of year		65,365	55,923
IFRS 9 transitional adjustment	6	16,420	n/a
Net income		10,615	10,265
Dividends declared		(8,681)	(6,946)
Balance, end of year		83,719	59,242
Accumulated other comprehensive income			
Balance, beginning of year		16,438	15,104
IFRS 9 transitional adjustment	6	(16,438)	n/a
Other comprehensive income (loss)		-	(1,525)
Balance, end of year		-	13,579
Total shareholders' equity		\$ 302,046	\$ 285,710

The accompanying notes and shaded areas of the "Risk Governance and Management" section of Management's Discussion and Analysis of Operations are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (in thousands of Canadian dollars)

For the Quarters Ended March 31	2018	2017
Cash provided by (used for):		
Operating Activities		
Net income	\$ 10,615	\$ 10,265
Adjustments to determine cash flows relating to operating activities:		
Deferred taxes	(171)	248
Equity income from MCAP Commercial LP	(3,439)	(1,892)
Gain on sale of investment in MCAP Commercial LP	(1,701)	(785)
Gain on dilution of investment in MCAP Commercial LP	-	(91)
Provision for credit losses	189	30
Unrealized gain/loss on financial instruments	56	-
Amortization of securitized mortgage and liability transaction costs	1,286	1,346
Amortization of other assets	143	132
Amortization of mortgage discounts	(17)	(12)
Changes in operating assets and liabilities:		
Marketable securities	513	(3,000)
Mortgages	6,580	24,124
Financial investments	(4,737)	(1,642)
Other loans	(43)	(991)
Other assets	3,196	(1,483)
Cash held in trust	(1,632)	1,299
Term deposits	(60,856)	(50,193)
Financial liabilities from securitization	(753)	15,852
Other liabilities	(1,097)	(1,639)
Cash flows for operating activities	(51,868)	(8,432)
Investing Activities		
Distributions from MCAP Commercial LP	3,410	1,209
Decrease in foreclosed real estate	-	94
Proceeds on sale of investment in MCAP Commercial LP	4,521	1,947
Acquisition of capital and intangible assets	(13)	(97)
Cash flows from investing activities	7,918	3,153
Financing Activities		
Issue of common shares	3,153	2,140
Increase in loans payable	3,020	-
Dividends paid	(17,331)	(13,869)
Cash flows for financing activities	(11,158)	(11,729)
Decrease in cash and cash equivalents	(55,108)	(17,008)
Cash and cash equivalents, beginning of year	117,571	111,732
Cash and cash equivalents, end of year	\$ 62,463	\$ 94,724
Supplementary Information	2018	2017
Interest received	\$ 18,420	\$ 18,572
Interest paid	10,128	9,393
Distributions received from investments	2,017	5,051

The accompanying notes and shaded areas of the "Risk Governance and Management" section of Management's Discussion and Analysis of Operations are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note	Page
1. Corporate Information	56
2. Basis of Preparation	56
3. Basis of Consolidation	57
4. Summary of Significant Accounting Policies	57
5. Significant Accounting Judgments and Estimates	62
6. Transition to IFRS 9	64
7. Marketable Securities	65
8. Mortgages - Corporate	66
9. Financial Investments	71
10. Equity Investment in MCAP Commercial LP	71
11. Securitization Activities	72
12. Mortgages - Securitized	74
13. Term Deposits	76
14. Income Taxes	77
15. Financial Liabilities from Securitization	78
16. Share Capital	78
17. Dividends	78
18. Accumulated Other Comprehensive Income	79
19. Unrealized Gain (Loss) on Financial Instruments	79
20. Mortgage Expenses	79
21. Provision for Credit Losses	80
22. Related Party Disclosures	80
23. Commitments and Contingencies	82
24. Credit Facilities	82
25. Interest Rate Sensitivity	83
26. Capital Management	85
27. Financial Instruments	86
28. Comparative Amounts	88

1. Corporate Information

MCAN Mortgage Corporation (the “Company” or “MCAN”) is a Loan Company under the *Trust and Loan Companies Act (Canada)* (the “Trust Act”) and a Mortgage Investment Corporation (“MIC”) under the *Income Tax Act (Canada)* (the “Tax Act”).

As a Loan Company under the Trust Act, the Company is subject to the guidelines and regulations set by the Office of the Superintendent of Financial Institutions Canada (“OSFI”).

MCAN’s primary objective is to generate a reliable stream of income by investing its corporate funds in a diversified portfolio of mortgages (including single family residential, residential construction, non-residential construction and commercial loans), as well as other types of financial investments, loans and real estate investments. MCAN employs leverage by issuing term deposits eligible for Canada Deposit Insurance Corporation (“CDIC”) deposit insurance up to a maximum of five times capital (on a non-consolidated income tax basis in the MIC entity) as limited by the provisions of the Tax Act applicable to a MIC. The term deposits are sourced through a network of independent financial agents.

As a MIC, MCAN is entitled to deduct from income for tax purposes 50% of capital gains dividends and 100% of other dividends paid. Such dividends are taxed in the hands of the Company’s shareholders as capital gains dividends and interest income, respectively, to the extent that they are held in a non-registered plan. Dividends paid to foreign investors outside of Canada may be subject to withholding taxes.

MCAN’s primary wholly owned subsidiary, XMC Mortgage Corporation (“XMC”) (formerly Xceed Mortgage Corporation), is an originator of residential first-charge mortgage products across Canada. As such, XMC operates primarily in one industry segment through its sales team and mortgage brokers. XMC is incorporated in the Province of Ontario.

MCAN is also a *National Housing Act* (“NHA”) mortgage-backed securities (“MBS”) issuer. For further details, refer to Note 11.

MCAN is incorporated in Canada. MCAN and XMC’s head office is located at 200 King Street West, Suite 600, Toronto, Ontario, Canada. MCAN is listed on the Toronto Stock Exchange under the symbol MKP.

The consolidated financial statements were approved in accordance with a resolution of the Board of Directors (the “Board”) on May 8, 2018.

2. Basis of Preparation

The consolidated financial statements of the Company have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*, using accounting policies consistent with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The consolidated financial statements have been prepared on a historical cost basis, except for marketable securities, foreclosed real estate and certain financial investments designated as fair value reported through profit and loss (“FVPL”), which have been measured at fair value. The consolidated financial statements are presented in Canadian dollars.

The disclosures that accompany the consolidated financial statements include the significant accounting policies applied (Note 4) and the significant judgments (Note 5(a)) and estimates (Note 5(b)) applicable to the preparation of the consolidated financial statements.

The Company separates its assets into its corporate and securitization portfolios for reporting purposes. Corporate assets represent the Company’s core strategic investments, and are funded by term deposits and share capital. Securitization assets consist primarily of mortgages that have been securitized through the NHA MBS program and subsequently sold to third parties. These assets are funded by the cash received from the sale of the associated securities, which is then classified as a financial liability from securitization.

3. Basis of Consolidation

The consolidated financial statements include the balances of MCAN and its subsidiaries as at March 31, 2018.

Subsidiaries are fully consolidated from the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. Per IFRS 10, *Consolidated Financial Statements*, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies.

All intercompany balances due to/from subsidiaries, income and expenses and unrealized gains and losses resulting from intercompany transactions and dividends are eliminated in full.

4. Summary of Significant Accounting Policies

The significant accounting policies applied by the Company in the preparation of its consolidated financial statements are the same with those disclosed in Note 4 to the Company's annual consolidated financial statements as at and for the year ended December 31, 2017, with the exception of the adoption of certain policies adopted as of January 1, 2018 that are discussed below.

Current Period Changes in Accounting Policy

IFRS 9, *Financial Instruments* ("IFRS 9")

On January 1, 2018, the Company adopted IFRS 9 which replaces IAS 39, *Financial Instruments: Recognition and Measurement*. The Company, as permitted, has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. All comparative period information is presented in accordance with the accounting policies as described in the annual consolidated financial statements for the year ended December 31, 2017. Differences arising from the adoption of IFRS 9 have been recognized directly in retained earnings as of January 1, 2018 and are disclosed in Note 6.

The adoption of IFRS 9 has resulted in changes to the Company's accounting policies for recognition, classification and measurement of financial assets and liabilities and impairment of financial assets. IFRS 9 also amends IFRS 7, *Financial Instruments: Disclosures* to introduce expanded qualitative and quantitative disclosures related to IFRS 9, which the Company has also adopted as of January 1, 2018.

Impairment

The adoption of IFRS 9 has fundamentally changed the Company's accounting for impairment by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss ("ECL") approach. IFRS 9 requires the Company to record an allowance for ECLs for all mortgages and other debt financial assets not held at fair value through profit or loss ("FVPL"), together with mortgage commitments and financial guarantee contracts not measured at FVPL.

Overview of ECL principles

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss. The Company's policies for determining if there has been a significant increase in credit risk are set out in Note 27.

The Company groups its mortgages into Stage 1, Stage 2 and Stage 3, as described below:

- Stage 1: When mortgages are first recognized, the Company recognizes an allowance based on 12 month ECLs, which represent the portion of lifetime ECLs that represent the ECLs that result from default events on a financial instrument that are expected or believed to be possible within the 12 months after the reporting date. Stage 1 mortgages also include facilities where the credit risk has subsequently improved such that the increase in credit risk since initial recognition is no longer significant and the mortgages have been reclassified from Stage 2.
- Stage 2: When a mortgage has shown a significant increase in credit risk ("SICR") since origination, the Company records an allowance for the lifetime ECLs. Stage 2 mortgages also include facilities where the credit risk has improved and the mortgage has been reclassified from Stage 3.
- Stage 3: Mortgages considered credit-impaired (as outlined below in "definition of default and cure"). The Company records an allowance for the lifetime ECLs.

4. Summary of Significant Accounting Policies (continued)

Both lifetime ECLs and 12 month ECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments. The Company's policy for grouping financial assets measured on a collective basis is explained in Note 27.

The Company has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. This is further explained in Note 27.

Significant increase in credit risk

The Company continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 month ECL or lifetime ECL, the Company assesses whether there has been a SICR since initial recognition. The primary indicators of SICR are relative changes in beacon scores for single family mortgages and changes in risk ratings for construction and commercial mortgages. The Company also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as changes in macroeconomic circumstances or the application of management's judgement. In certain cases, the Company may also consider that certain events are a significant increase in credit risk as opposed to a default. For a definition of default and cure, refer to Note 27. IFRS 9 provides a rebuttable presumption that a SICR has occurred if contractual payments are more than 30 days past due. The Company has not rebutted this presumption.

When estimating ECLs on a collective basis for a specified corporate mortgage line of business, the Company applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Calculation of ECLs

The Company calculates ECLs based on three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the effective interest rate ("EIR"). The cash shortfall is the difference between the cash flows that are due to the Company in accordance with the contract and the cash flows that the Company expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- PD: The Probability of Default ("PD") is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognized and is still in the portfolio. The concept of PDs is further explained in Note 27.
- EAD: The Exposure at Default ("EAD") is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in Note 27.
- LGD: The Loss Given Default ("LGD") is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realization of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in Note 27.

When estimating the ECLs, the Company considers three scenarios (base case, favourable and unfavourable). Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted mortgages are expected to be recovered, including the probability that the mortgages will cure and the value of collateral or the amount that might be received for selling the asset.

The maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Company has the legal right to call the instrument earlier.

Mortgage commitments and letters of credit

Undrawn mortgage commitments and letters of credit are commitments under which, over the duration of the commitment, the Company is required to provide a mortgage with pre-specified terms to the borrower. These contracts are in the scope of the ECL requirements.

The nominal contractual value of letters of credit and undrawn mortgage commitments, where the mortgage agreed to be provided is on market terms, are not recorded on in the consolidated balance sheet.

4. Summary of Significant Accounting Policies (continued)

When estimating lifetime ECLs for undrawn mortgage commitments, the Company estimates the expected portion of the mortgage commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the mortgage is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the mortgage. In the case of letters of credit, the ECL is also based on the present value of expected cash flow shortfalls and the other aforementioned parameters, to the extent applicable.

Definition of default and cure

The Company considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments and meets the qualitative threshold that may indicate unlikelihood to pay as a result of a credit event. When such events occur, the Company carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Significant financial difficulty of the borrower
- Breach of contract, such as a default or past due event
- The granting by the lender, for economic or contractual reasons relating to the borrower's financial difficulty, a concession(s) that the lender(s) would not otherwise consider
- The increased likelihood that the borrower will enter bankruptcy or other financial reorganization
- The origination or acquisition of a financial asset at a deep discount that reflects the incurred credit losses

The combined impact of several events may cause financial assets to become defaulted as opposed to one discrete event. It is the Company's policy to consider a financial instrument as "cured" and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least twelve consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the assessment of whether the significant increase in credit risk will reverse. The Company has also set probation periods for an asset to return to Stage 1.

Forward looking information

In its ECL models, the Company relies on a broad range of forward looking information as economic inputs, such as:

- House Price Indices
- Foreign exchange rate
- Interest rates
- Market mortgage rates
- Unemployment rates

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, the Company may make temporary qualitative adjustments or overlays using expert credit judgment when such differences are significantly material. Detailed information about these inputs and sensitivity analysis are provided in Note 27.

Modified financial assets

In a case where a borrower experiences financial difficulties, the Company may grant certain concessionary modifications to the terms and conditions of a mortgage. Modifications may include payment deferrals, extension of amortization periods, rate reductions, principal forgiveness, debt consolidation, forbearance and other modifications intended to minimize the economic loss and to avoid foreclosure, legal action or repossession of collateral. The Company has policies in place to determine the appropriate remediation strategy based on the individual borrower.

If the Company determines that a modification results in an expiry of cash flows, the original financial asset is derecognized while a new asset is recognized based on the new contractual terms. SICR is assessed relative to the risk of default on the date of modification.

If the Company determines that a modification does not result in derecognition, SICR is assessed based on the risk of default at initial recognition of the original asset. Expected cash flows arising from the modified contractual terms are considered when calculating the ECL for the modified asset. For mortgages that have been modified while having a lifetime ECL, the mortgages can revert to having a 12-month ECL after a period of performance and improvement in the borrower's financial condition.

4. Summary of Significant Accounting Policies (continued)

Write-offs

The Company's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the Company has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to provisions for losses.

Classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (FVPL, available for sale ("AFS"), held-to-maturity and amortized cost) have been replaced as follows:

- Debt instruments at amortized cost
- Debt instruments at fair value through other comprehensive income ("FVOCI"), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition
- Financial assets at FVPL

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to the income statement.

The Company's classification of its financial assets and liabilities and the quantitative impact of applying IFRS 9 as at January 1, 2018 is disclosed in Note 6.

Measurement categories

The Company classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, and they are measured as amortized cost, FVOCI or FVPL.

The Company only measures financial assets at amortized cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows.
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

Business model assessment

The Company determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. The business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected); and
- The expected frequency, value and timing of sales are also important aspects of the Company's assessment.

The business model assessment is based on reasonably expected scenarios without taking "worst case" or "stress case" scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Company's original expectations, the Company does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

4. Summary of Significant Accounting Policies (continued)

The SPPI test

As a second step of its classification process the Company assesses the contractual terms of financial instruments to identify whether they meet the SPPI test.

“Principal” for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortization of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Company applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Financial assets at fair value through profit and loss

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9.

Financial assets at FVPL are recorded in the consolidated balance sheets at fair value. Changes in fair value are recorded in profit and loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income using the EIR, taking into account any discount/premium and qualifying transaction costs being an integral part of the instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rates. Dividend income from equity instruments measured at FVPL is recorded in profit or loss when the right to the payment has been established.

Hedge accounting

The new hedge accounting principles incorporated into IFRS 9 are designed to align hedge accounting more closely with risk management. The Company currently does not have any hedging relationships eligible for hedge accounting under IFRS 9, and therefore the adoption of the hedge accounting rules of IFRS 9 did not have any impact on the Company.

IFRS 15, Revenue from Contracts with Customers

The Company adopted IFRS 15, *Revenue from Contracts with Customers* that established a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects in exchange for transferring goods or services to a customer. The standard does not apply to revenue associated with financial instruments under IFRS 9, therefore it did not impact the majority of the Company's revenue. As a result, the Company has had no material impact on its interim consolidated financial statements from the adoption of IFRS 15.

IFRS 2, Share-based Payment Transactions

The Company adopted amendments to IFRS 2, *Share-based Payment Transactions* that clarified the accounting for the effects on vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. The amendments to IFRS 2 have had no impact on the Company's interim consolidated financial statements.

Standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Company's consolidated financial statements are listed below. This listing is of standards and interpretations issued that the Company reasonably expects to be applicable at a future date. The Company intends to adopt those standards when they become effective.

4. Summary of Significant Accounting Policies (continued)

IFRS 16, Leases

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e., the customer (“lessee”) and the supplier (“lessor”). IFRS 16 is effective for annual periods beginning on or after January 1, 2019. All leases result in a company (the lessee) obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17, *Leases* and, instead, introduces a single lessee accounting model. Applying that model, a lessee is required to recognize: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the consolidated statement of income. The Company has not yet determined the impact of IFRS 16 on its consolidated financial statements.

IFRIC 23, Uncertainty over Income Tax Treatments

This Interpretation clarifies how to apply the recognition and measurement requirements in IAS 12, *Income Taxes* when there is uncertainty over income tax treatments. In such a circumstance, the Company shall recognize and measure its current or deferred tax asset or liability applying the requirements in IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Interpretation. This interpretation is effective for annual periods beginning on or after January 1, 2019. The Company has not yet determined the impact of this interpretation on the consolidated financial statements.

5. Significant Accounting Judgments and Estimates

The preparation of the Company’s consolidated financial statements requires management to make judgments, estimates 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. 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.

(a) Significant 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

Significant influence represents the power to participate in the financial and operating policy decisions of an investee, but does not represent control or joint control over the entity. In determining whether it has significant influence over an entity, the Company makes certain judgments to form the basis for the Company’s policies in accounting for its equity investments.

Income 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.

5. Significant Accounting Judgments and Estimates (continued)

(b) Significant 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 is 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.

Impairment of financial assets

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 and so allowances for financial assets should be measured on a lifetime ECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed 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.

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 effective interest rate method ("EIM").

Income taxes

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 on the likely timing and the level of future taxable income together with future tax planning strategies.

6. Transition to IFRS 9

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS as of January 1, 2018 is as follows:

(a) IFRS 9 transition summary

Financial instrument	Category ⁴	IAS 39		IFRS 9		Note
		Amount	Remeasurement	Amount	Category ⁴	
<u>Financial assets</u>						
Cash and cash equivalents	L&R	\$ 117,571	\$ -	\$ 117,571	AC	
Marketable securities	AFS	62,518	-	62,518	FVPL	1
Mortgages - corporate	L&R	863,384	(1)	863,383	AC	2
Financial investments	AFS	68,190	-	68,190	FVPL	3
Other loans	L&R	2,612	-	2,612	AC	
Cash held in trust	L&R	13,441	-	13,441	AC	
Mortgages - securitized	L&R	1,016,724	(17)	1,016,707	AC	
Other assets	FVPL	4,239	-	4,239	FVPL	
		<u>\$ 2,148,679</u>	<u>\$ (18)</u>	<u>\$ 2,148,661</u>		
<u>Financial liabilities</u>						
Term deposits	AC	\$ 884,460	\$ -	\$ 884,460	AC	
Financial liabilities from securitization	AC	1,015,699	-	1,015,699	AC	
		<u>\$ 1,900,159</u>	<u>\$ -</u>	<u>\$ 1,900,159</u>		

¹ Marketable securities were reclassified from available for sale under IAS 39 to FVPL under IFRS 9. Marketable securities are considered to be equity instruments and the Company did not elect to carry them at FVOCI, therefore they are carried at FVPL.

² Corporate mortgages had their ECL recalculated and other adjustments made upon the adoption of IFRS 9.

³ Financial investments were reclassified from available for sale under IAS 39 to FVPL under IFRS 9. Financial investments are considered to be equity instruments and the Company did not elect to carry them at FVOCI, therefore they are carried at FVPL.

⁴ Category acronyms are as follows: L&R - loans and receivables; AFS - available for sale; FVPL - fair value through profit and loss; AC - amortized cost.

As an "investment in associate" under IAS 28, the equity investment in MCAP is not directly in the scope of the classification and measurement principles of IFRS 9, which govern financial instruments. Since MCAP's fiscal year end is November 30, MCAP will not officially adopt IFRS 9 until December 1, 2018. However, IAS 28 requires the Company to consistently apply its accounting policies in accounting for investments in associates, and therefore the principles of IFRS 9 (including applicable policy choices by the Company), have been reflected in equity income from MCAP and the carrying value of the equity investment.

6. Transition to IFRS 9 (continued)

(b) Impact of IFRS 9 transition on retained earnings and accumulated other comprehensive income

<u>Retained earnings</u>	
Closing balance under IAS 39, December 31, 2017	\$ 65,365
Recognition of expected credit losses on corporate mortgages	(52)
Recognition of expected credit losses on securitized mortgages	(17)
Other adjustments - corporate mortgages	51
Reclassification of AFS financial investments to FVPL	13,125
Reclassification of AFS marketable securities to FVPL	3,313
Opening balance under IFRS 9, January 1, 2018	<u>\$ 81,785</u>
<u>Accumulated other comprehensive income</u>	
Closing balance under IAS 39, December 31, 2017	\$ 16,438
Reclassification of AFS financial investments to FVPL	(13,125)
Reclassification of AFS marketable securities to FVPL	(3,313)
Opening balance under IFRS 9, January 1, 2018	<u>\$ -</u>

(c) Reconciliation of mortgage allowances under IAS 39 and IFRS 9

	IAS 39	Remeasurement	IFRS 9
<u>Corporate</u>			
Insured single family	\$ -	\$ 2	\$ 2
Uninsured single family	910	(526)	384
Uninsured - completed inventory	220	180	400
Construction - residential	2,536	38	2,574
Construction - non-residential	32	22	54
Commercial - multi family residential	423	184	607
Commercial - other	689	152	841
Corporate total	4,810	52	4,862
Securitized	-	17	17
Total	\$ 4,810	\$ 69	\$ 4,879

7. Marketable Securities

<u>As at</u>	March 31 2018	December 31 2017
Real estate investment trusts	\$ 61,401	\$ 61,973
Corporate bonds	28	545
	<u>\$ 61,429</u>	<u>\$ 62,518</u>

Corporate bonds mature in 2022 while real estate investment trusts have no specific maturity date. Fair values are based on bid prices quoted in active markets (real estate investment trusts) and observable inputs other than quoted prices (corporate bonds), and changes in fair value are recognized in the consolidated statements of comprehensive income.

As at March 31, 2018, the marketable securities portfolio included an unrealized gain of \$2,738 (December 31, 2017 - \$3,313). For details of changes in unrealized gains on marketable securities, refer to Note 19.

8. Mortgages - Corporate

(a) Summary

As at March 31, 2018 (IFRS 9)	Gross		Allowance			Net	
	Principal		Stage 1	Stage 2	Stage 3	Total	Principal
Corporate portfolio:							
Single family mortgages							
- Insured	\$ 75,699	\$ 1	\$ -	\$ -	\$ -	\$ 1	\$ 75,698
- Uninsured	197,091	194	100	173		467	196,624
- Uninsured - completed inventory	7,458	48	-	-		48	7,410
Construction loans							
- Residential	407,683	2,352	344	-		2,696	404,987
- Non-residential	5,054	40	-	-		40	5,014
Commercial loans							
- Multi family residential	73,770	728	16	-		744	73,026
- Other commercial	97,655	799	243	-		1,042	96,613
	\$ 864,410	\$ 4,162	\$ 703	\$ 173	\$ 5,038		\$ 859,372

As at December 31, 2017 (IAS 39)	Gross		Allowance			Net	
	Principal		Collective	Individual	Total	Principal	
Corporate portfolio:							
Single family mortgages							
- Insured	\$ 80,377	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 80,377
- Uninsured	199,264	848	62		910		198,354
- Uninsured - completed inventory	51,410	220	-		220		51,190
Construction loans							
- Residential	389,098	2,536	-		2,536		386,562
- Non-residential	4,872	32	-		32		4,840
Commercial loans							
- Multi family residential	65,078	423	-		423		64,655
- Other commercial	78,095	689	-		689		77,406
	\$ 868,194	\$ 4,748	\$ 62	\$ 4,810			\$ 863,384

Gross principal as presented in the tables above includes unamortized capitalized transaction costs and accrued interest.

MCAN's corporate mortgage portfolio includes insured and uninsured single family mortgages. The Company does not invest in the United States mortgage market. Uninsured mortgages may not exceed 80% of the value of the real estate securing such loans at the time of funding. Residential mortgages insured by the Canada Mortgage and Housing Corporation ("CMHC") or other private insurers may exceed this ratio.

Uninsured completed inventory loans are credit facilities extended to developers to provide interim mortgage financing on residential units (condominium or freehold) where all construction has been completed and therefore no further construction risk exists.

Residential construction loans are made to homebuilders to finance residential construction projects. These loans generally have a floating interest rate and terms of one to two years.

Commercial loans include multi family residential loans (e.g. loans secured by apartment buildings), and other commercial loans, which consist of commercial term mortgages (e.g. loans secured by retail/industrial buildings) and high ratio mortgage loans (e.g. second mortgages on residential construction projects).

8. Mortgages - Corporate (continued)

(b) Mortgages by Risk Rating

The table below shows the credit quality of the Company's corporate mortgage portfolio based on the Company's internal risk rating system and stage classification. The Company's policy that outlines whether ECL allowances are calculated on an impaired or performing basis are set out in Note 27.

The Company's internal risk rating system involves significant judgment and combines multiple factors to arrive at a borrower-specific score to assess the borrower's probability of default and ultimately classify the mortgage into one of the categories listed in the table below. For single family mortgages, these factors include the loan to value ratio, the borrower's ability to service debt, property location and beacon score. For construction, commercial and completed inventory loans, these factors include borrower net worth, project presales, experience with the borrower, project location and loan to value ratio.

As at March 31, 2018	Stage 1		Stage 2		Stage 3		Total	
Insured single family								
Insured performing	\$	68,571	\$	4,901	\$	-	\$	73,472
Arrears		-		281		-		281
Impaired/default		-		-		1,945		1,945
		<u>68,571</u>		<u>5,182</u>		<u>1,945</u>		<u>75,698</u>
Uninsured single family								
Very low risk	\$	27,436	\$	5,616	\$	-	\$	33,052
Low risk		32,036		6,314		-		38,350
Normal risk		63,764		10,934		-		74,698
Moderate risk		22,252		4,217		-		26,469
High risk		14,538		2,539		-		17,077
Arrears		317		4,788		-		5,105
Impaired/default		-		-		1,873		1,873
		<u>160,343</u>		<u>34,408</u>		<u>1,873</u>		<u>196,624</u>
Uninsured completed inventory								
High risk	\$	7,410	\$	-	\$	-	\$	7,410
		<u>7,410</u>		<u>-</u>		<u>-</u>		<u>7,410</u>
Construction								
Moderate risk	\$	24,964	\$	-	\$	-	\$	24,964
High risk		140,476		-		-		140,476
Higher risk		198,932		32,393		-		231,325
Monitored/Watchlist		-		13,236		-		13,236
		<u>364,372</u>		<u>45,629</u>		<u>-</u>		<u>410,001</u>
Commercial - multi family residential								
Normal risk	\$	10,034	\$	-	\$	-	\$	10,034
Moderate risk		32,285		-		-		32,285
High risk		4,931		-		-		4,931
Higher risk		23,150		-		-		23,150
Monitored/Watchlist		-		2,626		-		2,626
		<u>70,400</u>		<u>2,626</u>		<u>-</u>		<u>73,026</u>
Commercial - other								
Low risk	\$	3,044	\$	-	\$	-	\$	3,044
Normal risk		18,830		-		-		18,830
Moderate risk		11,943		-		-		11,943
High risk		7,608		-		-		7,608
Higher risk		28,041		9,553		-		37,594
Monitored/Watchlist		-		17,594		-		17,594
		<u>69,466</u>		<u>27,147</u>		<u>-</u>		<u>96,613</u>
	\$	740,562	\$	114,992	\$	3,818	\$	859,372

8. Mortgages - Corporate (continued)

(c) Geographic Analysis

As at March 31, 2018 (IFRS 9)	Single Family	Construction	Commercial	Total	
Ontario	\$ 166,834	\$ 183,901	\$ 111,667	\$ 462,402	53.8%
Alberta	53,347	32,536	12,640	98,523	11.5%
British Columbia	28,810	190,853	45,332	264,995	30.8%
Quebec	9,505	2,711	-	12,216	1.4%
Atlantic Provinces	12,541	-	-	12,541	1.5%
Other	8,695	-	-	8,695	1.0%
	\$ 279,732	\$ 410,001	\$ 169,639	\$ 859,372	100.0%

As at December 31, 2017 (IAS 39)	Single Family	Construction	Commercial	Total	
Ontario	\$ 207,293	\$ 179,088	\$ 91,323	\$ 477,704	55.3%
Alberta	62,376	34,736	13,905	111,017	12.9%
British Columbia	28,202	177,578	36,833	242,613	28.1%
Quebec	9,357	-	-	9,357	1.1%
Atlantic Provinces	13,681	-	-	13,681	1.6%
Other	9,012	-	-	9,012	1.0%
	\$ 329,921	\$ 391,402	\$ 142,061	\$ 863,384	100.0%

(d) Mortgage Allowances

Details of the allowance for credit losses for the current quarter recorded under IFRS 9 are as follows:

	Stage 1	Stage 2	Stage 3	Total
Insured single family				
Allowance, January 1, 2018	\$ 2	\$ -	\$ -	\$ 2
Mortgages derecognized or repaid	(1)	-	-	(1)
Total provision for credit losses	(1)	-	-	(1)
Allowance, March 31, 2018	1	-	-	1
Uninsured single family				
Allowance, January 1, 2018	\$ 205	\$ 58	\$ 121	\$ 384
Transfer to stage 1	15	(15)	-	-
Transfer to stage 2	(68)	68	-	-
Transfer to stage 3	-	(40)	40	-
Net remeasurement of allowance	24	30	24	78
New originations or purchases	24	1	-	25
Mortgages derecognized or repaid	(5)	(2)	-	(7)
Total provision for credit losses	(10)	42	64	96
Write-offs	(1)	-	(12)	(13)
Allowance, March 31, 2018	194	100	173	467
Uninsured completed inventory				
Allowance, January 1, 2018	\$ 338	\$ 62	\$ -	\$ 400
Net remeasurement of allowance	1	-	-	1
Mortgages derecognized or repaid	(291)	(62)	-	(353)
Total provision for credit losses	(290)	(62)	-	(352)
Allowance, March 31, 2018	48	-	-	48

8. Mortgages - Corporate (continued)

Construction

Allowance, January 1, 2018	\$	2,293	\$	335	\$	-	\$	2,628
Net remeasurement of allowance		51		9		-		60
New originations or purchases		445		-		-		445
Mortgages derecognized or repaid		(367)		-		-		(367)
Total provision for credit losses		129		9		-		138
Reclassification		(30)		-		-		(30)
Allowance, March 31, 2018		2,392		344		-		2,736

Commercial - multi-family

Allowance, January 1, 2018	\$	563	\$	44	\$	-	\$	607
Net remeasurement of allowance		16		-		-		16
New originations or purchases		314		-		-		314
Mortgages derecognized or repaid		(165)		(28)		-		(193)
Total provision for credit losses		165		(28)		-		137
Allowance, March 31, 2018		728		16		-		744

Commercial - other

Allowance, January 1, 2018	\$	597	\$	244	\$	-	\$	841
Transfer to stage 2		(32)		32		-		-
Net remeasurement of allowance		(71)		8		-		(63)
New originations or purchases		438		-		-		438
Mortgages derecognized or repaid		(163)		(41)		-		(204)
Total provision for credit losses		172		(1)		-		171
Reclassification		30		-		-		30
Allowance, March 31, 2018		799		243		-		1,042

Total

Allowance, January 1, 2018	\$	3,998	\$	743	\$	121	\$	4,862
Transfer to stage 1		15		(15)		-		-
Transfer to stage 2		(100)		100		-		-
Transfer to stage 3		-		(40)		40		-
Net remeasurement of allowance		21		47		24		92
New originations or purchases		1,221		1		-		1,222
Mortgages derecognized or repaid		(992)		(133)		-		(1,125)
Total provision for credit losses		165		(40)		64		189
Write-offs		(1)		-		(12)		(13)
Allowance, March 31, 2018	\$	4,162	\$	703	\$	173	\$	5,038

Details of the allowances for mortgage credit losses for the prior year comparative period under IAS 39 are as follows:

For the Quarter Ended March 31, 2017	Collective	Individual	Total
Balance, beginning of quarter	\$ 4,859	\$ 390	\$ 5,249
Provisions	(63)	108	45
Reversal of provisions	-	(14)	(14)
Write-offs, net	(1)	(269)	(270)
Balance, end of quarter	\$ 4,795	\$ 215	\$ 5,010

8. Mortgages - Corporate (continued)

(e) Arrears and Impaired Mortgages

Mortgages past due but not impaired are as follows:

As at March 31, 2018 (IFRS 9)	1 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
Single family - uninsured	\$ 3,674	\$ 1,121	\$ 310	\$ -	\$ 5,105
Single family - insured	65	125	91	-	281
	\$ 3,739	\$ 1,246	\$ 401	\$ -	\$ 5,386

As at December 31, 2017 (IAS 39)	1 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
Single family - uninsured	\$ 3,303	\$ 225	\$ 688	\$ -	\$ 4,216
Single family - insured	1,296	157	-	569	2,022
	\$ 4,599	\$ 382	\$ 688	\$ 569	\$ 6,238

Impaired mortgages (net of individual allowances) are as follows:

As at	March 31, 2018 (IFRS 9)			December 31, 2017 (IAS 39)		
	SF Insured	SF Uninsured	Total	SF Insured	SF Uninsured	Total
Ontario	\$ 310	\$ -	\$ 310	\$ -	\$ 86	\$ 86
Alberta	891	1,459	2,350	32	1,546	1,578
Quebec	329	-	329	526	-	526
Atlantic Provinces	-	-	-	-	64	64
Other	415	414	829	274	-	274
	\$ 1,945	\$ 1,873	\$ 3,818	\$ 832	\$ 1,696	\$ 2,528

(f) Other Information

The weighted average yield of the Company's corporate mortgage portfolio is as follows:

As at	March 31 2018	December 31 2017
Single family - insured	3.13%	3.22%
Single family - uninsured	4.67%	4.72%
Single family - uninsured completed inventory	4.79%	6.17%
Construction - residential	5.90%	5.58%
Construction - non residential	5.89%	5.25%
Commercial - multi family residential	5.33%	5.11%
Commercial - other	7.24%	7.81%
Total	5.47%	5.36%

Outstanding commitments for future fundings of mortgages intended for the Company's corporate portfolio are as follows:

As at	March 31 2018	December 31 2017
Single family - insured	\$ 37,679	\$ 27,797
Single family - uninsured	12,947	9,535
Single family - uninsured completed inventory	7,220	1,955
Construction - residential	310,115	246,550
Construction - non residential	3,380	2,720
Commercial - multi family residential	2,728	1,362
Commercial - other	1,288	1,285
Total	\$ 375,357	\$ 291,204

8. Mortgages - Corporate (continued)

The fair value of the corporate mortgage portfolio as at March 31, 2018 was \$863,665 (December 31, 2017 - \$869,147). Fair values are calculated on a discounted cash flow basis using the prevailing market rates for similar mortgages. For information regarding the maturity dates of the Company's mortgages, refer to Note 25.

As at March 31, 2018, single family insured mortgages included \$28,040 of mortgages that had been securitized through the market MBS program, however the underlying MBS security has been retained by the Company for liquidity purposes (December 31, 2017 - \$28,597).

9. Financial Investments

As at	March 31 2018	December 31 2017
Investment - KingSett High Yield Fund	\$ 41,254	\$ 36,153
Investment - Crown Realty II Limited Partnership	32,192	32,037
	\$ 73,446	\$ 68,190

The Company holds an investment in the KingSett High Yield Fund ("KSHYF"), in which it has an 8.0% equity interest (December 31, 2017 - 8.1%). The KSHYF invests in mortgages secured by real estate with a focus on mezzanine, subordinate and bridge mortgages. As mortgage advances are made by the fund, the Company advances its proportionate share. The KSHYF pays a base distribution of 9% per annum, and distributes any additional income earned on a quarterly basis. The Company's total funding commitment is \$63,000, which consists of \$42,000 of capital advances for the Fund and \$21,000 that supports credit facilities throughout the life of the KSHYF. As at March 31, 2018, the Company's unfunded commitment was \$22,433 (December 31, 2017 - \$26,483).

The Company holds an investment in Crown Realty II Limited Partnership ("Crown LP"), in which it has a 14.1% equity interest (December 31, 2017 - 14.1%). Crown LP invests primarily in commercial office buildings and separates them into its core fund, which consists of buildings expected to provide stable cash flows over a longer time horizon, and its opportunity fund, which consists of buildings with medium-term capital appreciation. Its fair value is driven primarily by independent appraisals of the buildings. As property acquisitions are made by Crown LP, the Company advances its proportionate share to finance the acquisitions.

As at March 31, 2018, financial investments included an unrealized gain of \$13,644 (December 31, 2017 - \$13,125). For details of changes in unrealized gains on financial investments, refer to Note 19.

10. Equity Investment in MCAP Commercial LP

As at March 31, 2018, the Company held a 13.83% equity interest in MCAP (December 31, 2017 - 14.41%), consisting of 14.1% of voting class A units (December 31, 2017 - 14.7%), 0% of non-voting class B units (December 31, 2017 - 0%) and 16.0% of non-voting class C units (December 31, 2017 - 16.7%). The equity interest represents 4.0 million units held by MCAN of the 28.9 million total outstanding MCAP partnership units. MCAN holds a 14.1% voting interest in MCAP through its class A units (December 31, 2017 - 14.7%).

During Q1 2018, MCAN sold 200,000 partnership units in MCAP at a price of \$22.60 per unit, recognizing a gain on sale of \$1,701. The sale reduced MCAN's equity interest in MCAP from 14.41% to 13.83%.

During Q1 2017, MCAN sold 100,000 partnership units in MCAP at a price of \$19.47 per unit, recognizing a gain on sale of \$785. MCAP also issued additional class B units to other partners of MCAP at a price in excess of the carrying value per unit, resulting in a dilution gain of \$91.

Since MCAP's fiscal year end is November 30th, MCAN records equity income from MCAP on a one-month lag. To the extent that MCAP has a material transaction during the one-month lag, MCAN is required to reflect the transaction in the month in which it occurred instead of the subsequent month.

MCAP's head office is located at 200 King Street West, Suite 400, Toronto, Ontario, Canada. Although MCAN's voting interest in MCAP was less than 20% as at March 31, 2018, MCAN uses the equity basis of accounting for the investment as it has significant influence in MCAP per IAS 28, *Investments in Associates and Joint Ventures*, as a result of its entitlement to a position on MCAP's Board of Directors.

10. Equity Investment in MCAP Commercial LP (continued)

For information on the impact of the adoption of IFRS 9 on the equity investment in MCAP, refer to Note 6 to the consolidated financial statements.

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.

For the Quarters Ended March 31	2018	2017
Balance, beginning of period	\$ 59,189	\$ 50,805
Equity income	3,439	1,892
Dilution gain	-	91
Carrying value of portion of investment sold	(2,820)	(1,163)
Distributions received	(3,410)	(1,209)
Balance, end of period	\$ 56,398	\$ 50,416

Selected MCAP financial information is as follows:

As at	February 28 2018	November 30 2017
MCAP's balance sheet:		
Assets	\$ 31,335,656	\$ 29,719,416
Liabilities	30,905,531	29,279,919
Equity	430,125	439,497

For the Quarters Ended	February 28 2018	February 28 2017
MCAP revenue and net income:		
Revenue	\$ 112,797	\$ 106,977
Net income	\$ 23,692	\$ 12,369

11. Securitization Activities

The Company is an NHA MBS issuer, which involves the securitization of insured mortgages to create MBS. The Company issues MBS through its internal market MBS program and the Canada Housing Trust ("CHT") CMB program. In both programs, the Company originates or purchases mortgages for securitization.

Pursuant to the NHA MBS program, MBS investors receive monthly cash flows consisting of interest and scheduled and unscheduled principal payments. CMHC makes principal and interest payments in the event of any MBS default by the issuer, thus fulfilling the timely payment obligation to investors. To date, the Company has sold MBS as part of the market MBS program and the CMB program, which are discussed below.

Market MBS Program

MCAN originates and purchases insured single family mortgages to sell as MBS as part of the market MBS program. The Company may sell MBS to third parties and may also sell the net economics and cash flows from the underlying mortgages ("interest-only strips") to third parties. The MBS portion of the mortgage represents the core securitized mortgage principal and the right to receive coupon interest at a specified rate. The interest-only strips represent the right to receive excess cash flows after satisfying the MBS coupon interest payment and any other expenses such as mortgage servicing.

During Q1 2018, MCAN securitized \$27,762 of MBS to third parties (Q1 2017 - \$5,999). When the MBS is sold to third parties and the interest-only strip is retained by MCAN, the securitized mortgages remain on MCAN's consolidated balance sheet while a corresponding financial liability from securitization is incurred (Notes 12 and 15), due to the fact that MCAN retains significant continuing involvement with the assets.

11. Securitization Activities (Continued)

CMB Program

The CMB program involves the sale of MBS to CHT who in turn issues a non-amortizing bullet bond to external investors. The CMB program requires the reinvestment by the issuer of mortgage principal repayments received during their term into certain permitted assets. The Company has transferred the benefits and obligations associated with the principal reinvestment function to a third party such that it only earns spread income on the amortizing mortgage balance.

During Q1 2018, did not MCAN securitize any insured single family mortgages through the CMB program (Q1 2017 - \$41,627). Similar to the market MBS program, the Company does not derecognize the securitized mortgages from its consolidated balance sheet when it retains significant continuing involvement with the assets such that the associated mortgages remain on the consolidated balance sheet while a corresponding liability is incurred. The mortgage interest income and interest on the financial liability from securitization associated with these mortgages are recognized on the accrual basis over the term of the mortgages.

Other Accounting Considerations

The primary risks associated with the market MBS program and CMB program are prepayment, liquidity and funding risk, including the obligation to fund 100% of any cash shortfall related to the Timely Payment (discussed below).

Any mortgages securitized through the market MBS program or CMB program for which derecognition is not achieved remain on MCAN's consolidated balance sheet as securitized assets and are also included in total exposures in the calculation of the leverage ratio (Note 26). For income tax purposes, mortgage securitizations by MCAN have been evaluated as true mortgage sales and therefore are not included in income tax assets (Note 26).

MCAN has capitalized certain mortgage acquisition costs. These costs are amortized using the EIM, which incorporates mortgage prepayment assumptions.

Timely Payment

Consistent with all issuers of MBS, the Company is required to remit scheduled mortgage principal and interest payments to CMHC, even if these mortgage payments have not been collected from mortgagors. Similarly, at the maturity of the MBS pools that have been issued by MCAN, any outstanding principal must be paid to CMHC. If the Company fails to make a scheduled principal and interest payment to CMHC, CMHC may enforce the assignment of the mortgages included in all MBS pools in addition to other assets backing the MBS issued.

As part of its participation in the market MBS program and CMB program, the Company is required to fund 100% of any cash shortfall unless it has sold the interest-only strip, in which case the purchaser of the interest-only strip is obligated to fund 100% of any cash shortfall.

In the case of mortgage defaults, MCAN is required to make scheduled principal and interest payments to investors as part of the Timely Payment and then place the mortgage/property through the insurance claims process to recover any losses. These defaults may result in cash flow timing mismatches that may marginally increase funding and liquidity risks.

Transferred financial assets that are not derecognized in their entirety

Since MCAN neither transferred nor retained risks and rewards of ownership on sale and retained significant continuing involvement through the provision of the Timely Payment obligation, the majority of the market MBS program and single family CMB program sale transactions have resulted in MCAN continuing to recognize the securitized mortgages and financial liabilities from securitization on its consolidated balance sheet. The securitized mortgage balance as at March 31, 2018 was \$1,013,036 (December 31, 2017 - \$1,016,724) (Note 12). The financial liabilities from securitization balance as at March 31, 2018 was \$1,015,296 (December 31, 2017 - \$1,015,699) (Note 15).

Transferred financial assets that are derecognized in their entirety but where the Company has a continuing involvement

In previous years, MCAN sold MBS and in some cases sold the associated interest-only strips to third parties. Accordingly, MCAN then derecognized the mortgages from its consolidated balance sheet as a result of the transfer of control of the asset or substantially all risks and rewards on sale. MCAN's continuing involvement is the ongoing obligation in its role as MBS issuer to service the mortgages and MBS until maturity.

11. Securitization Activities (Continued)

The total outstanding derecognized MBS balance related to the market MBS program and CMB program was not reflected as an asset or liability on MCAN's consolidated balance sheet as at March 31, 2018. The MBS mature as follows:

	2020	2021	2026	Total
March 31, 2018	\$ 103,701	\$ 73,443	\$ 9,619	\$ 186,763
December 31, 2017	\$ 108,990	\$ 73,786	\$ 9,678	\$ 192,454

12. Mortgages - Securitized

MCAN's securitized mortgage portfolio consists of insured mortgages securitized through the market MBS program and CMB program. These mortgages are held as collateral against the related securitization liabilities (Notes 11 and 15).

(a) Summary

As at March 31, 2018 (IFRS 9)	Gross Principal	Allowance			Net Principal
		Stage 1	Stage 2	Total	
Single family insured - Market MBS program	\$ 867,160	\$ 11	\$ -	\$ 11	\$ 867,149
Single family insured - CMB program	145,908	7	14	21	145,887
	\$ 1,013,068	\$ 18	\$ 14	\$ 32	\$ 1,013,036

As at December 31, 2017 (IAS 39)	Gross Principal	Allowance		Net Principal
Single family insured - Market MBS program	\$ 867,406	\$ -	\$ -	\$ 867,406
Single family insured - CMB program	149,318	-	-	149,318
	\$ 1,016,724	\$ -	\$ -	\$ 1,016,724

(b) Mortgages by Risk Rating

The table below shows the credit quality of the Company's securitized mortgage portfolio based on the Company's internal risk rating system and stage classification. The Company's policy that outlines whether ECL allowances are calculated on an impaired or performing basis are set out in Note 27.

The Company's internal risk rating system combines multiple factors to arrive at a borrower credit score and ultimately classify the mortgage into one of the categories listed in the table below. These factors include the loan to value ratio, the borrower's ability to service debt, property location and beacon score.

As at March 31, 2018	Stage 1	Stage 2	Stage 3	Total
Market MBS program				
Insured performing	\$ 778,722	\$ 79,827	\$ -	\$ 858,549
Arrears	869	6,765	-	7,634
Impaired/default	-	-	966	966
	779,591	86,592	966	867,149
CMB program				
Insured performing	\$ 134,274	\$ 10,659	\$ -	\$ 144,933
Arrears	636	318	-	954
	134,910	10,977	-	145,887
	\$ 914,501	\$ 97,569	\$ 966	\$ 1,013,036

12. Mortgages - Securitized (continued)

(c) Geographic Analysis

As at	March 31, 2018 (IFRS 9)		December 31, 2017 (IAS 39)	
Ontario	\$ 578,407	57.1%	\$ 576,785	56.7%
Alberta	230,691	22.8%	231,335	22.8%
British Columbia	82,961	8.2%	90,174	8.9%
Quebec	41,638	4.1%	41,449	4.1%
Atlantic Provinces	45,924	4.5%	44,924	4.4%
Other	33,415	3.3%	32,057	3.1%
As at	\$ 1,013,036	100.0%	\$ 1,016,724	100.0%

(d) Mortgage Allowances

Details of the allowance for credit losses for the current quarter recorded under IFRS 9 are presented in the table below.

	Stage 1		Stage 2		Stage 3		Total	
Market MBS program								
Allowance, January 1, 2018	\$	11	\$	-	\$	-	\$	11
Allowance, March 31, 2018		11		-		-		11
CMB program								
Allowance, January 1, 2018	\$	4	\$	2	\$	-	\$	6
Transfer to stage 1		1		(1)		-		-
Net remeasurement of allowance		2		13		-		15
Total provision for credit losses		3		12		-		15
Allowance, March 31, 2018		7		14		-		21
Total								
Allowance, January 1, 2018	\$	15	\$	2	\$	-	\$	17
Transfer to stage 1		1		(1)		-		-
Net remeasurement of allowance		2		13		-		15
Total provision for credit losses		3		12		-		15
Allowance, March 31, 2018	\$	18	\$	14	\$	-	\$	32

12. Mortgages - Securitized (continued)

(e) Arrears and Impaired Mortgages

Securitized mortgages past due but not impaired are as follows:

As at March 31, 2018 (IFRS 9)	1 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
Single family - Market MBS Program	\$ 6,377	\$ 910	\$ 347	\$ -	\$ 7,634
Single family - CMB Program	954	-	-	-	954
	\$ 7,331	\$ 910	\$ 347	\$ -	\$ 8,588

As at December 31, 2017 (IAS 39)	1 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
Single family - Market MBS program	\$ 5,207	\$ 1,941	\$ 263	\$ 1,112	\$ 8,523
Single family - CMB program	280	-	-	-	280
	\$ 5,487	\$ 1,941	\$ 263	\$ 1,112	\$ 8,803

Impaired securitized mortgages are as follows:

As at	March 31, 2018 (IFRS 9)			December 31, 2017 (IAS 39)		
	CMB	Market MBS	Total	CMB	Market MBS	Total
Ontario	\$ -	\$ 125	\$ 125	\$ -	\$ -	\$ -
Alberta	-	658	658	-	-	-
Quebec	-	116	116	-	-	-
Atlantic Provinces	-	67	67	-	-	-
	\$ -	\$ 966	\$ 966	\$ -	\$ -	\$ -

(f) Other Information

Certain capitalized transaction costs are included in mortgages and are amortized using the EIM. As at March 31, 2018, the unamortized capitalized cost balance was \$5,767 (December 31, 2017 - \$6,536). The amortization of these transaction costs incorporates a 12% annual mortgage prepayment rate.

The fair value of the securitized mortgage portfolio as at March 31, 2018 was \$1,024,373 (December 31, 2017 - \$1,031,154).

The weighted average yield of the Company's securitized mortgage portfolio is as follows:

As at	March 31 2018	December 31 2017
Single family - Market MBS program	2.51%	2.49%
Single family - CMB program	2.21%	2.22%
Total	2.47%	2.45%

13. Term Deposits

Term deposits are issued to various individuals and institutions with contracted terms between 30 days and five years. The Company does 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 Company's term deposits are eligible for CDIC deposit insurance.

Term deposits maturities and the weighted average interest rate are as follows:

	Within 3 Months	3 Months to 1 Year	One to three years	Three to five years	Total	Average Rate
March 31, 2018	\$ 153,009	\$ 199,941	\$ 327,782	\$ 142,872	\$ 823,604	2.40%
December 31, 2017	\$ 98,760	\$ 314,574	\$ 318,321	\$ 152,805	\$ 884,460	2.34%

13. Term Deposits (continued)

Term deposits are classified as other financial liabilities and are recorded at amortized cost. The estimated fair value of term deposits as at March 31, 2018 was \$818,547 (December 31, 2017 - \$882,553), and is determined by discounting the contractual cash flows using market interest rates currently offered for deposits of similar remaining maturities.

14. Income Taxes

The composition of the provision for (recovery) of income taxes is as follows:

For the Quarters Ended March 31	2018	2017
Income before income taxes	\$ 10,444	\$ 10,513
Statutory rate of tax	0%	0%
Tax provision (recovery) before the following:	-	-
Income subject to tax in subsidiaries	(171)	248
\$ (171)	\$ 248	
For the Quarters Ended March 31	2018	2017
Current tax		
Current tax provision	\$ -	\$ -
Deferred tax provision (recovery)		
Financial investments	53	452
Relating to loss carry forward benefit	(117)	(296)
Other	(107)	92
\$ (171)	\$ 248	

The composition of the deferred tax asset and liability is as follows:

As at	March 31 2018	December 31 2017
Deferred tax asset		
Loss carry forward benefit	\$ 2,175	\$ 2,058
Other	699	614
\$ 2,874	\$ 2,672	
Deferred tax liability		
Financial investments	\$ 3,577	\$ 3,524
Other	26	48
\$ 3,603	\$ 3,572	

The loss carry forward benefit reflected in the deferred tax asset relates to losses in subsidiaries to which the Company has attributed a future benefit.

Deferred taxes recorded in accumulated other comprehensive income relating to financial investments were \$nil in Q1 2018 (Q1 2017 - \$(412)).

The Company has loss carry forward amounts in the non-consolidated MIC entity of \$11,269 (December 31, 2017 - \$11,269), the benefit of which has not been recorded in deferred tax assets. Tax activity for 2017 has not been reflected in the table below as the Company's 2017 tax position has not been finalized. Tax loss carry forwards expire after 20 years, as follows:

2033	\$ 5,527
2034	5,535
2036	207
	\$ 11,269

15. Financial Liabilities from Securitization

Financial liabilities from securitization consist of liabilities relating to the Company's participation in the market MBS program and the CMB program.

As at	Note	March 31 2018	December 31 2017
Financial liabilities - Market MBS program	11	\$ 870,618	\$ 868,244
Financial liabilities - CMB program	11	144,678	147,455
		\$ 1,015,296	\$ 1,015,699

The weighted average interest rate of financial liabilities from securitization is as follows:

As at	March 31 2018	December 31 2017
Financial liabilities - Market MBS program	1.84%	1.83%
Financial liabilities - CMB program	1.64%	1.64%
	1.82%	1.80%

Financial liabilities from securitization mature as follows:

	2018	2019	2020	2021	2022	2023	Total
March 31, 2018	\$ 101,942	\$ 386,815	\$ 344,541	\$ 89,080	\$ 82,628	\$ 10,290	\$ 1,015,296
December 31, 2017	\$ 99,020	\$ 397,944	\$ 349,519	\$ 90,813	\$ 78,403	\$ -	\$ 1,015,699

16. Share Capital

The authorized share capital of the Company consists of unlimited common shares with no par value.

	Number of Shares	2018	Number of Shares	2017
Balance, January 1	23,377,785	\$ 214,664	23,075,227	\$ 210,239
Issued				
Dividend reinvestment plan	181,360	3,153	142,019	2,040
Executive Share Purchase Plan	-	-	6,709	100
Balance, March 31	23,559,145	\$ 217,817	23,223,955	\$ 212,379

Common shares are issued under the dividend reinvestment plan ("DRIP") out of treasury at the weighted average trading price for the 5 days preceding such issue less a discount of 2%. The DRIP participation rate for the March 31, 2018 dividend was 20% (March 31, 2017 - 15%).

For details on the Executive Share Purchase Plan, refer to Note 22.

The Company had no potentially dilutive instruments as at March 31, 2018 or December 31, 2017.

17. Dividends

Subsequent to the end of the quarter and before the date that these consolidated financial statements were authorized for issuance, the Board declared a quarterly dividend of \$0.37 per share payable on June 29, 2018 to shareholders of record as of June 15, 2018.

18. Accumulated Other Comprehensive Income

Under IAS 39, accumulated other comprehensive income consisted of unrealized gains and losses on available for sale marketable securities and financial investments. Upon the adoption of IFRS 9 on January 1, 2018, all available for sale assets were reclassified to FVPL, therefore as at this date the accumulated other comprehensive income balance was reclassified to retained earnings.

As at	March 31 2018	December 31 2017
To be reclassified to the income statement in subsequent periods:		
Unrealized gain on available for sale marketable securities	\$ -	\$ 3,313
Unrealized gain on available for sale financial investments	-	15,183
Less: deferred taxes	-	(2,058)
	-	13,125
	\$ -	\$ 16,438

19. Unrealized Gain (Loss) on Financial Instruments

Upon the adoption of IFRS 9 on January 1, 2018, marketable securities and financial investments were reclassified to FVPL, with fair value changes recorded through profit and loss. Under IAS 39, fair value changes were recorded through accumulated other comprehensive income.

For the Periods Ended March 31	2018	2017
Change in unrealized gain on marketable securities	\$ (575)	\$ -
Change in unrealized gain on financial investments	519	-
	\$ (56)	\$ -

20. Mortgage Expenses

Corporate Assets

For the Quarters Ended March 31	2018	2017
Mortgage servicing expense	\$ 706	\$ 729
Letter of credit expense	146	142
Other mortgage expenses	99	88
	\$ 951	\$ 959

Letter of credit expense relates to outstanding letters of credit in the Company's credit facility, discussed in Note 24.

Securitization Assets

Mortgage expenses associated with securitization assets consist primarily of mortgage servicing expenses.

21. Provision for Credit Losses

For the Quarters Ended March 31	Note	2018	2017
IFRS 9 classifications - corporate mortgages			
Stage 1 - provisions on performing mortgages	8	\$ 165	n/a
Stage 2 - provisions on performing mortgages	8	(40)	n/a
Stage 3 - provisions on impaired mortgages	8	64	n/a
		189	n/a
IAS 39 classifications - corporate mortgages			
Collective provisions	8	n/a	\$ (63)
Individual provisions	8	n/a	45
Other provisions (recoveries), net		(15)	48
Corporate provision for credit losses		174	30
IFRS 9 classifications – securitized mortgages			
Stage 1 - provisions on performing mortgages	12	3	n/a
Stage 2 - provisions on performing mortgages	12	12	n/a
Securitized provision for credit losses		15	n/a
		\$ 189	\$ 30

22. Related Party Disclosures

Transactions between the Company and its subsidiaries meet the definition of related party transactions. If these transactions are eliminated on consolidation, they are not disclosed as related party transactions.

The consolidated financial statements include the financial statements of the Company and its equity-accounted associate, MCAP. The Company holds a 13.83% equity interest in MCAP (December 31, 2017 - 14.41%), a non-public entity. MCAP's principal activities include the origination and servicing of mortgages. The Company holds one of six seats on MCAP's Board of Directors.

In Q1 2018, the Company purchased certain corporate services from MCAP in the amount of \$3 (Q1 2017 - \$25) and purchased certain mortgage origination and administration services from MCAP in the amount of \$851 (Q1 2017 - \$943). The Company received \$1,080 of mortgage fees from MCAP in Q1 2018 (Q1 2017 - \$1,028). Related party balances with MCAP are reflected in other assets and other liabilities on the consolidated balance sheet where applicable.

In Q1 2018, the Company purchased \$689 of uninsured single family mortgages from MCAP (Q1 2017 - \$nil).

The Company held construction loans as at March 31, 2017 totalling \$638 for which the borrower is a close family member of a member of the Board. These loans paid out in Q2 2017. In Q1 2017, the Company earned interest income of \$8 on these loans. The loans were contracted at market terms.

All related party transactions noted above were in the normal course of business.

Executive Share Purchase Plan

The Company has an Executive Share Purchase Plan (the "Share Purchase Plan") whereby the Board can approve loans to senior management for the purpose of purchasing the Company's common shares. The maximum amount of loans approved under the Share Purchase Plan is limited to 10% of the issued and outstanding common shares.

Dividend distributions on the common shares are used to reduce the principal balance of the loans as follows: 50% of regular distributions; 75% of capital gain distributions. Common shares are issued out of treasury for the Share Purchase Plan at the weighted average trading price for the 20 days preceding such issue.

In Q1 2018, the Company did not advance any new loans under the Share Purchase Plan (Q1 2017 - \$100). As at March 31, 2018, \$1,108 of loans were outstanding (December 31, 2017 - \$1,141). The loans under the Share Purchase Plan bear interest at prime plus 1% (4.45%) as at March 31, 2018 (December 31, 2017 - prime plus 1% (4.20%)) and have a five-year term. The shares are pledged as security for the loans and had a fair value of \$2,459 as at March 31, 2018 (December 31, 2017 - \$2,554). In Q1 2018, MCAN recognized \$12 of interest income (Q1 2017 - \$14) on the Share Purchase Plan loans.

22. Related Party Disclosures (continued)

Deferred Share Units Plan

The Company has a Deferred Share Units Plan (the “DSU Plan”) whereby the Board granted units under the DSU Plan to the President and Chief Executive Officer (the “DSU Participant”). Each unit is equivalent in value to one common share of the Company. Following his retirement/termination date, the DSU Participant is entitled to receive cash for each unit. The individual unit value is based on the average market value of the Company’s common shares for the five days preceding the retirement/termination date. The DSU Participant was initially granted 30,000 units under the DSU Plan and is entitled to receive dividend distributions in the form of additional units. All dividends paid after July 6, 2014 vest immediately such that as at March 31, 2018, all 60,225 units issued had vested (December 31, 2017 - 57,790).

The Company recognizes compensation expenses associated with the DSU Plan over the vesting period. The compensation expense recognized related to the DSU Plan for Q1 2018 was \$42 (Q1 2017 - \$64). As at March 31, 2018, the accrued DSU Plan liability was \$1,064 (December 31, 2017 - \$1,022).

Restricted Share Units Plan

The Company has a Restricted Share Units Plan (the “RSU Plan”) whereby the Board granted units under the RSU Plan to certain members of senior management of the Company (the “RSU Participants”). Each unit is equivalent in value to one common share of the Company. The RSU Participants are entitled to receive cash for each unit three years subsequent to the awarding of the units subject to continued employment with the Company. The individual unit values are based on the value of the Company’s common shares at the time of payment. In addition, the RSU Participants are entitled to receive dividend distributions in the form of additional units. All RSU units vest after three years.

In Q1 2018, the Company granted 5,508 new units to the RSU Participants under the RSU Plan (Q1 2017 - 5,873). No units vested during Q1 2018 and Q1 2017.

As at March 31, 2018, 47,324 units were outstanding (December 31, 2017 - 40,014) of which no units had vested (December 31, 2017 - nil).

The Company recognizes compensation recoveries or expenses associated with the RSU Plan over the vesting period. The compensation expense recognized related to the RSU Plan for Q1 2018 was \$69 (Q1 2017 - \$61). As at March 31, 2018, the accrued RSU Plan liability was \$522 (December 31, 2017 - \$453).

Performance Share Units Plan

The Company has established a Performance Share Units Plan (the “PSU Plan”) whereby the Board granted units under the PSU Plan to certain members of senior management of the Company (the “PSU Participants”). Each unit is equivalent in value to one common share of the Company and vests three years subsequent to the awarding of the units subject to continued employment with the Company. The individual unit values are based on the value of the Company’s common shares at the time of payment. In addition, the PSU Participants are entitled to receive dividend distributions in the form of additional units. At the time of vesting, a “Performance Factor” of 0-150% is applied to the number of units awarded which is based on earnings per share and other adjustments in the fiscal year two years subsequent to the grant date.

The units granted under the PSU Plan may be either PSU units or Performance Deferred Share Units (“PDSU” units). Holders of PSU units are paid in cash at the time of vesting. Holders of PDSU units are paid in cash at their retirement/termination date, provided that the units have vested. Additionally, the PDSU units earn dividends subsequent to vesting until the retirement/termination date.

In Q1 2018, the Company granted 31,446 new units to the PSU Participants under the PSU Plan (Q1 2017 - 44,279) and 303 units were forfeited (Q1 2017 - 1,844). As at March 31, 2018, 109,738 units were outstanding (December 31, 2017 - 74,791). As at March 31, 2018, no units had vested (December 31, 2017 - nil).

The Company recognizes compensation recoveries or expenses associated with the PSU Plan over the vesting period. The compensation expense recognized related to the PSU Plan for Q1 2018 was \$128 (Q1 2017 - \$65). As at March 31, 2018, the accrued PSU Plan liability was \$620 (December 31, 2017 - \$492).

23. Commitments and Contingencies

The Company's mortgage funding commitments relate primarily to its corporate residential construction loan portfolio. The commitment as noted below represents the undrawn portion of the authorized loan facility for construction and commercial loans. For single family mortgages, the commitment represents irrevocable offers to clients that the Company is contractually obligated to fund. For further information on mortgage funding commitments, refer to Note 8.

For further details on the commitment associated with the KSHYF investment, refer to Note 9.

The Company also has contractual obligations associated with its premises lease. In 2017, the Company entered into an agreement to increase the size of its leased premises and the duration of the lease. The increased lease obligation is reflected in the table below.

	Less than one year	One to three years	Three to five years	Over five years	March 31 2018	December 31 2017
Mortgage funding commitments	\$ 266,963	\$ 108,394	\$ -	\$ -	\$ 375,357	\$ 291,204
Commitment - KSHYF	-	22,433	-	-	22,433	26,483
Operating lease	852	1,753	1,769	4,164	8,538	8,652
	\$ 267,815	\$ 132,580	\$ 1,769	\$ 4,164	\$ 406,328	\$ 326,339

The Company incurred \$260 of operating lease expenses during Q1 2018 (Q1 2017 - \$145), included in general and administrative expenses.

The Company outsources the majority of its mortgage servicing and continues to pay servicing expenses as long as the mortgages remain on its consolidated balance sheet.

In the ordinary course of business, MCAN and its service providers (including MCAP), their subsidiaries and related parties may from time to time be party to legal proceedings which may result in unplanned payments to third parties.

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 \$6,000. MCAP was awarded a judgment for approximately \$500 against the same plaintiff in related proceedings. MCAN 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, the Company does not expect to incur any material liability arising out of this indemnification obligation to MCAP and accordingly has not recorded a provision.

24. Credit Facilities

The Company has a \$75,000 line of credit facility from a Canadian Schedule I Chartered bank bearing interest at prime plus 0.75% (4.20%) as at March 31, 2018 (December 31, 2017 - prime plus 0.75% (3.95%)). The facility has a sub limit of \$50,000 for issued letters of credit and \$50,000 for overdrafts, and is due and payable upon demand. As at March 31, 2018, the outstanding overdraft balance was \$3,020 (December 31, 2017 - \$nil). The letters of credit have a term of up to one year from the date of issuance, plus a renewal clause providing for an automatic one-year extension at the maturity date subject to the bank's option to cancel by written notice at least 30 days prior to the letters of credit expiry date. The letters of credit are for the purpose of supporting developer obligations to municipalities in conjunction with residential construction loans. As at March 31, 2018, there were letters of credit in the amount of \$44,178 issued (December 31, 2017 - \$32,164) and additional letters of credit in the amount of \$33,614 committed but not issued (December 31, 2017 - \$31,521).

The Company has an agreement with a Canadian Schedule I Chartered bank that enables the Company to execute repurchase agreements for liquidity purposes. This facility allows the Company to encumber certain eligible securities for financing purposes. As part of the agreement, the Company may sell assets to the counterparty at a specified price with an agreement to repurchase at a specified future date. The interest rate on the borrowings is driven by market spot rates at the time of borrowing. As at March 31, 2018, the outstanding facility balance was \$nil (December 31, 2017 - \$nil).

25. Interest Rate Sensitivity

Interest rate risk, or sensitivity, is the potential impact of changes in interest rates on financial assets and liabilities. Interest rate risk arises when principal and interest cash flows have mismatched repricing and maturity dates.

An interest rate gap is a common measure of interest rate sensitivity. A positive gap occurs when more assets than liabilities reprice/mature within a particular time period. A negative gap occurs when there is an excess of liabilities over assets repricing/maturing. The former provides a positive earnings impact in the event of an increase in interest rates during the time period. Conversely, negative gaps are positively positioned for decreases in interest rates during that particular time period. The determination of the interest rate sensitivity or gap position is based upon the earlier of the repricing or maturity date of each asset and liability, and includes numerous assumptions.

The interest rate sensitivity analysis is based on the Company's consolidated balance sheets as at March 31, 2018 and December 31, 2017 and does not incorporate mortgage and loan prepayments. The Company currently cannot reasonably estimate the impact of prepayments on its interest rate sensitivity analysis. The analysis is subject to significant change in subsequent periods based on changes in customer preferences and in the application of asset/liability management policies.

Floating rate assets and liabilities are immediately sensitive to a change in interest rates while other assets are sensitive to changing interest rates periodically, either as they mature or as contractual repricing events occur. Non-interest rate sensitive assets and liabilities are not directly affected by changes in interest rates.

The Company manages interest rate risk by matching the terms of corporate assets and term deposits. To the extent that the two components offset each other, the risks associated with interest rate changes are reduced. The Asset and Liability Management Committee ("ALCO") reviews the Company's interest rate exposure on a monthly basis using interest rate spread and gap analysis as well as interest rate sensitivity analysis based on various scenarios. This information is also formally reviewed by the Investment Committee of the Board each quarter.

The following tables present the assets and liabilities of the Company by interest rate sensitivity. Yield spread represents the difference between the weighted average interest rate of the assets and liabilities in a certain category.

25. Interest Rate Sensitivity (continued)

As at March 31, 2018	Floating Rate	Within 3 Months	3 Months to 1 Year	1 to 3 Years	3 to 5 years	Over 5 years	Non Interest Sensitive	Total
Assets								
Corporate	\$ 576,650	\$ 38,954	\$ 148,835	\$ 177,270	\$ 20,980	\$ 3,083	\$ 156,034	\$ 1,121,806
Securitization	15,073	10,275	144,605	684,838	173,318	-	3,969	1,032,078
	<u>591,723</u>	<u>49,229</u>	<u>293,440</u>	<u>862,108</u>	<u>194,298</u>	<u>3,083</u>	<u>160,003</u>	<u>2,153,884</u>
Liabilities								
Corporate	3,020	153,009	199,941	327,782	142,872	-	9,918	836,542
Securitization	-	-	129,640	708,858	176,798	-	-	1,015,296
	<u>3,020</u>	<u>153,009</u>	<u>329,581</u>	<u>1,036,640</u>	<u>319,670</u>	<u>-</u>	<u>9,918</u>	<u>1,851,838</u>
Shareholders' Equity	-	-	-	-	-	-	302,046	302,046
GAP	\$ 588,703	\$ (103,780)	\$ (36,141)	\$ (174,532)	\$ (125,372)	\$ 3,083	\$ (151,961)	\$ -
YIELD SPREAD	1.52%	2.43%	1.90%	1.62%	0.41%	2.98%		

As at December 31, 2017	Floating Rate	Within 3 Months	3 Months to 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	Non Interest Sensitive	Total
Assets								
Corporate	\$ 611,563	\$ 31,558	\$ 177,465	\$ 168,748	\$ 25,668	\$ 5,250	\$ 162,119	\$ 1,182,371
Securitization	13,441	677	126,688	720,383	168,976	-	4,239	1,034,404
	<u>625,004</u>	<u>32,235</u>	<u>304,153</u>	<u>889,131</u>	<u>194,644</u>	<u>5,250</u>	<u>166,358</u>	<u>2,216,775</u>
Liabilities								
Corporate	-	98,760	314,574	318,321	152,805	-	19,639	904,099
Securitization	-	-	99,020	747,463	169,216	-	-	1,015,699
	<u>-</u>	<u>98,760</u>	<u>413,594</u>	<u>1,065,784</u>	<u>322,021</u>	<u>-</u>	<u>19,639</u>	<u>1,919,798</u>
Shareholders' Equity	-	-	-	-	-	-	296,977	296,977
GAP	\$ 625,004	\$ (66,525)	\$ (109,441)	\$ (176,653)	\$ (127,377)	\$ 5,250	\$ (150,258)	\$ -
YIELD SPREAD	4.43%	3.16%	2.22%	1.52%	0.42%	2.94%		

Certain construction and commercial mortgages are subject to the greater of a minimum interest rate (ranging between 3.75% and 10.25%) or a prime based interest rate. To the extent that the minimum rate exceeds the prime based rate as at March 31, 2018, these mortgages have been reflected in the table above as fixed rate mortgages, as follows: within 3 months - \$nil (December 31, 2017 - \$nil), 3 months to 1 year - \$807 (December 31, 2017 - \$807) and 1 to 5 years - \$nil (December 31, 2017 - \$nil).

An immediate and sustained parallel 1% increase to market interest rates as at March 31, 2018 would have an estimated positive effect of \$4,415 (December 31, 2017 - \$4,253) to net income over the following twelve month period. An immediate and sustained parallel 1% decrease to market interest rates as at March 31, 2018 would have an estimated adverse effect of \$3,352 (December 31, 2017 - \$2,061) to net income over the following twelve month period.

When calculating the effect of an immediate and sustained parallel 1% change in market interest rates on net investment income, the Company determines which assets and liabilities reprice over the following twelve months and applies a 1% change to their respective yields at the time of repricing to determine the change in net investment income for the duration of the twelve month period.

26. Capital Management

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

Regulatory Capital

As a Loan Company under the Trust Act, OSFI oversees the adequacy of the Company's capital. For this purpose, OSFI has imposed minimum capital to risk-weighted asset ratios and a minimum leverage ratio.

For further information on the Company's regulatory capital management, refer to the "Regulatory Capital" sub-section of the Capital Management section of Management's Discussion and Analysis (the "MD&A").

Income Tax Capital

As a MIC under the Tax Act, the Company is 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 the non-consolidated balance sheet in the MIC entity measured at its tax value. For further information on the Company's income tax capital management, refer to the "Income Tax Capital" sub-section of the Capital Management section of the MD&A.

27. Financial Instruments

The majority of the Company's 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.

All financial instruments that are carried at fair value on the consolidated balance sheets (marketable securities and certain financial investments) or for which fair value is disclosed are estimated using valuation techniques based on observable market data such as market interest rates currently charged for similar financial investments to expected maturity dates.

The following tables summarize financial assets reported at fair value and financial assets and liabilities for which fair values are disclosed.

As at March 31, 2018	Level 1	Level 2	Level 3	Total	Carrying Value
Assets measured at fair value					
Cash and cash equivalents	\$ 62,463	\$ -	\$ -	\$ 62,463	\$ 62,463
Marketable securities	61,401	28	-	61,429	61,429
Financial investments - Crown LP ¹	-	-	32,192	32,192	32,192
Financial investments - KSHYF ²	-	-	41,254	41,254	41,254
Securitization program cash held in trust	15,073	-	-	15,073	15,073
	<u>\$ 138,937</u>	<u>\$ 28</u>	<u>\$ 73,446</u>	<u>\$ 212,411</u>	<u>\$ 212,411</u>
Assets for which fair values are disclosed					
Mortgages - corporate ³	\$ -	\$ -	\$ 863,665	\$ 863,665	\$ 859,372
Other loans ⁴	-	-	2,655	2,655	2,655
Mortgages - securitized ³	-	-	1,024,373	1,024,373	1,013,036
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,890,693</u>	<u>\$ 1,890,693</u>	<u>\$ 1,875,063</u>
Liabilities measured at fair value					
Other liabilities - corporate ⁵	\$ -	\$ -	\$ 6,315	\$ 6,315	\$ 6,315
Liabilities for which fair values are disclosed					
Term deposits ⁶	\$ -	\$ -	\$ 818,547	\$ 818,547	\$ 823,604
Loans payable	-	-	3,020	3,020	3,020
Financial liabilities from securitization ⁷	-	-	1,008,429	1,008,429	1,015,296
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,829,996</u>	<u>\$ 1,829,996</u>	<u>\$ 1,841,920</u>

¹ Fair value of investment is based on the underlying real estate properties determined by the discounted cash flow method and direct capitalization method. The significant unobservable inputs are the capitalization rate and discount rate.

² Fair value is based on the redemption value of the fund less a credit allowance based on the nature of the underlying mortgages.

³ Corporate and securitized fixed rate mortgages are calculated based on discounting the expected future cash flows of the mortgages, adjusting for credit risk and prepayment assumptions at current market rates for offered mortgages based on term, contractual maturities and product type. For variable rate mortgages, fair value is assumed to equal their carrying amount since there are no fixed spreads. The Company classifies its mortgages as Level 3 given the fact that although many of the inputs to the valuation models used are observable, the mortgages are not specifically quoted in an open market.

⁴ Fair value is assumed to be the carrying value as underlying mortgages and loans are variable rate.

⁵ The carrying value of the asset/liability approximates fair value.

⁶ As term deposits are non-transferable by the deposit holders, there is no observable market. As such, the fair value of the term deposits is determined by discounting expected future cash flows of the deposits at current offered rates for deposits with similar terms.

⁷ Fair value of financial liabilities from securitization is determined using current market rates for CMB and MBS.

27. Financial Instruments (continued)

As at December 31, 2017	Level 1	Level 2	Level 3	Total	Carrying Value
Assets measured at fair value					
Cash and cash equivalents	\$ 117,571	\$ -	\$ -	\$ 117,571	\$ 117,571
Marketable securities	61,973	545	-	62,518	62,518
Financial investments - Crown LP ¹	-	-	32,037	32,037	32,037
Financial investments - KSHYF ²	-	-	36,153	36,153	36,153
Securitization program cash held in trust	13,441	-	-	13,441	13,441
	<u>\$ 192,985</u>	<u>\$ 545</u>	<u>\$ 68,190</u>	<u>\$ 261,720</u>	<u>\$ 261,720</u>
Assets for which fair values are disclosed					
Mortgages - corporate ³	\$ -	\$ -	\$ 869,147	\$ 869,147	\$ 863,384
Other loans ⁴	-	-	2,612	2,612	2,612
Mortgages - securitized ³	-	-	1,031,154	1,031,154	1,016,724
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,902,913</u>	<u>\$ 1,902,913</u>	<u>\$ 1,882,720</u>
Liabilities measured at fair value					
Other liabilities - corporate ⁵	\$ -	\$ -	\$ 16,067	\$ 16,067	\$ 16,067
Liabilities for which fair values are disclosed					
Term deposits ⁶	\$ -	\$ -	\$ 882,553	\$ 882,553	\$ 884,460
Financial liabilities from securitization ⁷	-	-	1,010,975	1,010,975	1,015,699
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,893,528</u>	<u>\$ 1,893,528</u>	<u>\$ 1,900,159</u>

¹ Fair value of investment is based on the underlying real estate properties determined by the discounted cash flow method and direct capitalization method. The significant unobservable inputs are the capitalization rate and discount rate.

² Fair value is based on the redemption value of the fund less a credit allowance based on the nature of the underlying mortgages.

³ Corporate and securitized fixed rate mortgages are calculated based on discounting the expected future cash flows of the mortgages, adjusting for credit risk and prepayment assumptions at current market rates for offered mortgages based on term, contractual maturities and product type. For variable rate mortgages, fair value is assumed to equal their carrying amount since there are no fixed spreads. The Company classifies its mortgages as Level 3 given the fact that although many of the inputs to the valuation models used are observable, the mortgages are not specifically quoted in an open market.

⁴ Fair value is assumed to be the carrying value as underlying mortgages and loans are variable rate.

⁵ The carrying value of the asset/liability approximates fair value.

⁶ As term deposits are non-transferable by the deposit holders, there is no observable market. As such, the fair value of the term deposits is determined by discounting expected future cash flows of the deposits at current offered rates for deposits with similar terms.

⁷ Fair value of financial liabilities from securitization is determined using current market rates for CMB and MBS.

The following table shows the continuity of Level 3 financial assets recorded at fair value:

Balance, December 31, 2017	\$ 68,190
Advances	4,737
Changes in fair value, recognized in net income	519
Balance, March 31, 2018	\$ 73,446

There were no transfers between levels during the quarters ended March 31, 2018 or March 31, 2017.

27. Financial Instruments (continued)

Risk Management

The types of risks to which the Company is exposed include but are not limited to interest rate, credit, liquidity and market risk. The Company's enterprise risk management framework includes policies, guidelines and procedures, with oversight by senior management and the Board. These policies are developed and implemented by management and reviewed and approved annually by the Board.

The nature of these risks and how they are managed is provided in the Risk Governance and Management section of the MD&A. Certain disclosures required under IFRS 7, *Financial Instruments: Disclosures*, related to the management of credit, interest rate, liquidity and market risks inherent with financial instruments are included in the MD&A. The relevant MD&A sections are identified by shading within boxes and the content forms an integral part of these consolidated financial statements.

The management of credit risk associated with the Company's assessment of impairment under IFRS 9 is also discussed in the MD&A section noted above.

28. Comparative Amounts

Certain comparative amounts have been reclassified to conform to the presentation adopted in the current year. There was no impact to the financial position or net income as a result of these reclassifications.

DIRECTORS**Verna Cuthbert**

Corporate Director, MCAN Mortgage Corporation
 Member of Investment Committee
 Member of Enterprise Risk Management and Compliance Committee
 Director since September 2013

Susan Doré

Corporate Director, MCAN Mortgage Corporation
 Member of Audit Committee
 Member of Conduct Review, Corporate Governance and Human Resources Committee
 Director since May 2010

William Jandrisits

President and Chief Executive Officer, MCAN Mortgage Corporation
 Director since August 2010

Brian A. Johnson

Partner, Crown Realty Partners
 Chair of Conduct Review, Corporate Governance and Human Resources Committee
 Chair of Investment Committee
 Director since January 2001

Loraine McIntosh

Corporate Director, MCAN Mortgage Corporation
 Member of Audit Committee
 Member of Enterprise Risk Management and Compliance Committee
 Director since May 2017

Gaelen Morphet

Corporate Director
 Member of Investment Committee
 Director since January 2018

Derek Sutherland

President, Canadazil Capital Inc.
 Member of Enterprise Risk Management and Compliance Committee
 Member of Investment Committee
 Director since May 2017

Ian Sutherland

Chair, MCAN Mortgage Corporation
 Director since January 1991

Karen Weaver

Corporate Director, MCAN Mortgage Corporation
 Chair of Audit Committee
 Member of Conduct Review, Corporate Governance and Human Resources Committee
 Director since November 2011

W. Terrence Wright

Counsel, Pitblado LLP
 Member of Audit Committee
 Chair of Enterprise Risk Management and Compliance Committee
 Director since September 2013

EXECUTIVE OFFICERS**William Jandrisits**

President and Chief Executive Officer

Jeffrey Bouganim

Senior Vice President and Chief Financial Officer

Leonard Zaidener

Vice President, Investments

Robert Horton

Vice President and Chief Risk Officer

Martin Beaudry

Vice President, Single Family Mortgage Operations

Carl Brown

Vice President, Operations
 Business Continuity/Disaster Recovery Coordinator

Jeffrey Lum

Vice President, Treasury and Securitization

Sylvia Pinto

Vice President, Chief Compliance Officer & Corporate Secretary

Emily Randle

Vice President, Credit Risk Monitoring and Management

CORPORATE INFORMATION

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Stock Listing

Toronto Stock Exchange
Symbol: MKP

Corporate Counsel

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Toronto, Ontario

Auditors

Ernst & Young LLP
Toronto, Ontario

Bank

Bank of Montreal
First Canadian Place
Toronto, Ontario

Registrar and Transfer Agent

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Websites

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Dividend Reinvestment Plan (DRIP)

For further information regarding MCAN's Dividend Reinvestment Plan, please visit: www.mcanmortgage.com/investor-relations/investor-materials.

An Enrolment Form may be obtained at any time upon written request addressed to the Plan Agent, Computershare. Registered Participants may also obtain Enrolment Forms online at www.us.computershare.com/investor/.

Shareholders

For dividend information, change in share registration or address, lost certificates, estate transfers, or to advise of duplicate mailings, please call MCAN Mortgage Corporation's Transfer Agent and Registrar, Computershare (see left for contact).

Report Copies

This MCAN Mortgage Corporation 2018 First Quarter Report is available for viewing/printing on our website at www.mcanmortgage.com, and also on SEDAR at www.sedar.com.

To request a printed copy, please contact Ms. Sylvia Pinto, Corporate Secretary, or e-mail spinto@mcanmortgage.com.

General Information

For general enquiries about MCAN Mortgage Corporation, please write to Ms. Sylvia Pinto, Corporate Secretary (head office details at left) or e-mail mcanexecutive@mcanmortgage.com



