# MANAGEMENT DISCUSSION & ANALYSIS

## QUARTER ENDED JUNE 30, 2023

# FRONTENAC MORTGAGE INVESTMENT CORPORATION
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## BASIS OF PRESENTATION

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

This Management Discussion & Analysis ("MD&A") is dated August 30, 2023 and should be read in conjunction with the audited financial statements of the Corporation and the notes thereto for the year ended December 31, 2022 and the unaudited interim financial statements for the six months ended June 30, 2023 and 2022.

## OUR BUSINESS

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

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

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

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

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

## HIGHLIGHTS

Frontenac Mortgage Investment Corporation continues to meet its primary objective of offering its shareholders capital preservation while providing a stable stream of monthly dividend income. As at June 30, 2023, the Corporation's assets totaled $208.4 million including a mortgage investment portfolio totaling $199.4 million and shareholder's equity of $200.6 million. Total assets, mortgage investments and shareholders' equity are down slightly from December 31, 2022, when the Corporation's assets totaled $225.8 million including a mortgage investment portfolio of $216.9 million while shareholders' equity was $201.7 million.

Net income and comprehensive income for the Corporation for the three months ended June 30, 2023 decreased on a gross basis to $2.7 million from $3.3 million for the three months ended June 30, 2022 while, on a per share basis, net earnings decreased to $0.41 from $0.47 per common share. The carrying value per share increased to $30.08 as at June 30, 2023 ($30 as at March 31 2023 and December 31, 2022) with an annualized dividend yield, assuming dividends are re-invested under the Corporation's dividend re-investment plan, of 5.90% for the first six months ended June 30 2023. The carrying value per share increased in the quarter as of the Corporations decision to defer the monthly dividend payment scheduled to be paid on or before July 30, 2023.

Subsequent to the reporting period, the Corporation escrowed monthly sales of common shares in July and August 2023 and deferred dividend payments in July 2023 pending resolution of certain issues raised in the Ontario Securities Commission continuous disclosure review in respect of four loans related to the single development property in Stage 3 as described under the mortgage impairments and provisions. Following resolution of questions relating to the value of the loans on a property securing a large development loan, the Corporation intends to process the sales of common shares and pay the monthly dividend.

Global financial markets continue to be volatile in part due to high levels of inflation and rising interest rates. There remains uncertainty associated with the estimates, judgements and assumptions made by management in the preparation of the financial statements. Given the economic uncertainty, it is difficult to predict with certainty the impact these will have on the Company's estimate of credit losses. Our conservative lending approach coupled with our professional underwriting expertise, and our focus on high quality lending opportunities will serve our loan portfolio well.

**MORTGAGE INVESTMENT PORTFOLIO**

The carrying value of the Corporation's mortgage investment portfolio totaled $199.4 million as at June 30, 2023 as compared to $216.9 million as at December 31, 2022. Key metrics related to the mortgage investment portfolio include the following.

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

| | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | **#** | **$ (000's)** | **% of total** | **#** | **$ (000's)** | **% of total** |
| Residential | 98 | 39,529 | 19.8% | 137 | 45,163 | 20.8% |
| Residential construction | 188 | 132,268 | 66.4% | 222 | 140,542 | 64.8% |
| Residential developments | 5 | 11,629 | 5.8% | 5 | 12,388 | 5.7% |
| Commercial | 2 | 421 | 0.2% | 2 | 426 | 0.2% |
| Vacant land | 45 | 15,508 | 7.8% | 57 | 18,414 | 8.5% |
| Total | 338 | 199,355 | 100.0% | 423 | 216,933 | 100.0% |

Residential construction comprises construction loans for single residential buildings for housing one to three units, typically single-family residences. Residential development mortgages comprise larger multi-unit construction or land development projects including sub-division developments or multi-unit housing builds. Included in the residential development type is a fully constructed apartment building which is operating and leased with a loan value after provision for impairment of $11.3 million as at June 30, 2023 ($12.1 million as at December 31, 2002). Commercial mortgages have a municipal commercial zoning component but typically also involve a residential component.

The Corporation has strategically decided for the long term that the percentage of the portfolio dedicated to residential developments will be reduced over the next year to instead focus on its rural residential and residential construction core business. Currently, there is one last large development legacy project remaining As at June 30, 2023, loans reported in this category represented 5.8% of the mortgage loan portfolio which is up slightly from 5.7% as at December 31, 2022 and down from 17.1% as at December 31, 2021. As at December 31, 2021, there were two outstanding residential developments in the mortgage portfolio while as at December 31, 2022 there was one outstanding residential development with 4 related loans that have a total principal value of $13.6 million. As at June 30, 2023 the same residential development with 4 related loans was outstanding with a total principal value of $14.1 million and is included in stage 3 with an expected credit loss provision of $2.8 million. The total principal amount increased from December 2022 to June 2023 because of legal fees incurred related to impairment status of the loans and funds advanced to the Borrower in order to pay property taxes. The Corporation is actively working with the borrower to severe and sell the underlying real estate properties in order to discharge these loans. The expected credit loss provision is subject to significant estimation and actual results could differ from these estimates and judgements.

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

| | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | # | $ (000's) | % of total | # | $ (000's) | % of total |
| Ontario – East | 214 | 130,775 | 67.1% | 273 | 140,623 | 64.8% |
| Ontario – Southwest | 25 | 14,898 | 7.4% | 31 | 15,939 | 7.3% |
| Ontario – Central | 42 | 32,594 | 14.7% | 49 | 36,120 | 16.7% |
| Ontario – North | 57 | 21,088 | 10.8% | 70 | 24,251 | 11.2% |
| Total | 338 | 199,355 | 100.0 % | 423 | 216,933 | 100.0% |
| | | | | | | |
| Loans - Ontario rural property | 215 | 100,273 | 50.3% | 275 | 118,263 | 54.5% |

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

The Corporation's mortgage portfolio has been historically centered on the Ontario – East market, which aside from the Ottawa and Kingston markets is primarily a rural and small-town market area. As the Corporation's assets grow, management is targeting to diversify the mortgage loan portfolio to include a greater allocation to the rural areas of Ontario – Southwest to further mitigate any geographic concentration risk in the mortgage portfolio. There have been no significant changes to the investment portfolio by location from December 31, 2022 to June 30, 2023.

As at June 30, 2023, only one of the Ontario – Central loans was for properties located in the Toronto market (postal code M – two in December 31, 2022).

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

| | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | **#** | **$ (000's)** | **% of total** | **#** | **$ (000's)** | **% of total** |
| < 5% | 2 | 3,385 | 1.7% | 1 | 17 | 0.1% |
| 6% | 1 | 6,725 | 3.4% | 1 | 6,626 | 3.0% |
| 7% | - | - | - | - | - | - |
| 8% | 1 | 2,832 | 1.4% | 9 | 8,214 | 3.8% |
| 9% | 23 | 9,167 | 4.6% | 51 | 24,353 | 11.2% |
| 10% | 122 | 85,578 | 42.9% | 277 | 150,484 | 69.4% |
| 11% | 90 | 33,292 | 16.7% | 57 | 19,615 | 9.0% |
| 12% | 93 | 54,764 | 27.5% | 27 | 7,624 | 3.5% |
| 13% | 6 | 3,612 | 1.8% | - | - | - |
| Total | 338 | 199,355 | 100.0% | 423 | 216,933 | 100.0% |

Substantially all of the mortgage loans are issued with either 1 or 2 year terms, have fixed interest rates and can be repaid in full before maturity without penalty. The weighted average interest rate as at June 30, 2023 was 10.32%, up from 9.82% as at December 31, 2022 reflecting mortgages that were originated in 2023 at interest rates higher than those originated in 2022 and reflective of a higher interest rate market following the Bank of Canada's 5% increase in interest rates in 2022 and 2023.

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

| | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | **#** | **$ (000's)** | **% of total** | **#** | **$ (000's)** | **% of total** |
| Within one year | 322 | 194,795 | 96.1% | 399 | 212,882 | 97.2% |
| Within following year | 16 | 7,712 | 3.9% | 24 | 6,104 | 2.8% |
| Total | 338 | 202507 | 100.0% | 423 | 218,986 | 100.0% |

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

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

| | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | # | $ (000's) | % of total | # | $ (000's] | % of total |
| First mortgage loans | 337 | 199,252 | 99.9% | 422 | 216,830 | 99.9% |
| Average gross loan balance | | 599 | | | 518 | |

**Mortgage impairments and provision for impairment losses**

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

| (All figures $000's) | Jun 30, 2023 | | | Dec 31, 2022 | | |
|---|---|---|---|---|---|---|
| | Gross loan amount (1) | Allowance for impairment losses | Net carrying amount | Gross loan amount (1) | Allowance for impairment losses | Net carrying amount |
| Residential | - | - | - | 848 | - | 848 |
| Residential construction | 309 | - | 309 | | | |
| Residential developments | 14,104 | 2,788 | 11,316 | 13,636 | 1,532 | 12,104 |
| Commercial | - | - | - | - | - | - |
| Vacant land | 1,415 | - | 1,415 | - | - | - |
| Total | 15,828 | 2,788 | 13,040 | 14,484 | 1,532 | 12,952 |

(1) Gross amount shown at amortized cost

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

As at June 30, 2023, there were 7 mortgages totaling $15.8 million (December 31, 2022 – 10 mortgages totaling $14.5 million) which were considered by management to be impaired with a total provision for impairment losses of $2.8 million (December 31, 2022 – $1.5 million) against those loans. As discussed above under the "Portfolio by Type" section, 4 of the 7 impaired loans related to a single large residential development project with the same borrower. The remaining 3 impaired mortgage loans have a total provision of $nil.

During the six-month period ending June 30, 2023, the four loans with the same borrower for a single large residential development project loan remained in stage 3. The principal dollar value, accrued interest and expected credit loss of the loans was $14.1 million, $4.6 million and $2.8 million respectively as of June 30, 2023. On May 29, 2023, the Corporation extended the forbearance agreement with the borrower to June 30, 2023. The forbearance agreement which expired on June 30, 2023 has not been renewed as the Corporation did not see any further benefit of renewing the agreement. The Corporation will continue to receive all the benefits that were obtained under the agreement even though the forbearance agreement was not extended. The Corporation is actively working with the borrower to recover these loans. In the three months ended June 30, 2023, the Corporation extended the estimated date to recover these loans from Q3 2023 to Q2 2024 based on current market conditions and lowered the expected recoverable amount of the loans based on third-party appraisal reports. As a result, there was a significant increase in the stage 3 net remeasurement of the loans of $1.0 million.
This represents the last large loan residential development project in excess of $10 million in a business line the Company strategically decided to exit. As at June 30, 2023 the Company's next largest loan value was $3.2 million.

## RESULTS OF OPERATIONS

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

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

| | Q2 2023 | Q1 2023 | Q4 2022 | Q3 2022 | Q2 2022 | Q1 2022 | Q4 2021 | Q3 2021 |
|---|---|---|---|---|---|---|---|---|
| Interest income | 5,173 | 5,356 | 5,360 | 5,230 | 4,965 | 4,016 | 4,396 | 3,870 |
| Management & admin fees | 1,102 | 1,186 | 1,234 | 1,143 | 1,139 | 1,141 | 1,094 | 1,084 |
| Interest on credit line | 141 | 371 | 372 | 119 | 4 | - | - | - |
| Provision for impairment losses | 842 | 378 | 495 | 270 | 227 | 156 | 217 | 66 |
| Other operating expenses | 354 | 313 | 253 | 274 | 268 | 225 | 224 | 180 |
| Total operating expenses | 2,439 | 2,248 | 2,354 | 1,806 | 1,638 | 1,522 | 1,535 | 1,330 |
| Net income and comprehensive income | 2,734 | 3,107 | 3,006 | 3,424 | 3,328 | 2,494 | 2,861 | 2,540 |
| Earnings per share – basic and fully diluted | 0.41 | 0.46 | 0.44 | 0.49 | 0.47 | 0.35 | 0.42 | 0.38 |

Interest income decreased by $183 thousand in Q2 2023 compared to Q1 2023 primarily as a result of the mortgage portfolio decreasing by $8.4 million ($199.4 million as at Q2 2023 compared to $207.8 million Q1 2023); however, the mortgages that matured and paid out Q2 2023 were replaced with new mortgages at higher, market interest rates. The weighted average interest rate as at June 30, 2023 was 10.32%, up from 10.07% as at March 31, 2023. The increase in interest rates is being driven by significant increase in the Bank of Canada's overnight lending over the past 15 months as well as an increase in demand for mortgages outside of traditional financial institutions. The Corporation's loans are short-term, generally offered for 12-month terms, allowing for interest rates on mortgage loans to be reassessed against current market conditions.

Management and administration fees are based on a fixed percentage of total assets of the Corporation with 1% per annum paid to the Manager and 1% per annum paid to the Administrator calculated and paid on a monthly basis. Management and administration fees decreased in Q2 2023 because total assets have decreased. Total assets as at Q2 2023 were 208.4 million compared to $215.8 million as at Q1 2023.

The Corporation does not use leverage as a long-term strategy but does utilize its line of credit in the short term to smooth out its cash inflows and outflows related to mortgage advances and repayments as well as share sales and redemptions. The amount of interest expense in any quarter fluctuates with the actual utilization of the available credit line. The Bank line of Credit as at Q2 2023 was $7.4 million compared to $16.8 million as at Q1 2023.

The provision for impairment losses in Q2 2023 increased significantly from Q1 2023 primarily due an increase in the stage 3 remeasurement of four loans for a large residential development project (see Mortgage impairments and provision for impairment losses).

Other operating expenses comprise of legal, audit, directors' fees and expenses, and other operating costs of the Corporation and may fluctuate based on the timing of these expenses throughout the year. Other operating

expenses increased in Q2 2023 primarily due to higher legal and audit expenses incurred that were associated with an Ontario Securities commission continuous disclosure review. The Corporation expects to incur continued higher legal and audit expenses in Q3 2023 as the continuous disclosure review continues.

**Results of Operations – Three Months Ended June 30, 2023**

Net income and comprehensive income for the Corporation for the three months ended June 30, 2023 decreased on a gross basis to $2.7 million from $3.3 million for the three months ended June 30, 2022 while, on a per share basis, net earnings decreased to $0.41 from $0.47 per common share.

Revenues for the Corporation for the three months ended June 30, 2023 increased on a gross basis to $5.2 million as compared to $5.0 million for the three months ended June 30, 2022 while, on a per share basis, revenues increased to $0.77 from $0.70 per common share. The quarter-over-quarter increase in the gross amount of interest revenue and the revenue per share is attributable to , mortgages that matured being replaced with higher market interest rates. The Corporation earns little to no return on its cash balances.

Total operating expenses for the three months ended June 30, 2023 increased on a gross basis to $2.4 million from $1.6 million for the three months ended June 30, 2022 while, on a per share basis, these expenses increased to $0.36 from $0.23 per common share. The period over period increase in expenses is primarily due to an increase in bank line of credit interest $137 thousand, provision for impaired mortgage losses $615 thousand and other operating expenses $86 thousand. The Corporation utilizes its line of credit in the short term to smooth out its cash inflows and outflows related to mortgage advances and repayments as well as share sales and redemptions. The amount of interest expense in any quarter fluctuates with the actual utilization of the available credit line. The provision for impairment losses increased significantly primarily due an increase in the stage 3 remeasurement of four loans for a large residential development project (see Mortgage impairments and provision for impairment losses). Other operating expenses increased primarily due to higher legal and audit expenses incurred that were associated with an Ontario Securities commission continuous disclosure review.

## RECENT DEVELOPMENTS

### Inflation and Rising Interest Rates

The annual inflation rate in Canada was 3.3% in July 2023 on a year-over-year basis according to Statistics Canada and has continued its downward trend since hitting a peak of 8.1% in June 2022. The rate in July is also down from the March inflation rate of 4.3% and but increased slightly from 2.8% in June 2023. Global factors such as the war in Ukraine, supply chain issues, and domestic price pressures continue to put pressure on inflation and most economists believe inflation will be higher than the Bank of Canada's target rate of 2% until 2024 or 2025.

Controlling inflation is the Bank of Canada's primary concern. The Bank of Canada rapidly increased interest rates in 2022 by a total of 400 bps from March to December taking the overnight rate to 4.25%. In 2023 the Bank of Canada further increased rates by another 25 bps in each of the months of January, June and July taking the overnight lending rate to its current rate 5.00%. The prime interest rate charged by banks and credit unions has increased at the same rate as the Bank of Canada's policy rate increases and the current prime rate at most traditional financial institutions is 7.20%. Most economists believe interest rates will continue to stay at current levels or possibility go higher by another 25 basis points by the end of the year as well as stay at higher levels for longer into 2024. Further increases or decreases in 2023 will be dependent on the rate of inflation, the state of economy and labour market. The principal risk cited by most economists is that the Bank of Canada increases interest rates too much and risks having the economy fall into a hard recession. Any decreases in interest rates would be positive for the housing market. In addition to interest rate increases, the Bank of Canada announced in April 2022 that it was ending the reinvestment phase of its asset purchase program and beginning quantitative tightening where maturing Government of Canada bonds will no longer be replaced. In a speech on March 29, 2023, Deputy Governor Toni Gravelle said quantitative tightening will likely end in late 2024 or the first half of 2025 per a Bloomberg article (Randy Thanthong-Knight and Erik Hertzberg. "Bank of Canada Sees Quantitative Tightening Ending by 2025." March 29, 2023)

As interest rates increase, the interest expense on our line of credit facility will also increase as it is tied to the bank's prime rate. In addition, it affords the Corporation the opportunity to increase interest rates on new mortgage loan originations to higher, current market rates and improve the average interest rate on the mortgage portfolio.

The real estate market is highly influenced by interest rate changes by the Bank of Canada. Per the Ontario Real Estate Association, on a year-to-date basis, Ontario home sales totaled 105,395 units over the first seven months of the year. This was down by 15.5% from the same period in 2022. The July year-to-date residential average price was $888,891, a decrease of 9.2% from the first seven months of 2022. The housing slowdown has moderated since the fall of 2022. Overall, the housing market continues to adjust to higher interest rates and inflation as well as high indebtedness of consumers. Factors contributing to the stability of prices include a chronic housing shortage, supply chain delays, skilled labour shortages and increased levels of immigration. According to RBC's July 14, 2023 housing market outlook "We believe the slower pace of resales growth in June marks a shift in Canada's market recovery. The strength of this spring's rebound, in our view, wasn't sustainable—especially in light of the Bank of Canada turning up the screw a couple more times, further raising the bar for potential buyers. We expect the overall trajectory to be flatter through the remainder of 2023, as buyers contend with very challenging affordability conditions and an expected recession. This would set aggregate prices on a more moderate appreciation path."

It is unclear whether recent interest rate increases, together with any future interest rate increases, will trigger a recession which could negatively impact the Corporation's financial performance due to recessionary effects

such as higher unemployment and the curtailment of real estate development. Higher unemployment may lead to the Corporation experiencing an increase in impairments and as such, an increase would translate into lower earnings due to the unlikely collectability of further interest on those loans. The curtailment of real estate development may lead the Corporation to experience lower construction mortgage origination volumes. The unemployment rate was 5.5% in July 2023 according to Statistics Canada compared to 5.0% in December 2022.

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

Nevertheless, the market demand for Corporation's loans remains strong. Our conservative lending approach coupled with our professional underwriting expertise, and our focus on high quality lending opportunities will serve our loan portfolio well. To the end of 30 June 2023, the Corporation has not experienced any significant loan loss provision increases due to higher interest rates and real estate market changes. The significant increase in loan impairments in 2023 was primarily due an increase in the stage 3 remeasurement of four loans for a large residential development project (see Mortgage impairments and provision for impairment losses).

**Continuous Disclosure Review**

Subsequent to the reporting period, the Corporation escrowed monthly sales of common shares in July and August 2023 and deferred dividend payments in July 2023 pending resolution of certain issues raised in the Ontario Securities Commission continuous disclosure review in respect of four loans related to the single development property in Stage 3 as described under "Mortgage impairments and provisions" above. The Corporation's review of regulatory questions is ongoing and FMIC is working diligently to complete the review.

As discussed above under the "Portfolio by Type" section, 4 of the 7 impaired loans relate to a single large residential development project with the same borrower. The gross loan amount of the 4 impaired loans related to the single large residential development project is $14.1 million or 7.1% of the mortgage portfolio as at June 30, 2023. The remaining 334 mortgage loans totaling $185.3 represent 92.9% of the mortgage portfolio, and as at June 30, 2023 had 3 impaired mortgage loans that have a total provision of $nil. As older mortgages mature and get paid out 2023, they are being replaced with new mortgages at higher, market interest rates. The weighted average interest rate of the Corporation's mortgage portfolio as at June 30, 2023 was 10.32%, up from 10.07% as at March 31, 2023. Outside of the single large development project, the mortgage portfolio is strong; interest rates on new mortgage originations at higher, current market rates are increasing the average weighted interest of the mortgage portfolio, and once expenses normalize with respect to the single large residential development project, the monthly rate of return is expected to increase in parallel.

## LIQUIDITY AND CAPITAL RESOURCES

The Corporation is authorized to issue an unlimited number of common shares. Under the terms of the Corporation's continuous offering prospectus, Frontenac issues common shares on a monthly basis. Shareholders may redeem shares in the Corporation on a quarterly basis, subject to a 30-day notice period. As at June 30, 2023, there were 6.7 million common shares issued and outstanding with a total book value of $200.6 million.

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

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

The Corporation has a revolving line of credit with a major Canadian chartered bank with a limit equal to the lessor of 15% of shareholders' equity and the borrowing base calculation of risk adjusted mortgages. The maximum limit of the revolving line of credit is $40 million. The line of credit is secured by a General Security Agreement and a first ranking interest in the mortgages, is repayable on demand, and bears interest at bank prime rate plus 1%. Financial covenants require the Corporation to maintain minimum levels for equity, debt to equity ratio, and percentage of residential mortgages. As at June 30, 2023, the Corporation was in compliance with the bank's financial covenants, and management expects to remain in compliance with such covenants going forward. As at June 30, 2023, the Corporation was using $7.4 million (December 31, 2022 - $23.2 million) of its available credit line.

The line of credit is used to smooth out the cash flows of the Corporation and as a reserve for unexpected share redemptions and is not used to leverage the mortgage portfolio. The Corporation's cash resources come from (1) sales of Shares (2) payouts of maturing mortgage loans, and (3) the Corporation's line of credit. The Corporation's cash requirements are principally used for (1) mortgage loans, (2) the Corporation's expenses, and (3) redemptions. Based on the Corporation's anticipated cash availability and cash requirements the Manager can adjust, on a monthly basis, one or more of the Corporation's (1) cash reserves (2) funded loans, and/or (3) utilization of its line of credit. As part of its cash management function the Manager reviews quarterly redemption requests and determines whether adequate cashflow is available to fund redemption requests.

Subsequent to the reporting period, the Corporation escrowed monthly sales of common shares in July and August, 2023 and deferred July 2023 dividend payments pending the resolution of certain issues raised in the Ontario Securities commission continuous disclosure review in respect of the four loans relating to the single development property in Stage 3 as described under 'Mortgage impairments and provision for impairment losses' above. As at August 30, 2023, the value of funds held in escrow was $4.4 million. The Corporation is responding to the regulator's questions and is working to resolve regulatory issues relating to the single development property. Subsequent to the reporting period the Corporation

has received higher than normal redemption requests in the aggregate amount of $11.5 million for Q3 redemption date and $10.4 million for Q4 redemption date, which the Corporation attributes primarily to the uncertainty caused by the escrow of share issuances related to the regulator's ongoing continuous disclosure review.

## CHANGES IN FINANCIAL POSITION

The Corporation is authorized to issue an unlimited number of common shares. Under the terms of its continuous offering prospectus, the Corporation issues common shares on a monthly basis and redeems commons shares quarterly (up to November 30, 2021, shareholders have had the ability to redeem shares in the Corporation only once per year).

| | Six Months ended June 30, 2023 | | Year ended December 31, 2022 | |
|---|---|---|---|---|
| Common shares: | # | $ | # | $ |
| Balance – beginning of period | 6,723,982 | 201,610,430 | 6,757,281 | 202,609,406 |
| Issued for cash | 463,341 | 13,900,243 | 1,607,091 | 48,212,723 |
| Issued under dividend re-investment plan | 100,340 | 3,010,192 | 207,667 | 6,230,020 |
| Redeemed | (619,393) | (18,581,796) | (1,848,057) | (55,441,719) |
| Balance – end of period | 6,668,270 | 199,939,069 | 6,723,982 | 201,610,430 |

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

During Q2 2023, total common shares sales totaled $7.1 million as compared to $6.8 million in Q1 2023. This increase is primarily due to the strengths of the fund and over-coming challenges in the capital markets that include increased volatility, rising interest rates and rising stock and bond markets as well as competition from risk free products offering interest rates that are much higher compared to the last several years.

During 2022, the Corporation experienced an increase in redemptions, year over year. For reference purposes, aggregate redemptions for the year ended December 31, 2021 were $11,216,252 and for the year ended December 31, 2022 were $55,441,7191 made by the successor adviser and their client. The Manager gave notice to its Qualified Investor clients in February 2022 that it would be exiting its managed accounts business and that they would need to transition their accounts to other advisers.

During Q2 2023, share redemptions totaled $6.5 million as compared to $12.1 million in Q1 2023. Management estimates that approximately $2.0 million of the Q2 redemptions was due to the transition of accounts to new advisors. Share redemptions are due to a number of factors including but not limited to investor asset allocation changes and associated rates of returns, unexpected life situations such as divorce or the passing away of an investor, and the Corporation's performance.

The Corporation decided to escrow subscription funds received in relation to the monthly sale of common shares scheduled to close on July 5, 2023 and August 2, 2023 and offered to reverse sales, if requested by investors. The amount of funds currently in escrow as of August 30, 2023 is $4.4 million.

## CONTRACTUAL OBLIGATIONS

Contractual obligations due at June 30, 2023 are all due within one year and are as follows:

| | |
|---|---|
| Bank line of credit | $7,400,000 |
| Dividends Payable | nil |
| Accounts payable and accrued liabilities | $278,033 |
| | $7,678,033 |

As at June 30, 2023, the Corporation has commitments to advance additional funds of $51.6 million under existing mortgages (Dec 31, 2022 - $77.9 million). These outstanding commitments are generally expected to be funded over the next 12 months. These commitments relate primarily to residential construction mortgages where funds are advanced as projects are completed subject to third party inspections and other underwriting controls and procedures. In our experience, a portion of the unfunded commitments on existing mortgage loans will never be drawn.

## TRANSACTIONS WITH RELATED PARTIES

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

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

Administration and management fees paid under these agreements totaled $1.1 million for the three months ended June 20, 2023 (three months ended June 30, 2022 - $1.1 million) including applicable sales taxes.

## CRITICAL ACCOUNTING ESTIMATES AND POLICIES

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

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

**(i) Mortgage investments:**

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

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

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

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

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

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

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

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

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

**Loan Modification**

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

**(ii) Fair value measurements:**

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

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

The Corporation's cash and cash equivalents are valued using Level 1 measures and the properties held for sale under foreclosure are valued using Level 3 measures as there are no quoted prices in an active market for these investments. As explained in more detail in Note 9 of the financial statements, management makes its determination of fair value of mortgages by discounting future cash flows at the Corporation's prevailing rate of return on new mortgages of similar type, term, and credit risk.

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

## FINANCIAL INSTRUMENTS

The Corporation's most significant financial asset consists of its mortgage investments. Mortgage investments are classified as measured at amortized cost. The financial risks associated with the Corporation's mortgage investments and the Corporation's management of those risks are discussed in note 9 of the interim financial statements.

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

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

(i) Financial assets:
Cash and cash equivalents are classified as FVTPL. Due from administrator in trust, accrued interest receivable, and mortgage investments are classified as measured at amortized cost.
(ii) Financial liabilities:
Bank line of credit, dividends payable, and accounts payable and accrued liabilities are classified as financial liabilities at amortized cost.

The tables in note 9 of the financial statements present the fair values of the Corporation’s financial instruments as at June 30, 2023 and December 31, 2022.

## CHANGES IN ACCOUNTING POLICIES

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

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

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

### IAS 1 - Presentation of Financial Statements

In January 2020, the IASB issued an amendment to IAS 1, Presentation of Financial Statements, to come into effect January 1, 2022. The amendment is to provide clarification on the classification of liabilities as current or non-current. The effective date of these amendments was deferred to January 1, 2024, with early adoption permitted. The Corporation will adopt the amendments in its financial statements for the annual period beginning January 1, 2024. The Corporation does not expect the amendments to have a material impact on its financial statements.

### IAS 1 - Presentation of Financial Statements

In February 2021, the IASB issued an amendment to IAS 1, Presentation of Financial Statements, to come into effect on January 1, 2023. The amendment is to provide clarification to financial statement preparers on which accounting policies to disclose in the financial statements. The Corporation has adopted the amendments in its financial statements for the annual period beginning January 1, 2023. The adoption of this standard has had no material impact on the financial statements.

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

In February 2021, the IASB issued an amendment to IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, to come into effect January 1, 2023. The amendment is to help entities to distinguish between accounting policies and accounting estimates. The Corporation has adopted the amendments in its financial statements for the annual period beginning January 1, 2023. The adoption of this standard has had no material impact on the financial statements.

## RISKS AND UNCERTAINTIES

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

See "Forward-Looking Information" below and the Risk Factors section of the Corporation's prospectus for further information on risks and uncertainties faced by the Corporation. The Corporation's prospectus is available on www.sedar.com and on the Corporation's website at www.fmic.ca.

## FORWARD-LOOKING INFORMATION

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

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

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

## RESPONSIBILITY OF MANAGEMENT AND THE BOARD OF DIRECTORS

Management is responsible for the information disclosed in this MD&A and has in place the appropriate information systems, procedures and controls to ensure the information used internally by management and externally is materially complete and reliable. In addition, our audit committee and board of directors provide an oversight role with respect to our public financial disclosures and have reviewed and approved this MD&A and the financial statements as at June 30, 2023.

## ADDITIONAL INFORMATION

Additional information about Frontenac Mortgage Investment Corporation, including the interim financial statements for the period ended June 30, 2023 and the audited financial statements for the year ended December 31, 2022, are available on SEDAR at www.sedar.com or on our website at www.fmic.ca. You may also obtain information by contacting the Corporate Secretary for Frontenac Mortgage Investment Corporation by telephone at (613) 279-2116 or by email at amber.kehoe@robinsonsgroup.com.