

Financial Statements of

**TREZ CAPITAL SENIOR MORTGAGE INVESTMENT
CORPORATION**

And Independent Auditors' Report thereon

Years ended December 31, 2019 and 2018



KPMG LLP
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada
Telephone (604) 691-3000
Fax (604) 691-3031

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Trez Capital Senior Mortgage Investment Corporation

We have audited the financial statements of Trez Capital Senior Mortgage Investment Corporation (the Entity), which comprise:

- the statements of financial position as at December 31, 2019 and December 31, 2018
- the statements of income (loss) and comprehensive income (loss) for the years then ended
- the statements of changes in shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2019 and December 31, 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

Without qualifying our opinion, we draw attention to note 1 to the financial statements. A plan to wind up the Entity was approved by shareholders on June 16, 2016. Subsequent to that date, the Company has pursued the process of monetizing its portfolio of mortgage investments in an orderly manner and distributing the net proceeds to its shareholders.



Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.



As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is Jeremie Jamin

Vancouver, Canada

March 30, 2020

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Statements of Financial Position

December 31, 2019 and 2018

	Notes	2019	2018
Assets			
Investments in mortgages	4	\$ 12,883,546	\$ 13,703,314
Cash and cash equivalents		10,668,051	10,674,599
Total assets		\$ 23,551,597	\$ 24,377,913

Liabilities and Shareholders' Equity

Accounts payable and accrued liabilities		\$ 20,000	\$ 20,000
Management fees payable	6, 8	55,684	36,180
Incentive fee provision	7	711,943	1,071,943
Total liabilities		787,627	1,128,123
Shareholders' equity		22,763,970	23,249,790
Total liabilities and shareholders' equity		\$ 23,551,597	\$ 24,377,913

Subsequent event (note 13)

The accompanying notes are an integral part of these financial statements.

Approved on behalf of the Board:

(signed) "Alexander Manson" Director
Alexander Manson

(signed) "Stephen Pustil" Director
Stephen Pustil

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Statements of Income (Loss) and Comprehensive Income (Loss)

Years ended December 31, 2019 and 2018

	Notes	2019	2018
Revenue:			
Interest and fee income		\$ 1,379,382	\$ 1,228,391
Expenses:			
Management fees	6, 8	221,529	214,643
Incentive fees	7	(360,000)	43,320
General and administrative		203,673	366,737
		65,202	624,700
Income from operations before undernoted		1,314,180	603,691
Fair value loss adjustment on investments in mortgages	4	1,800,000	-
Net income (loss) and comprehensive income (loss)		\$ (485,820)	\$ 603,691
Earnings (loss) per share:			
Basic and diluted	9	\$ (0.07)	\$ 0.08

The accompanying notes are an integral part of these financial statements.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Statements of Changes in Shareholders' Equity

Year ended December 31, 2019:

	Notes	Common shares	Deficit	Total
Shareholders' equity at December 31, 2018		\$ 70,195,908	\$ (46,946,118)	\$ 23,249,790
Net loss and comprehensive loss for the year		-	(485,820)	(485,820)
Shareholders' equity at December 31, 2019		\$ 70,195,908	\$ (47,431,938)	\$ 22,763,970

Year ended December 31, 2018:

	Notes	Common shares	Deficit	Total
Shareholders' equity at December 31, 2017		\$ 70,195,908	\$ (47,568,963)	\$ 22,626,945
Net income and comprehensive income for the year		-	603,691	603,691
Return of dividends previously declared	5	-	19,154	19,154
Shareholders' equity at December 31, 2018		\$ 70,195,908	\$ (46,946,118)	\$ 23,249,790

The accompanying notes are an integral part of these financial statements.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Statements of Cash Flows

Years ended December 31, 2019 and 2018

	2019	2018
Cash provided by (used in):		
Operations:		
Net income (loss) and comprehensive income (loss)	\$ (485,820)	\$ 603,691
Non-cash items:		
Interest income	(1,379,382)	(1,228,391)
Fair value adjustment on investments in mortgages	1,800,000	-
Incentive fee	(360,000)	43,320
Interest received	322,217	299,091
	<u>(102,985)</u>	<u>(282,289)</u>
Changes in non-cash operating items:		
Management fees payable	19,504	18,167
Amounts receivable	-	9,616
Accounts payable and accrued liabilities	-	(38,812)
	<u>(83,481)</u>	<u>(293,318)</u>
Financing:		
Return of dividends previously declared	-	19,154
Investing:		
Funding of investments in mortgages	-	(216,599)
Principal repayments or sold investment in mortgages	76,933	7,112,661
	<u>76,933</u>	<u>6,896,062</u>
Increase (decrease) in cash and cash equivalents	(6,548)	6,621,898
Cash and cash equivalents, beginning of year	10,674,599	4,052,701
Cash and cash equivalents, end of year	<u>\$ 10,668,051</u>	<u>\$ 10,674,599</u>

The accompanying notes are an integral part of these financial statements.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

1. Operations:

Trez Capital Senior Mortgage Investment Corporation (the "Company") was a non-bank lender providing residential and commercial short-term bridge and conventional real estate financing, including construction and mezzanine mortgages. The Company was incorporated on October 18, 2012 under the Canada Business Corporations Act and is managed by Trez Capital Fund Management Limited Partnership (the "Manager"). The Mortgage Broker for the Company is Trez Capital Limited Partnership.

The shares of the Company are publicly listed on the Toronto Stock Exchange under the symbol TZS. The Company is a Canadian mortgage investment corporation and the registered office of the Company is 1700-745 Thurlow Street, Vancouver, BC, V6E 0C5.

On May 9, 2016, the Special Committee of the Board of Directors announced the completion of its strategic review process and a plan for the orderly wind-up of the Company's assets and the return of capital to shareholders (the "Orderly Wind-Up Plan"). The Orderly Wind-Up Plan in its entirety was approved by shareholders at the Company's annual and special meeting of shareholders held on June 16, 2016.

Under the Orderly Wind-Up Plan, the Company ceased originating new loans and all mortgage renewal activity, subject to contractual rights, and its assets are being monetized over time. Management has estimated the fair value of its mortgage portfolio based on its best judgement as to the eventual cash flows that it expects to receive in the normal course of business. Eventual cash flows could vary by a material amount as outlined in note 4. The Orderly Wind-Up Plan was implemented in 2016 and capital is being returned to shareholders under the supervision of the Board of Directors with the assistance of the Manager. In addition, the Manager and its affiliates as part of the Orderly Wind-Up Plan ceased providing any financial support in respect to any of the mortgages held in the Company's portfolio. The fees to the Manager were restructured as outlined in notes 6 and 7.

2. Basis of presentation:

(a) Statement of compliance:

The financial statements of the Company have been prepared by the Manager in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These financial statements were approved by the Board of Directors on March 30, 2020.

(b) Functional and presentation currency:

These financial statements are presented in Canadian dollars, which is the functional currency of the Company.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

2. Basis of presentation (continued):

(c) Use of estimates and judgments:

The preparation of financial statements requires the Manager to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The most significant estimates that the Manager is required to make relate to the fair value of the investments in mortgages.

The estimate of fair value of the investments in mortgages may include assumptions regarding local real estate market conditions, interest rates and the availability of credit, cost and terms of financing, the impact of present or future legislation or regulation, prior encumbrances and other factors affecting the investments in mortgages and underlying security of the mortgages.

The incentive fee provision is an estimate based on the risk-adjusted proceeds expected to be received on monetization of the mortgages.

These assumptions are limited by the availability of reliable comparable data, economic uncertainty, ongoing geopolitical concerns and the uncertainty of predictions concerning future events. By their nature, estimates of fair value are subjective and do not necessarily result in precise determinations. Should the underlying assumptions change, the estimated fair value could vary by a material amount.

3. Significant accounting policies:

(a) Cash and cash equivalents:

The Company considers highly liquid investments with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, to be cash equivalents.

(b) Investments in mortgages:

Investments in mortgages are designated at fair value through profit and loss, with any changes in fair value reflected in the statement of income and comprehensive income. The fair value of investments in mortgages is calculated based on a discounted cash flow analysis of the future expected cash flows from the period end to the maturity of the investment.

The discount rate used to discount the future estimated cash flows of each applicable mortgage investment is the Company's estimate of the current market discount rate based on the current lending market for mortgages of similar terms.

The gains or losses on disposal or repayment transactions are recorded as realized gains or losses at the time of disposal or repayment, respectively.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

3. Significant accounting policies (continued):

(c) Class A shares:

The Class A shares are not redeemable. The Company classifies financial instruments issued as either financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument. Accordingly, the non-redeemable Class A shares are classified as equity.

Dividends payable to holders of Class A shares are recognized in the statement of changes in shareholders' equity.

(d) Interest income:

Interest income is recognized in the statement of income and comprehensive income on an accrual basis.

(e) Income taxes:

The Company is a Mortgage Investment Corporation ("MIC") pursuant to the Income Tax Act (Canada). As such, the Company is entitled to deduct from its taxable income, dividends paid to shareholders during the year or within 90 days of the end of the year to the extent the dividends were not deducted previously. The Company intends to maintain its status as a MIC and intends to distribute sufficient dividends in the year and in future years to ensure that the Company is not subject to income taxes. Accordingly, for financial statement reporting purposes, the tax deductibility of the Company's dividends results in the Company being effectively exempt from taxation and no provision for current or deferred income taxes is required.

As at December 31, 2019, the Company has non-capital losses carried forward for income tax purposes of \$1,714,396 (2018 - \$2,663,225), which will expire between 2034 and 2038.

(f) Financial instruments:

(i) Recognition and classification of financial assets and liabilities:

Under IFRS 9, on initial recognition, a financial asset is measured at fair value and subsequently classified as measured at: amortized cost; Fair value through other comprehensive income ("FVOCI")-debt investment; FVOCI-equity investment; or fair value through profit or loss ("FVTPL"). The classification of financial assets that are debt instruments under IFRS 9 are generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

A financial asset that is a debt instrument is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL.

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

3. Significant accounting policies (continued):

(f) Financial instruments (continued):

(i) Recognition and classification of financial assets and liabilities (continued):

The most significant financial asset of the Company were investments in mortgages. Due to the Orderly Wind-Up, the business model of the Company is to liquidate and monetize these financial assets and return capital to the shareholders. The investments in mortgages are classified as FVTPL

Financial liabilities are recognized initially at fair value and are classified as other financial liabilities or FVTPL. A financial liability is classified as FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVPTL are measured at fair value and net gains and losses including any interest expense, are recognized in profit or loss. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense is recognized in profit or loss. Any gain or loss on derecognition is also recognized in profit or loss.

Financial instruments subsequently measured at amortized cost are done so using the effective interest method, less any impairment losses. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

The Company has classified its financial instruments as follows:

Classification	Classification	Measurement
Financial assets:		
Investments in mortgages	FVTPL	FVTPL
Cash and cash equivalents	Amortized cost	Amortized cost
Financial liabilities:		
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Management fees payable	Other financial liabilities	Amortized cost

(ii) Impairment:

Under IFRS 9, an entity recognizes loss allowances for expected credit losses (“ECL”) to financial assets measured at amortized cost, contract assets and debt investments at FVOCI.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

3. Significant accounting policies (continued):

(f) Financial instruments (continued):

(ii) Impairment (continued):

This includes both quantitative and qualitative information analysis, based on the Company's historical experience and informed assessment of forward looking information.

The Company's financial assets at amortized cost consist only of cash and cash equivalents.

(iii) De-recognition:

(A) Financial assets:

The Company derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire; or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred, or in which the Company neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial assets. Any interest in such transferred financial assets that qualify for de-recognition that is created or retained by the Company is recognized as a separate asset or liability. On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in the statement of comprehensive income (loss).

(B) Financial liabilities:

The Company derecognizes a financial liability when the obligation under the liability is discharged, cancelled or expired.

4. Investments in mortgages:

(a) Mortgages:

Property type	2019		2018	
	Number	Amount	Number	Amount
Residential	2	\$ 16,235,281	2	\$ 15,257,332
Accrued interest and fees receivable		98,265		95,982
Fair value adjustments on investments in mortgages (note 4(b))		(3,450,000)		(1,650,000)
		<u>\$ 12,883,546</u>		<u>\$ 13,703,314</u>

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

4. Investments in mortgages (continued):

(a) Mortgages (continued):

Property location	2019		2018	
	Number	Amount	Number	Amount
Alberta (note 4(b))	1	\$ 13,665,646	1	\$ 12,610,765
Ontario	1	2,569,635	1	2,646,567
	2	\$ 16,235,281	2	\$ 15,257,332

The mortgages are secured by the real property to which they relate, bear interest at a weighted average interest rate of 7.27% (2018 - 7.54%) and mature between 2020 and 2024. The mortgage agreements stipulate a minimum interest rate and a variable interest rate based on the Prime Rate for Canadian Dollar Loans established by HSBC ("Prime Rate"). Current premium to the Prime Rate range from plus 0.32% to plus 3.88% (2018 - between 0.32% to plus 4.28%), with the current rates ranging from 4.27% to 7.83% (2018 - between 4.27% to 8.23%), excluding loans in default.

All mortgages, except for the single mortgage under the CMBS program as discussed below, are conventional uninsured mortgages which contain a prepayment option, whereby the borrower may repay the principal at any time prior to maturity without penalty or yield maintenance.

In 2014, the Company invested in a mortgage with a stated interest rate of 4.41% and principal amount of \$2,569,635 which matures in September 2024. The mortgage was intended to be a short-term, one-time investment whereby the Company would hold the investment until it could be funded under a CMBS program led by Trez Commercial Finance Limited Partnership ("TCF"), a related party by virtue of common management.

Principal repayments based on contractual maturity dates are as follows:

	Number	December 31, 2019
2020	1	\$ 13,665,646
2024	1	2,569,635
	2	\$ 16,235,281

As part of the assessment of fair value, the Manager routinely reviews each mortgage for changes in credit risk to determine whether or not the fair value of a mortgage should be adjusted for the change in credit risk.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

4. Investments in mortgages (continued):

(a) Mortgages (continued):

Management has estimated the value of its mortgage portfolio based on its best judgment as to the eventual cash flows that it expects to receive. However, given the illiquid nature of the assets, the time frame to realize any expected cash flows and the inherent credit risk of the underlying security, the eventual value to be realized could vary by a material amount. Furthermore, Management's estimates are based on the assumption that it will continue to realize value from the Company's investments in the normal course of business. Any change in management's intended course of action would have a significant impact on the value eventually realized.

As at December 31, 2019, the Manager assessed the fair value of the mortgage portfolio and recognized an additional fair value provision of \$1,800,000 relating to the mortgage outstanding in Alberta, described further in note 4(b).

(b) Renewed default mortgage:

In the first quarter of 2018, the borrower for the loan in Alberta, that was previously in default requested a new three-year loan agreement with pay down of \$1,000,000. Management approached the loan-sharing partner which still holds the senior portion of the loan and requested their input regarding a potential renewal. A new term for 31 months was agreed upon between the parties, with the borrower agreeing to pay on a go forward basis the portion of the principal that was being paid by the Company. The borrower also agreed to make the requested \$1,000,000 pay down on June 1, 2018, and additional payments of \$500,000 every six months thereafter until December 1, 2020 when payment in full is due. All the scheduled payments for 2018 and 2019 were made by the borrower and used to pay down the position of the senior loan sharing partner.

The Manager considers this loan to be performing however, due to continued risk and the challenged nature of the loan, the Manager has reassessed the cash flows expected from the borrower, the obligations to the loan-sharing partner and reasonability of being repaid on maturity. This analysis of the fair value of the mortgage resulted in an additional fair value loss provision of \$1,800,000 to the existing \$1,650,000 provision. The total fair value provision at December 31, 2019 is \$3,450,000 (2018 - \$1,650,000).

5. Class A shares:

As at December 31, 2019 and December 31, 2018, there were an unlimited number of Class A common shares and an unlimited number of Class B common shares authorized. As at December 31, 2019, there were 7,318,067 Class A shares outstanding (December 31, 2018 - 7,318,067).

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

5. Class A shares (continued):

The holders of the Class A shares are entitled to receive dividends as and when declared by the Board of Directors of the Company.

(a) Dividends:

The Company made no dividend payments for the year ended December 31, 2019 (December 31, 2018 - nil). Regular monthly distributions were discontinued in December 2018.

6. Management fees:

The Manager is responsible for the day-to-day operations, including administration of the Company's mortgage portfolio. Pursuant to the Management Agreement dated November 21, 2012 (amended November 30, 2013 and May 6, 2016), the Manager is entitled to a fee of 0.85% per annum of the gross assets of the Company (the "Management Fee"), plus applicable taxes, calculated monthly and paid monthly in arrears.

7. Incentive fees:

The Manager is assisting in the Orderly Wind-Up Plan and had agreed to certain amendments to the Company's management agreement to facilitate the Orderly Wind-Up Plan. Pursuant to those amendments, the Manager is currently providing full asset management services necessary to support the Orderly Wind-Up Plan. The Manager has also waived its rights, if any, to early termination fees, in exchange for an incentive fee calculated as the greater of the following:

(a) 20% of the amount by which the sum of:

- (i) The aggregate realized proceeds; and
- (ii) The Company's unrestricted cash as at April 30, 2016 exceeds \$65,549,596; and

(b) \$300,000.

Aggregate realized proceeds are defined as the amount of proceeds on the sale, repayment or maturity of mortgages or any other transaction resulting in the monetization of the mortgages under the Orderly Wind-Up Plan.

Unrestricted cash is defined as the amount of Company's cash derived from the proceeds on the sale, repayment on maturity of mortgages or any other transaction resulting in the monetization of the mortgages on or prior to April 30, 2016.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

7. Incentive fees (continued):

At December 31, 2019, the estimated total amount of the incentive fee is \$942,623 (December 31, 2018 - \$1,302,623) of which \$230,680 (December 31, 2018 - \$230,680) has been paid to date, with the remaining incentive fee obligation totaling \$711,943 (December 31, 2018 - \$1,071,943). The provision has been calculated using the projected realized proceeds at the current fair value of investments in mortgages at December 31, 2019. The amount of the provision is subject to change with any changes to realized proceeds as a result of timing or fair value adjustments of the mortgage portfolio. The provision is assessed each quarter and adjusted accordingly.

The current realized portion of the obligation payable to the Manager at December 31, 2019 is \$32,380 (December 31, 2018 - \$36,854). This amount is a percentage of the lower threshold level, determined by adding the sum of total realized proceeds received to the period end, plus the unrestricted cash as at April 30, 2016, divided by the upper threshold. At December 31, 2019, realized proceeds totaled \$54,552,681 (December 31, 2018 - \$55,530,630).

A reconciliation of incentive fee payable for the years ended December 31, 2019 and December 31, 2018 is as follows:

	2019	2018
Opening balance	\$ 1,071,943	\$ 1,028,623
Increase (decrease) in provision	(360,000)	43,320
Incentive fees realized and paid	-	-
Incentive fee provision	\$ 711,943	\$ 1,071,943

8. Related party transactions and balances:

The following are related party transactions not disclosed elsewhere in the financial statements:

- The Company is managed by the Manager, a related party by virtue of common management. Pursuant to the Management Agreement referred to in note 6, during the year ended December 31, 2019, the Company incurred management fees of \$221,529 (2018 - \$214,643). At December 31, 2019, \$55,684 (December 31, 2018 - \$36,180) of these fees were payable.
- As at December 31, 2019, the Company has co-invested in one mortgage (December 31, 2018 - one) mortgage investments with other funds managed by the Manager. The total amount of the co-invested mortgages is \$27,655,322 (December 31, 2018 - \$29,315,281), of which the Company's share is \$13,665,646 (December 31, 2018 - \$12,610,765).

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

8. Related party transactions and balances (continued):

All related party transactions are measured at the amount of consideration established and agreed to by the related parties. The Company invests in mortgages on a participation basis with parties related to the Manager. Title to mortgages is held by Computershare Canada, (the "Custodian"), on behalf of the beneficial owners of the mortgages. In addition, certain Mortgage Broker duties are performed by the Mortgage Broker. The Manager and the Mortgage Broker are related to the Company through common management.

9. Earnings (loss) per share:

Basic and diluted earnings (loss) per share are calculated by dividing net income attributable to common shares by the weighted average number of common shares during the year. There are no options outstanding that would dilute the earnings per share:

Year ended December 31, 2019:

Total income (loss) and comprehensive income (loss) for the period	\$ (485,820)
Weighted average number of common shares (basic and diluted)	7,318,067
<u>Loss per share (basic and diluted)</u>	<u>\$ (0.07)</u>

Year ended December 31, 2018:

Total income and comprehensive income for the period	\$ 603,691
Weighted average number of common shares (basic and diluted)	7,318,067
<u>Earnings per share (basic and diluted)</u>	<u>\$ 0.08</u>

10. Capital management:

As a result of the Orderly Wind-Up Plan, the Company's objective has shifted away from maintaining to be a going concern and generating returns to a more increased focus on monetization of its current asset base. It has ceased originating new loans and all mortgage renewal activity, subject to contractual rights, and its assets are being monetized over time. The Orderly Wind-Up Plan has been implemented and capital is being returned to shareholders under the supervision of the Board of Directors with the assistance of the Manager. The Company's primary objective with respect to capital management is to ensure sufficient cash resources to maintain operations and facilitate the Orderly Wind-Up process. The Company is not subject to externally imposed capital requirements.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

11. Fair value of financial instruments and risk management:

(a) Fair value of financial instruments:

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. The Company's investments in mortgages are carried at fair value in the financial statements.

The following table shows a hierarchy for disclosing fair value based on inputs used to value the Company's investments. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy are as follows:

- Quoted prices (unadjusted) in active markets for identical assets and liabilities (Level 1);
- Inputs other than quoted prices in active markets included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The Company's assets and liabilities recorded at fair value have been categorized as follows:

2019	Level 1	Level 2	Level 3	Total
Investments in mortgages	\$ -	\$ -	\$ 12,883,546	\$ 12,883,546

2018	Level 1	Level 2	Level 3	Total
Investments in mortgages	\$ -	\$ -	\$ 13,703,314	\$ 13,703,314

There were no transfers between levels during 2019 and 2018.

A reconciliation of Level 3 assets at December 31, 2019 is as follows:

Investment in mortgages, December 31, 2018	\$ 13,703,314
Funding of investment in mortgages	-
Interest capitalized to investment in mortgages	1,054,882
Change in accrued interest and fees receivable	2,283
Principal repayments or sale of investment in mortgages	(76,933)
Unrealized increase (decrease) in fair value	(1,800,000)
Investment in mortgages, December 31, 2019	\$ 12,883,546

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

11. Fair value of financial instruments and risk management (continued):

(a) Fair value of financial instruments (continued):

A reconciliation of Level 3 assets at December 31, 2018 is as follows:

Investment in mortgages, December 31, 2017	\$ 19,670,075
Funding of investment in mortgages	216,599
Interest capitalized to investment in mortgages	950,350
Change in accrued interest and fees receivable	(21,049)
Principal repayments or sale of investment in mortgages	(7,112,661)
Investment in mortgages, December 31, 2018	\$ 13,703,314

The key valuation techniques used in measuring the fair values of investments in mortgages include:

Valuation technique	Significant unobservable inputs	Inter-relationship between significant unobservable inputs and fair value measurement
Discounted cash flow model	The adjusted credit risk premium based on the change in the borrower's credit risk utilizing the knowledge gained since the loan was originated.	The estimate of fair value would increase (decrease) if: - The adjusted risk premium rate was lower (higher)
	Assessment of fair value of collateral of loans in default where payments expected from sale of property.	- Estimated fair value of collateral was (lower) higher
	The projected length of time the mortgage will remain in default without the underlying property being liquidated or foreclosed upon.	- The term of the mortgage was shortened (or extended)

At December 31, 2019, a 100 basis point increase in the credit risk premium of the discount rate used in the discounted cash flow would decrease the fair value by \$350,000 (December 31, 2018 25 basis points increase - \$87,202) and a 100 basis point decrease in the credit risk premium would increase the fair value by \$380,000. (December 31, 2018 25 basis points decrease - \$87,908).

The fair values of cash and cash equivalents, amounts receivable, dividends payable, accounts payable and accrued liabilities, and management fees payable approximate their carrying amounts due to their short-term nature.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

11. Fair value of financial instruments and risk management (continued):

(b) Risk management:

The Company has exposure to the following risks from financial instruments:

- credit risk;
- liquidity risk; and
- market risk.

The Company's revised strategy is to maintain a diversified portfolio of mortgages on real property in Canada in order to facilitate the Orderly Wind-Up Plan.

Progress of the Orderly Wind-Up Plan is monitored by the Board of Directors on an ongoing basis.

(i) Credit risk:

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company, resulting in a financial loss to the Company. This risk arises principally from the mortgages held, and also from cash, and receivables. For risk management reporting purposes, the Company considers and consolidates all elements of credit risk exposure (such as loan-to-value, sector risk, location risk, and individual obligor default risk).

The Company's policy over credit risk is to minimize its exposure to counterparties with perceived higher risk of default by dealing only with counterparties meeting the credit standards set out by the Manager's Credit Committee.

Credit risk is monitored on an on-going basis by the Manager in accordance with policies and procedures in place. The Company's credit risk is monitored on a quarterly basis by the Board of Directors.

The Company's maximum credit risk exposure (without taking into account collateral and other credit enhancements) at December 31, 2019 and 2018 is represented by the respective carrying amounts of the relevant financial assets in the statement of financial position.

(ii) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

11. Fair value of financial instruments and risk management (continued):

(b) Risk management (continued):

(ii) Liquidity risk (continued):

The Company's liquidity risk is managed on an ongoing basis by the Manager in accordance with the policies and procedures in place. The Company's overall liquidity is monitored on a quarterly basis by the Board of Directors.

The following are the contractual maturities of financial liabilities as at December 31, 2019:

	Carrying values	Contractual cash flows	Within a year (12-24 months)	Within
Accounts payable and accrued liabilities	\$ 20,000	\$ 20,000	\$ 20,000	\$ -
Management fees payable	55,684	55,684	55,684	-
	\$ 75,684	\$ 75,684	\$ 75,684	\$ -

(iii) Market risk:

Market risk is the risk that changes in market factors, such as interest rates, currency and other price risks will affect the Company's income or the fair value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposure within acceptable parameters, while optimizing the return.

The Company's strategy for the management of market risk is driven by the Company's revised strategy to maintain a diversified portfolio of mortgages on real property in Canada in order to facilitate the Orderly Wind-Up Plan.

The Company's market risk is managed on a daily basis by the Manager in accordance with policies and procedures in place.

(A) Interest rate risk:

The Company is exposed to the risk that the fair value or future cash flows of its financial instruments will fluctuate as a result of changes in market interest rates. In respect of the Company's interest-bearing financial instruments, the Company's policy is to transact in financial instruments that mature in the short-term, i.e., no longer than 36 months and the mortgage investment agreements for all mortgages held by the Company stipulate an interest rate floor for the respective mortgage. Accordingly, the Company would be subject to limited exposure to fair value or cash flow interest rate risk due to fluctuations in the prevailing levels of market interest rates.

TREZ CAPITAL SENIOR MORTGAGE INVESTMENT CORPORATION

Notes to Financial Statements

Years ended December 31, 2019 and 2018

11. Fair value of financial instruments and risk management (continued):

(b) Risk management (continued):

(iii) Market risk (continued):

(A) Interest rate risk (continued):

A 1% decrease in interest rates, with all other variables held constant, would decrease income from operations by \$269,033 due to decreased interest income on variable rate investments and the amount of cash held. A 1% increase in interest rates, with all other variables held constant, would increase income from operations by \$269,033 arising from higher interest income generated on variable rate investments in mortgages and increased interest income on cash held.

(B) Currency risk:

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Company is not currently exposed to currency risk.

(C) Other price risk:

Other price risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. The Company is exposed to price risk because of its investments in mortgages. The risk arises from changes in the real estate market and could be local, national, and global in nature. Deteriorating real estate values increase the Company's risk. The Company manages the risk by actively maintaining strong borrower relationship and active monitoring of all loans. Further, the Company has diversified its portfolio of investments in mortgages geographically to manage this risk.

12. Key management personnel compensation:

The Company paid \$65,387 (2018 - \$92,440) to the members of the Board of Directors and Independent Review Committee for their services to the Company. The compensation to the Manager is paid through the management fees paid to the Manager (note 6).

13. Subsequent event:

Subsequent to December 31, 2019 the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and our business are not known at this time. These impacts could include decreases in the fair value of our mortgage investments or potential future decreases in revenue or the profitability of our ongoing operations.

It is not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company as it relates to its ability to complete the Orderly Wind-Up Plan.