Fundamental Research Corp.
Investment Analysis for Intelligent Investors

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June 5, 2019

Three Point Capital Corp. – A High Yield MIC Focused on First Mortgages / Investors Received 7.2% in 2018

Sector/Industry: Real Estate Mortgages **www. threepointcapital.ca**

Offering Summary	
Issuer	Three Point Capital Corp.
Date of OM	23-Apr-19
Securities Offered	Class A Shares
Unit Price	$1
Minimum Subscription	N/A
Distribution to Investors	Monthly
Redemption	Penalties apply in the first 3 years
Management Fee	1.95% p.a. of NAV (AUM <$100M) / 1.75% p.a. (AUM between $100M and $150M) / 1.50% p.a. (AUM >$150 million)
Sales Commissions	Up to 5% of the gross proceeds + 1% trailer (EMDs)
Auditor	Grant Thornton

FRC Rating	
Yield (2019)	~7.0%
Rating	2-
Risk	2

*see back of report for rating definitions

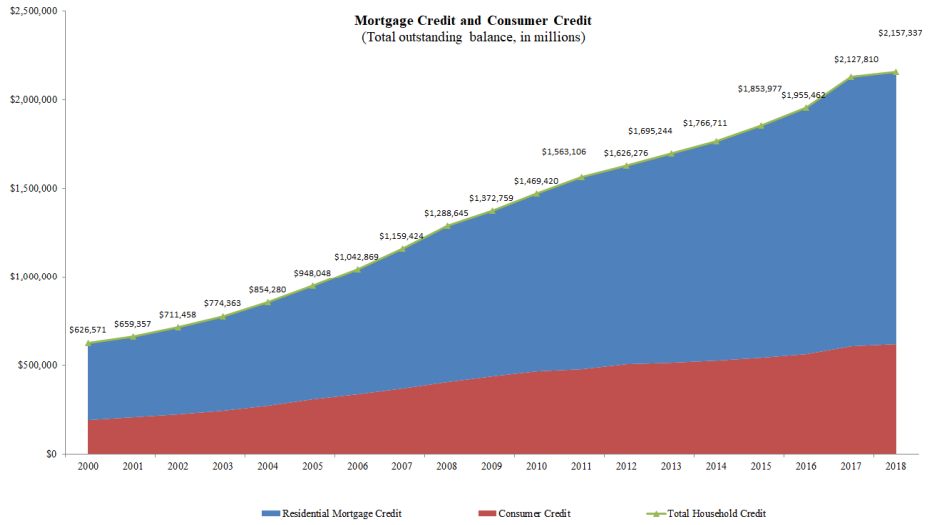
Highlights

- Three Point Capital, formed in 2017, expanded its portfolio to $74 million in mortgage receivables (gross) across 275 properties by the end of Q1-2019, up 30% from $57 million across 249 properties at the end of 2017.
- At the end of 2018, approximately 89% of the mortgages were on residential (already built single family) properties.
- First mortgages accounted for 94% by the end of Q1-2019. The portfolio's Loan-to-Value ("LTV") was 55%.
- Mortgages in British Columbia ("B.C.") accounted for 85% at the end of Q1-2019. In 2018, the MIC started investing in Ontario ("ON") mortgages. Although the Vancouver real estate market remains soft, the Toronto market seems to be on a rebound. Overall, we expect the market weakness (partially offset by the conservative lending policies by the banks) to impact originations of MICs this year.
- Investors received 7.17% in 2018 (7.08% in 2017), exceeding management's target of 7%. **The regular dividend for 2019 is 6% p.a. (paid monthly), with a 1% special dividend likely to be paid at the end of the year - which we believe is relatively high compared to other private MICs focused on first mortgages.** We believe this is because the Manager passes 100% of the origination and lender fees to the MIC.
- Management and directors maintain a strong equity position in the MIC (10.4% of the total), aligning their interest with other investors.
- We are maintaining our overall rating of 2-, and risk rating of 2.

Market Update

We estimate that the total Assets Under Management ("AUM") at the end of 2018, of the 15 largest Mortgage Investment Entities ("MIEs"), was $6.64 billion. We estimate there are approximately 200 MICs in the country, with a total portfolio size of approximately $12 billion.

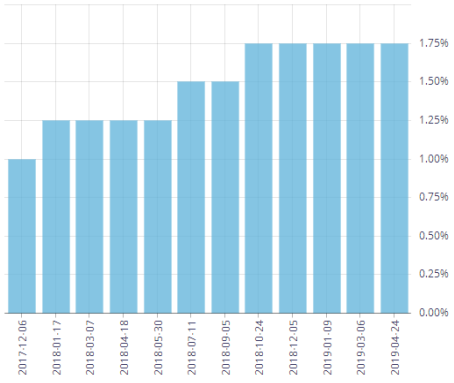
The total debt (mortgage and consumer credit) held by Canadians at the end of December 2018 was $2.16 trillion, up 1.4% YoY. **Total mortgage credit ($1.54 trillion) grew 1.1% YoY.** At the end of December, mortgage credit accounted for 71%, and consumer credit accounted for the remaining 29% of the total debt.



Data Source: Statistics Canada

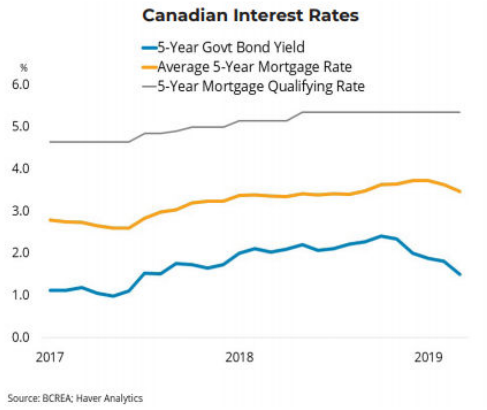
The Canadian real estate market **experienced a dramatic slowdown in the past 12 months,** primarily due to the tighter lending policies of the major banks (especially the stress test that was introduced in early 2018), and a rising interest rate environment, followed by a decline in real estate prices. In 2018, the Bank of Canada ("BoC") increased the benchmark rate three times. However, the BoC held the rate at 1.75% at its most recent meeting in April 2019.

Benchmark Interest Rate



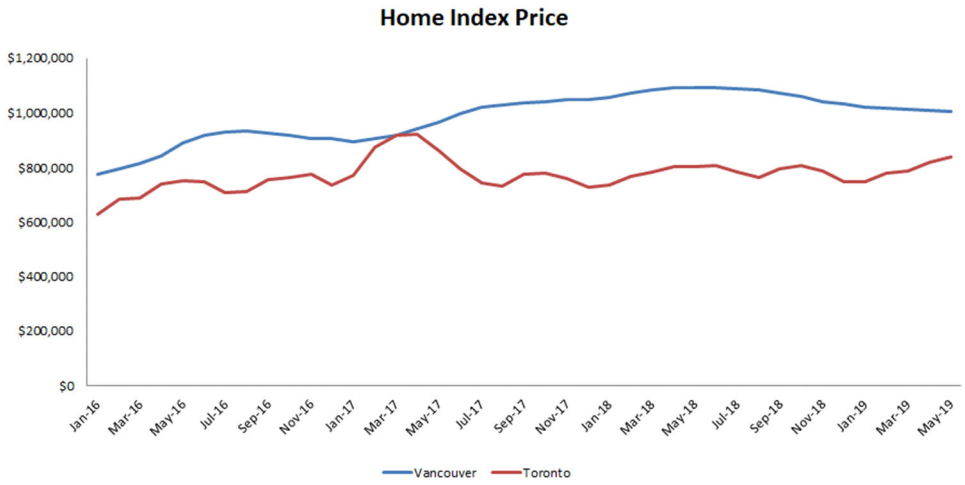
Source: Bank of Canada

Despite the steady benchmark rate, mortgage rates have been on a declining trend (as shown below), which we believe is primarily due to overall weakness in the economy, indicating potential rate cuts in 2019.



The Federal Government recently introduced an **incentive (up 5% of a home price as an interest free loan) for first-time homebuyers** with household incomes of up to $120,000 per year to purchase homes under $480k. Although this is encouraging, we do not believe this should have much of an impact on the overall market in Vancouver or Toronto, as the average price of a home is significantly higher in both cities. The CMHC estimates that only approximately 10% of the transactions in Vancouver are on units priced lower than $500k.

Three Point started investing in ON in 2018. At the end of Q1-2019, the MIC had four mortgages totaling $0.92 million, or 1.2% of the portfolio, in ON. With approximately 85% of the portfolio, B.C. dominated the portfolio at the end of Q1-2019. The following chart shows average home prices in Vancouver and Toronto.



Source: TREB and REBGV

Vancouver's real estate sales have declined every month on a YoY basis since February 2018. However, the YoY sales drop has been on a declining trend since the beginning of December

2018, as shown in the tables below. May 2019 sales dropped by just 9% - the first single digit decline since March 2018. The average price was down 8% YoY in May 2019, and 0.2% MoM. Another encouraging aspect was that the sales to active ratio increased to 18% in May 2019 (up from 13% in April 2019), versus 25% in May 2018.

Metro Vancouver	Oct-17	Oct-18	YoY	Nov-17	Nov-18	YoY	Dec-17	Dec-18	YoY
Residential Sales	3,022	1,966	-35%	2,795	1,608	-42%	2,016	1,072	-47%
New Listings	4,539	4,873	7%	4,109	3,461	-16%	1,891	1,407	-26%
Active Listings	9,137	12,984	42%	9,137	12,307	35%	6,958	10,275	48%
Sales to Listings	33.07%	15.14%		30.59%	13.07%		28.97%	10.43%	
MLS Home Price Index	$1,042,300	$1,062,100	2%	$1,046,900	$1,042,100	-0.46%	$1,050,300	$1,032,400	-2%

Metro Vancouver	Jan-18	Jan-19	YoY	Feb-18	Feb-19	YoY	Mar-18	Mar-19	YoY	Apr-18	Apr-19	YoY	May-18	May-19	YoY
Residential Sales	1,818	1,103	-39%	2,207	1,484	-33%	2,517	1,727	-31%	2,579	1,829	-29%	2,833	2,578	-9%
New Listings	3,796	4,848	28%	4,223	3,892	-8%	4,450	4,949	11%	5,820	5,742	-1%	6,375	5,861	-8%
Active Listings	6,947	10,808	56%	7,822	11,590	48%	8,380	12,774	52%	9,822	14,357	46%	11,292	14,685	30%
Sales to Listings	26.17%	10.21%		28.22%	12.80%		30.04%	13.52%		26.26%	12.74%		25.09%	17.56%	
MLS Home Price Index	$1,056,500	$1,019,600	-3%	$1,071,800	$1,016,600	-5.2%	$1,084,000	$1,011,200	-6.7%	$1,092,000	$1,008,400	-8%	$1,094,000	$1,006,400	-8%

Source: Real Estate Board of Greater Vancouver

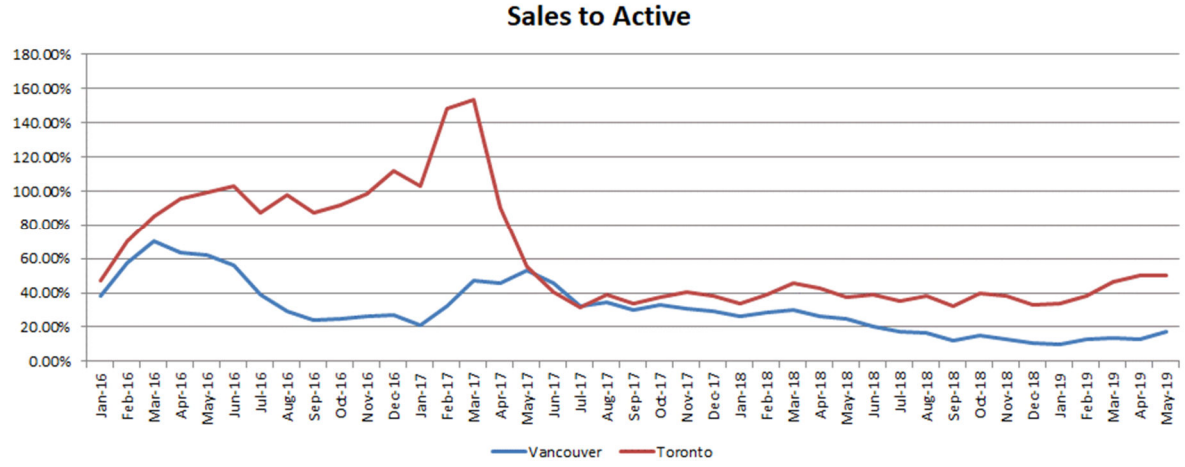
Toronto MLS sales seems to be rebounding, as sales were up 16% YoY in April 2019 and 28% YoY in May 2019, after five consecutive months of YoY decline. The average price was up 4% YoY in May 2019, and up 2.2% MoM.

Toronto	Oct-17	Oct-18	YoY	Nov-17	Nov-17	YoY	Dec-17	Dec-18	YoY
Residential Sales	7,118	7,492	5%	7,374	6,251	-15%	4,930	3,781	-23%
New Listings	14,903	14,431	-3%	14,349	10,534	-27%	6,330	4,308	-32%
Active Listings	18,859	18,926	0%	18,197	16,420	-10%	12,926	11,431	-12%
Sales to Listings	37.74%	39.59%		40.52%	38.07%		38.14%	33.08%	
MLS Home Price Index	$780,104	$807,340	3%	$761,757	$788,345	3%	$730,124	$750,180	3%

Toronto	Jan-18	Jan-19	YoY	Feb-18	Feb-19	YoY	Mar-18	Mar-19	YoY	Apr-18	Apr-19	YoY	May-18	May-19	YoY
Residential Sales	4,019	4,009	0%	5,175	5,025	-3%	7,228	7,188	-1%	7,792	9,042	16%	7,834	9,989	28%
New Listings	8,585	9,456	10%	10,520	9,828	-7%	14,866	13,996	-6%	16,273	17,205	6%	19,022	19,386	2%
Active Listings	11,894	11,962	1%	13,362	13,284	-1%	15,971	15,576	-2%	18,206	18,037	-1%	20,919	20,017	-4%
Sales to Listings	33.79%	33.51%		38.73%	37.83%		45.26%	46.15%		42.80%	50.13%		37.45%	49.90%	
MLS Home Price Index	$736,783	$748,328	2%	$767,818	$780,397	2%	$784,558	$788,335	0.5%	$804,584	$820,148	2%	$805,320	$838,540	4%

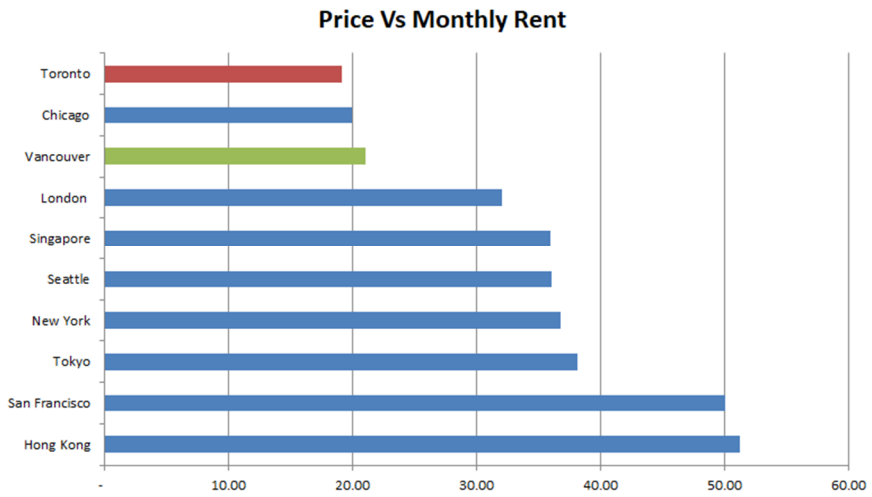
Source: Toronto Real Estate Board

The sales to active listings was 50% in May 2019, up from 37% in May 2018.



Source: TREB and REBGV

Vancouver and Toronto's price to rent ratio remains at the lower end relative to the other major cities globally, indicating that long-term prospects for housing prices remain strong for both cities.



Source: Smartasset / PadMapper / TREB and REBGV

Overall, **we expect the market weakness to impact originations this year.** The negative impact, we believe, will be partially offset by the conservative lending policies by the banks, which will continue to drive more traffic towards MICs.

Update on Three Point's Operations and Management

As detailed in our initiating report, Three Point Capital was incorporated in February 2017 to purchase a portfolio of performing mortgages ($49 million) as part of a re-organization of Paradigm Mortgage Investment Corporation. Of the $49 million mortgages purchased, approximately $3 million (or 4.2% of the total) were purchased at a discount as they were either in default or in foreclosure. Three Point has agreed to refund Paradigm any amount received in excess of the original purchase price. At the end of 2018, all but one of these mortgages have been repaid.

Paradigm has also provided a corporate guarantee for up to $1.50 million for three years on 55 mortgages totaling $13.46 million. At the end of 2018, this guarantee was applicable to $5.26 million / 24 mortgages, of which, $1.21 million was impaired. Approximately $0.40 million of the guarantee is used, implying a remaining amount of $1.10 million, which management believes is likely to cover any realized losses on the guaranteed mortgages.

The Manager of Three Point is Three Point Capital Management Corp., which was incorporated in 2001. The manager does not originate or administer loans for third-parties. In return for their services, the manager charges an annual management fee (paid monthly) of 1.95% of the Assets Under Management ("AUM") by the MIC, but receives no fee for origination / renewal of each loan. 100% of the origination / renewal fees are passed on to the fund. The fee drops to 1.75% p.a. when the AUM is between $100 and $150 million, and to 1.50% when the AUM is over $150 million. Overall, we believe **the management fee and operating expenses of the MIC are towards the lower end of comparable MICs** of similar size, which is typically in the 1.0% to 2.0% p.a. range. We estimate that the management fee and operating expenses, net of revenues from the origination fees received, were approximately 1.31% of the net mortgage receivables in 2018.

The MIC maintains a seven-member board of directors, of which, six are independent and do not hold any management position. Management and directors increased their equity ownership in the MIC YoY from 5.83 million shares (12.8% of the total outstanding shares) to 6.39 million shares (10.4% of the total). The high equity ownership (relative to comparable MICs) strongly aligns management and the board's interest with investors. The shares have voting rights – a feature that further enhances alignment of interest. Most comparable MICs do not offer any voting rights to investors.

			Dec-17				Dec-18			
Name	Position	Positions held since (ThreePoint or predecessor companies)	Class A Shares (MIC)	% of the Total (MIC)	% of the Total (Manager)	% of the Total (TPCM)	Class A Shares (MIC)	% of the Total (MIC)	% of the Total (Manager)	% of the Total (TPCM)
Crompton, Donald J.	Director (Chairman)	1994	886,815	1.90%	28.25%	20.00%	940,042	1.50%	28.25%	20.00%
Lee, Ryan G.	President	2017	25,000	0.10%	10.25%	20.00%	26,278	0.04%	15.25%	20.00%
Needham, Marylyn W	VP	2007	412,379	0.90%	10.25%	20.00%	469,101	0.80%	15.50%	20.00%
Graham, Bradley D.	Chief Credit Officer	2011	202,261	0.40%	10.25%	20.00%	373,212	0.60%	15.25%	20.00%
Wilson, Leanne P	COO	2011	482,221	1.10%	12.75%	20.00%	717,957	1.20%	15.50%	20.00%
Braam, Francis R.	Independent Director	2014	534,776	1.20%			657,564	1.10%		
Kippan, Duncan R.	Independent Director	1994	655,335	1.40%			788,660	1.30%		
MacKenzie, Alan R.	Independent Director	2018	191,344	0.40%			222,069	0.40%		
Pushor, Richard J	Independent Director	2014	1,493,964	3.30%			1,177,653	1.90%		
Turik, Grant R	Independent Director	2011	47,868	0.10%			56,280	0.10%		
Ungaro, Joseph F.	Independent Director	2014	899,359	2.00%			961,588	1.50%		
Meier Enterprises Ltd	Investor				28.25%				10.25%	
Total			**5,831,322**	**12.80%**	**100.00%**	**100.00%**	**6,390,404**	**10.44%**	**100.00%**	**100.00%**

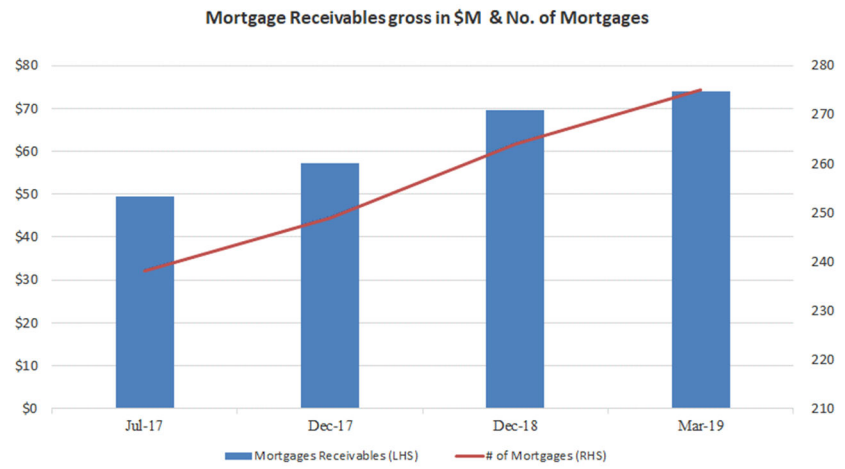
Source: Company

Also, as shown in the table above, the Manager is owned by six individuals. We consider this a good sign as it lowers key person risks. Management also has a related company (as a capital raising arm), named Three Point Capital Marketing Corp (TPCM). TPCM is entitled to receive sales commissions for new capital raised for the MIC.

The following section presents a review of Three Point's portfolio.

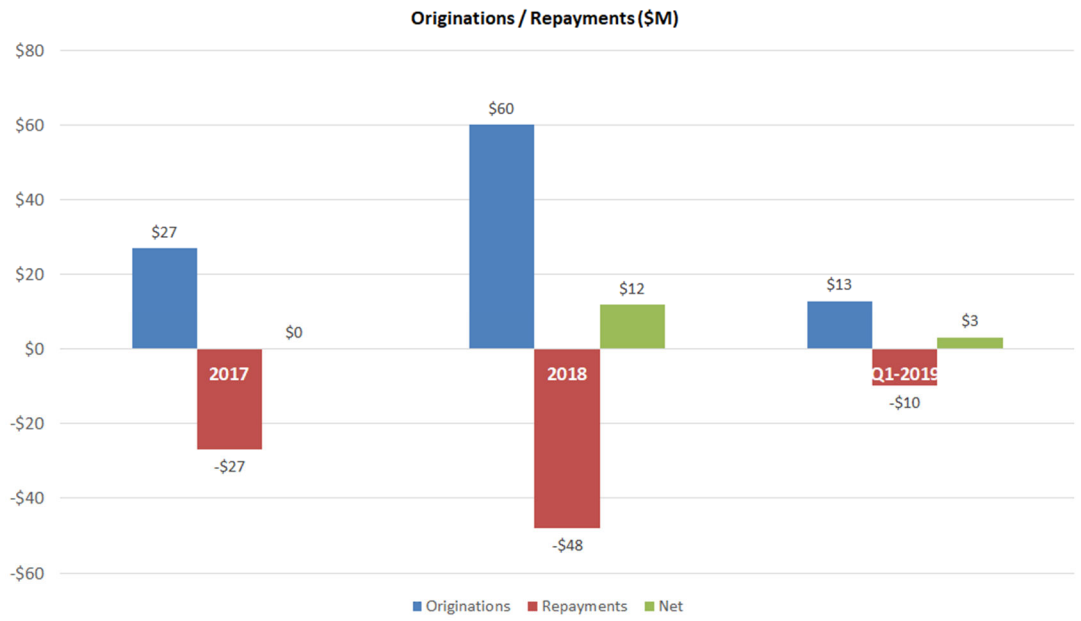
Portfolio Review

At the end of Q1-2019, the MIC had $74 million in mortgage receivables (gross) across 275 properties, up 30% from $57 million across 249 properties at the end of 2017. The following chart shows the growth in the portfolio.



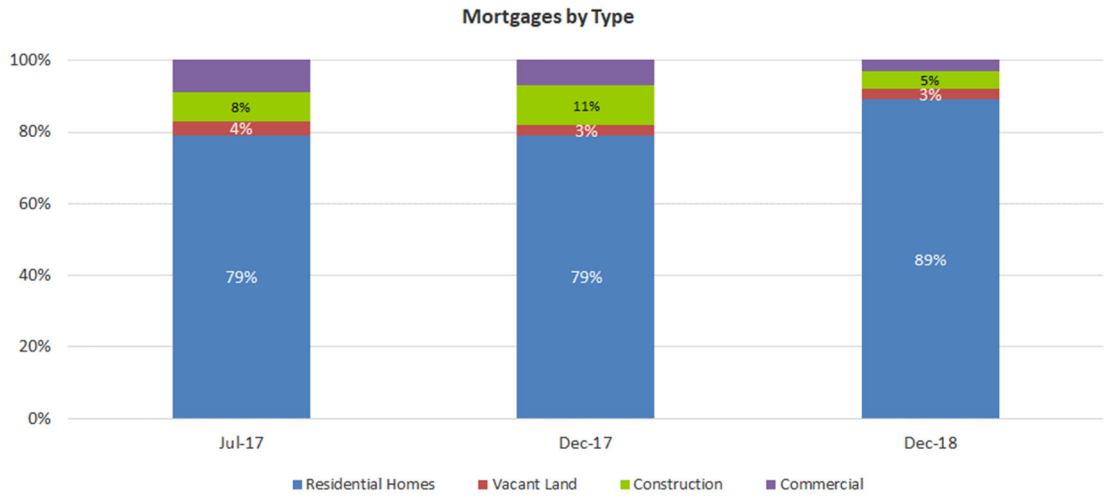
Data Source: Company

The MIC originated $60 million in new mortgages in 2018 ($27 million in 2017) and had $48 million in repayments ($27 million in 2017). Management expects new originations to total $65 million in 2019.



Data Source: Company

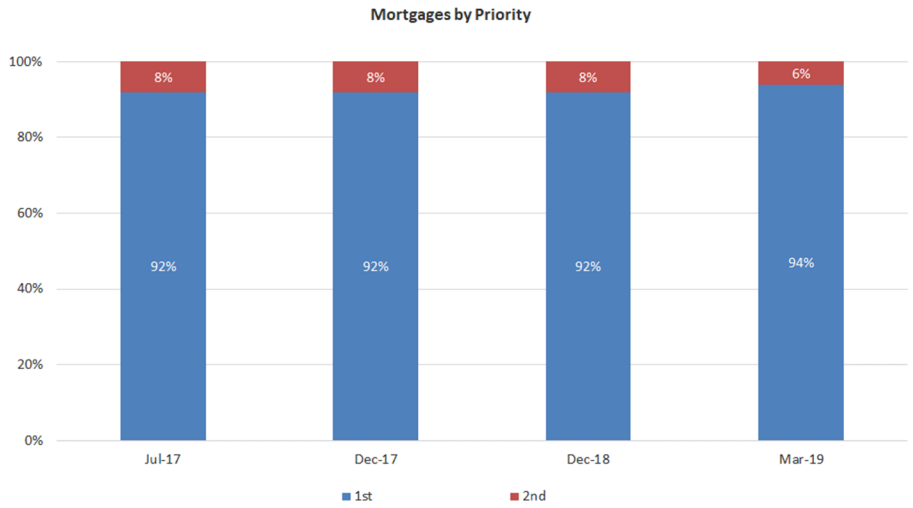
Mortgages by Type: At the end of 2018, approximately 89% (79% at the end of 2017) of the mortgages were on residential properties, 5% (8% at the end of 2017) on residential construction, 3% on vacant land (4% at the end of 2017), and 3% (9% at the end of 2017) on commercial properties.



Data Source: Company

The significant increase in exposure to residential properties is in line with the MIC's mandate. As mentioned in our initiating report, Three Point's strategy is strictly focused on lower risk first mortgages on residential homes in urban locations. No mortgage will exceed $1 million. Paradigm used to lend to large development projects and commercial properties, some of which went into default. Three Point's lending guidelines, and investment philosophy, are significantly different and specifically prohibit such lending. The commercial mortgages in the current portfolio were acquired from Paradigm.

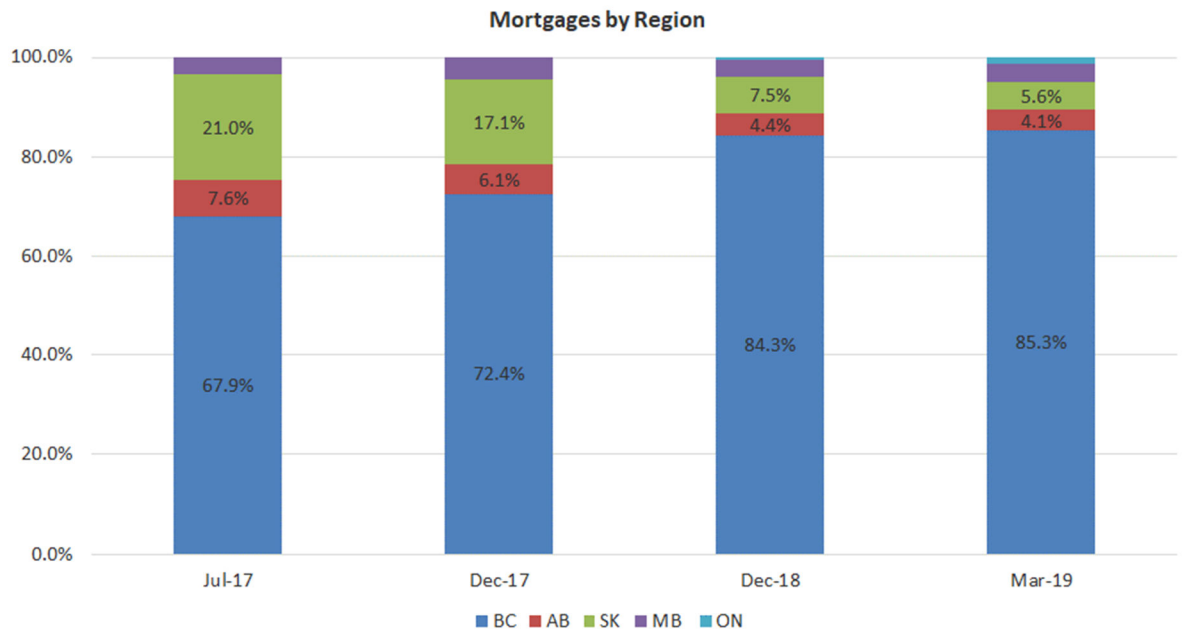
Mortgages by Priority: First mortgages increased from 92% at the end of 2017, to 94% by the end of Q1-2019.



Data Source: Company

Mortgages by Region: The portfolio's exposure to B.C. has been increasing (85% at the end of Q1-2019 versus 72% at the end of 2017), while exposure to AB, SK, and MB has been decreasing (13.5% at the end of Q1-2019 versus 27.6% at the end of 2017). As mentioned earlier, the MIC started investing in ON in 2018. At the end of Q1-2019, the MIC had four

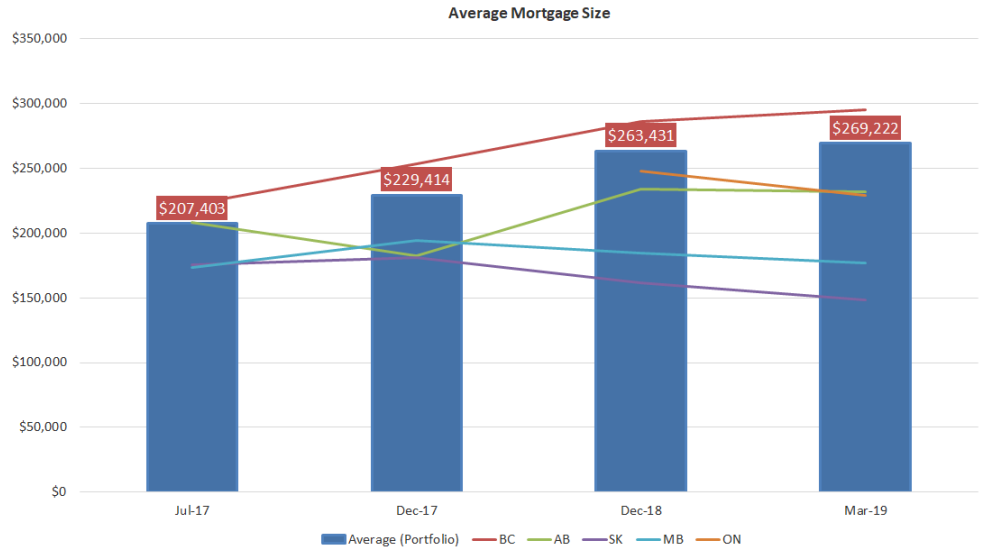
mortgages totaling $0.92 million, or 1.2% of the portfolio, in ON. Management's proposed mix by the end of 2019 is B.C. (76%), ON (12%), Others (12%). We believe geographical diversification is vital to reduce exposure to region specific risks.



Data Source: Company

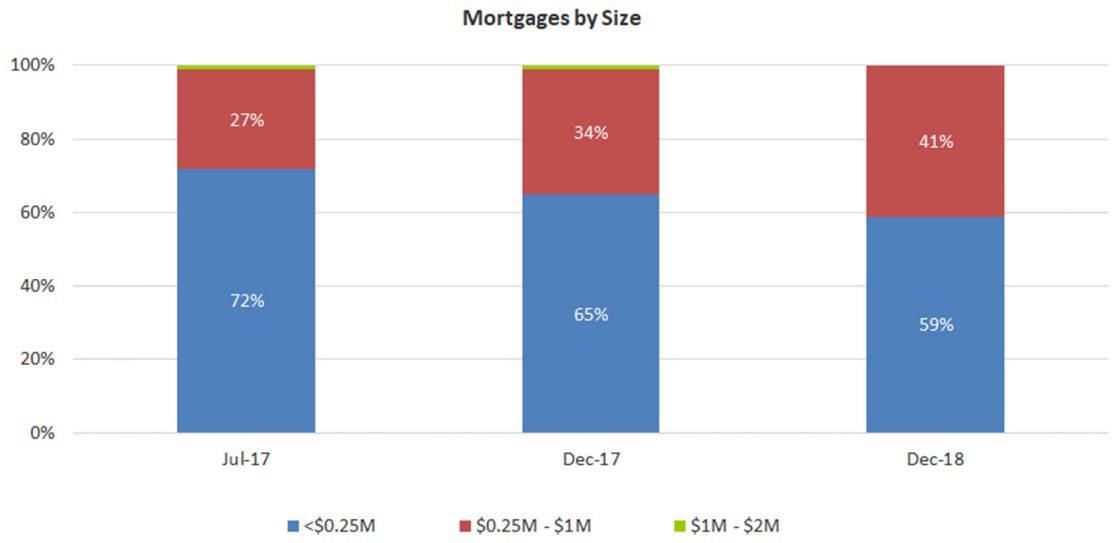
Within B.C., the MIC's focus is on the Okanagan. The Okanagan accounted for approximately 52%. The remaining 48% of the portfolio is relatively well diversified.

Mortgages by Size: The average mortgage size at the end of Q1-2019 was $269k, up from $229k at the end of 2017. B.C. had the highest average ($295k).



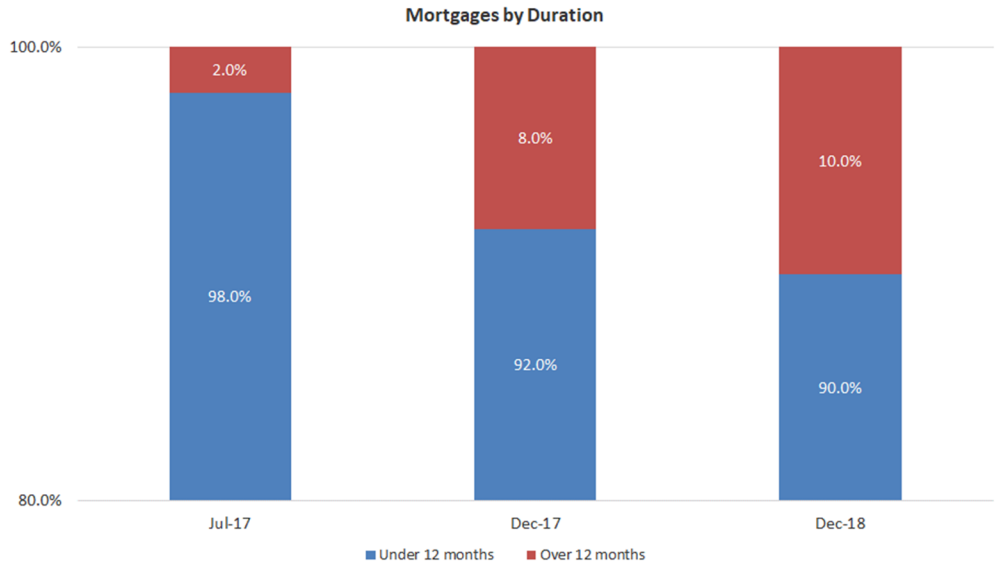
Data Source: Company

At the end of 2018, approximately 59% (65% at the end of 2017) of the mortgages were under $0.25 million, 41% (34% at the end of 2017) were between $0.25 million and $1 million, and nil (1% at the end of 2017) were over $1 million. Note that the 1% of the mortgages over $1 million were acquired from Paradigm (now repaid) as Three Point does not lend on mortgages over $1 million.



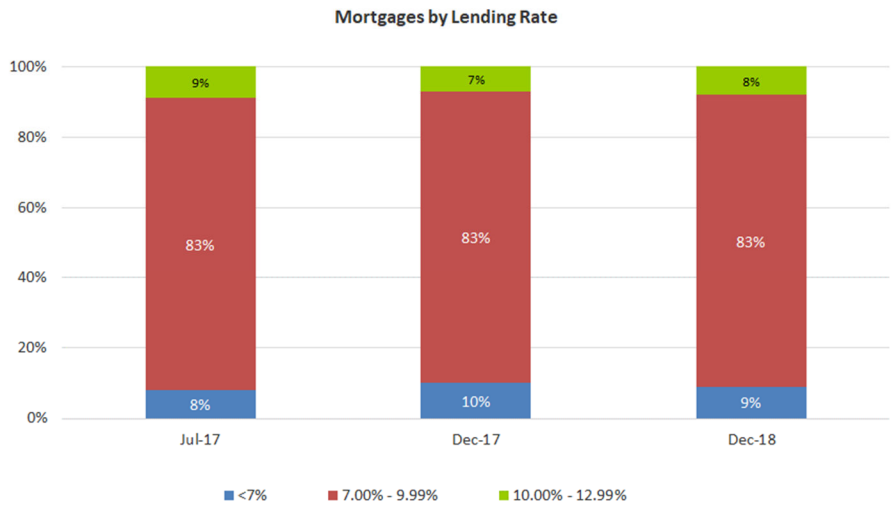
Data Source: Company

Mortgages by Duration: At the end of 2018, approximately 90% of the portfolio had terms of 12 months or less versus 92% at the end of 2017. Note that a lower duration generally implies lower risk.



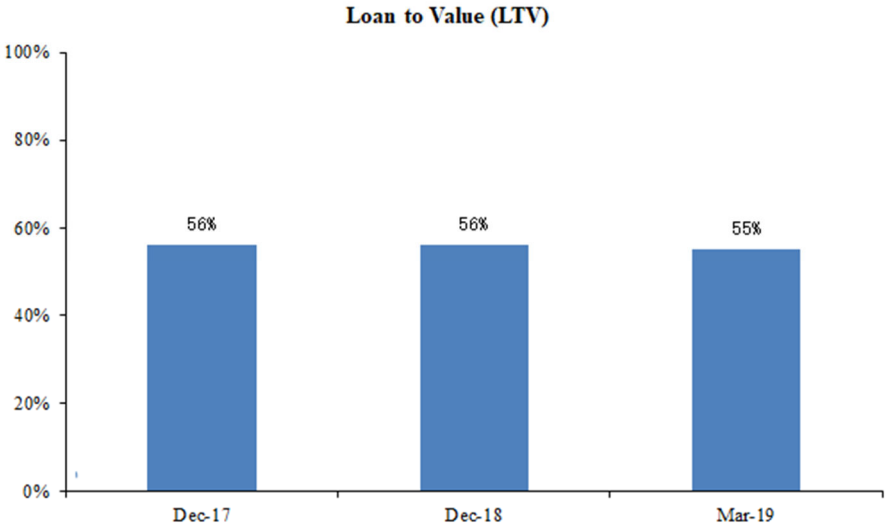
Data Source: Company

Lending Rate: The weighted average lending rate was 8.58% at the end of Q1-2019 and 2018, versus 8.35% at the end of 2017. The following chart shows the interest rates charged to borrowers. Approximately 83% of the mortgages had rates between 7% and 10%.



Source: Company

Loan to Value (LTV): The portfolio's LTV dropped slightly from 56% to 55% by the end of Q1-2019. As the MIC is focused on first mortgages, we believe the portfolio's LTV is likely to stay below 65%.



Overall, we believe the trust portfolio's risk profile has decreased primarily due to the increase in first mortgages, and a decrease in LTV and exposure to residential construction and commercial mortgages. The following chart summarizes the change in risk levels based on YoY changes in key parameters.

Parameter	Risk Profile
Total Portfolio Size	↑
Average Mortgage	↑
Diversification	-
Duration	↑
Priority	↓
LTV	↓
Property Type	↓
Defaults	↓

- red (green) indicates an increase (decrease) in risk level

Source: FRC

Structure

The MIC raises capital through three channels:

1. Exempt Market Dealers – the MIC is offering sales commissions of up to 5% of the gross proceeds raised (paid upfront), plus a 1% p.a. trailer to third-party EMDs.

2. IIROC members - trailer fees of up to 1% p.a.

3. The company may also pay commissions (up to 5% and no trailer) to TPCM for new capital raised. However, this channel will no longer exist once Three Point's pending EMD registration is approved.

There is no market or exchange that the shares trade on. They are eligible for redemption, at the book value, at any time. As per the OM, the MIC will not have to redeem if there are redemption requests totaling more than 10% of the total number of shares outstanding per year. A redemption fee is applicable to new investors to offset the 5% commission paid upfront. The penalties will be 3% within the first year, 2% within the second year, 1% within the third year, and nil penalties after that. We believe that penalties for early redemption are not unusual for MICs that pay out a relatively high sales commission.

Financials

In 2018, the MIC generated $5.20 million in revenues and reported $3.66 million in net income. As operations started in mid 2017; 2017 figures only represent six months performance.

Income Statement	2017 Feb 22 - Dec 31 (operations started in June)	2018 Jan 1 - Dec 31
Revenues		
Interest Income	$2,305,911	$5,197,158
Other Income	$271,790	$581,571
	$2,577,701	**$5,778,729**
Expenses		
G&A	$95,762	$125,187
Management Fees	$570,923	$1,281,610
Loan Loss Provision	$185,833	$210,175
Interest on Loan Payable	$244,867	$502,474
	$1,097,385	**$2,119,446**
Net Income	**$1,480,316**	**$3,659,283**
Dividends	$1,466,796	$3,558,899
Net Asset Value	$0.998	$0.993
Shares Outstanding	42,610,755	58,212,515

YE – December 31st

We estimate that interest + other income as a percentage of mortgage receivables was 9.2% p.a. in 2018, versus 9.0% in 2017. The dividend yield (dividends as a percentage of invested capital) was 7.1% in 2018, versus 6.9% p.a. in 2017.

% of Mortgage Receivable	2017	2018
Interest Income	8.07%	8.23%
Other Income	0.95%	0.92%
Interest Income + Others	**9.02%**	**9.15%**
Less:		
Management Fee	-2.00%	-2.03%
G&A Expenses	-0.34%	-0.20%
Loan Loss Provision	-0.65%	-0.33%
Interest	-0.86%	-0.80%
Trailer		
Net	**5.18%**	**5.79%**
Investors' Returns (% of Invested Capital)	**6.88%**	**7.06%**

Note that the above figures may be slightly different from the figures reported by Three Point due to the difference in the method of calculation. We used the average of the opening balance, and year-end balance of the mortgages outstanding, and invested capital, to arrive at the above figures.

Source: FRC

According to the MIC, investors received 7.17% in 2018 (7.08% in 2017), exceeding management's target of 7%. The regular dividend for 2019 is 6% p.a. (paid monthly), with a

1% special dividend likely to be paid at the end of the year. **The target yield for 2019 is 7% - which we believe is relatively high compared to other private MICs focused on first mortgages.** We believe this is likely because the Manager passes 100% of the origination and lender fees to the MIC.

In 2018, the MIC had $17k in realized losses, or 0.03% of the portfolio. At the end of the year, a loan loss provision of $0.38 million, or 0.55% of the portfolio, was assigned. We estimate that comparable MICs typically assign 0.5% - 1.25% of their portfolios as loan loss provisions.

	2017	2018
Actual Losses	-	17,239
Actual Losses (% of mortgage receivable)	0.00%	0.03%
Distributions	$1,466,796	$3,558,899
Reinvested	$1,206,361	$2,440,946
Reinvested (as a % of Distributions)	82%	69%
Redemptions	$1,578,924	$1,711,136
Redemption (% of invested capital)	4%	3%
Loan loss reported	$185,833	$210,175
Loan loss provision (year/quarter ended)	$185,833	$378,769
Provision % of Receivable	0.33%	0.55%

Data Source: Company

At the end of 2018, approximately 1.7% of the portfolio was impaired, but they are fully covered under the guarantee agreement with Paradigm Mortgage Investment Corp. (discussed earlier in this report).

Impaired	2017	2018
Residential		$814,912
LTV		60%
Commercial		$364,752
LTV		68%
Total		$1,179,664
LTV		62%
% of the Portfolio		1.7%

Arrears	2017	2018
60+ days	$4,800,000	
	8.4%	

Source: Company

At the end of 2018, the MIC had $69 million (net) in mortgage receivables, up 21% YoY. **Management's goal is to grow its portfolio to approximately $85 million by the end of 2019.**

Balance Sheet	2017	2018
Assets		
Cash	-	-
Accounts Receivable	$139,830	$0
Prepaid Expense	$22,509	$20,596
Mortgage Investments (net)	$57,125,378	$69,167,136
	$57,287,717	**$69,187,732**
Liabilities		
Loan Payable	$11,052,914	$7,581,036
Promissory Notes	$3,429,664	$3,036,033
Accounts Payable & Accured Liabilities	$259,956	$746,165
	$14,742,534	$11,363,234
Net Asset	$42,545,183	$57,824,498
SE + Liabilities	**$57,287,717**	**$69,187,732**
Debt to Capital	25%	16%
Debt as a % of Mortgage Outstanding	25%	15%
Interest Coverage Ratio	7.0	8.3

Data Source: Financial Statements

The interest coverage ratio improved YoY from 7x to 8.3x. Debt to capital was 16% at the end of 2018, down from 25% at the end of 2017. We estimate that comparable MICs typically use debt levels ranging between 20% and 40%.

Risk

Investors are exposed to the following risks:

- Loans are short term and need to be sourced and replaced quickly.
- Timely deployment of capital is crucial.
- A drop in housing prices will result in higher LTVs, and higher default risk, as the value of collateral decreases.
- Shareholders' principal is not guaranteed, as the NAV per share could decrease from current levels (as a result of loan losses). Shareholders are also not guaranteed minimum distributions.
- The fund has the ability to use leverage, which would increase the exposure of the fund to negative events.
- Although the MIC's primary focus is on first mortgages, it may invest in second mortgages which carry higher risk.
- Annual redemptions may be limited to 10% of the total invested capital.

Rating

Based on our review of the fund's 2018 results and its portfolio, we are maintaining our overall rating of 2-, and risk rating of 2.

FRC Rating	
Yield (2019)	~7.0%
Rating	2-
Risk	2

Fundamental Research Corp. Rating Scale:

Rating – 1: Excellent Return to Risk Ratio
Rating – 2: Very Good Return to Risk Ratio
Rating – 3: Good Return to Risk Ratio
Rating – 4: Average Return to Risk Ratio
Rating – 5: Weak Return to Risk Ratio
Rating – 6: Very Weak Return to Risk Ratio
Rating – 7: Poor Return to Risk Ratio
A "+" indicates the rating is in the top third of the category, A "-" indicates the lower third and no "+" or "-" indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk)
2 (Below Average Risk)
3 (Average Risk)
4 (Speculative)
5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	30%	Risk - 2	8%
Rating - 3	47%	Risk - 3	41%
Rating - 4	9%	Risk - 4	33%
Rating - 5	4%	Risk - 5	8%
Rating - 6	1%	Suspended	10%
Rating - 7	0%		
Suspended	10%		

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