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Residential Mortgage Underwriting Policy

2020

Three Point Capital Corp. ("TPC") has published this Residential Mortgage Underwriting Policy ("TPC Policy"), which was adapted from and based on the November 2014 OSFI publication, and calls on all Three Point Capital Management Corp. Underwriters and Mortgage Portfolio Managers to ensure that they adhere to the TPC Policies. This Policy articulates five fundamental principles for sound residential mortgage underwriting.

Sound Business & Financial Practices

Three Point Capital Corp.

Residential Mortgage Underwriting Policy and Procedures

Sound Business and Financial Practices – Updated February 2020

I. Purpose and Scope of this TPC Policy

Three Point Capital Corp. ("TPC") has published this *Residential Mortgage Underwriting Policy* ("TPC Policy"), which was adapted from and based on the November 2014 OSFI publication, and calls on all Three Point Capital Management Corp. Underwriters and Portfolio Managers to ensure that they adhere to the TPC Policies and Lending Guidelines.

This Policy sets out TPC's expectations for prudent residential mortgage underwriting, and is applicable to all residential mortgage underwriting contemplated by TPC. It complements the established Lending Guidelines and the additional requirements of the *Income Tax Act, FICOM and BCSC,* which establishes the rules for Mortgage Investment Corporation (MIC) mortgage lending in Canada and raising capital in BC.

For the purpose of this Policy, a "residential mortgage" includes any loan to an individual or corporation that is secured by residential property (i.e., one to four unit dwellings).

This Policy articulates five fundamental principles for sound residential mortgage underwriting by TPC. The first principle relates to governance and the development of overarching business objectives, strategy and oversight mechanisms in respect of residential mortgage underwriting.

The next three principles focus on the residential mortgage credit decision and the underwriting process, specifically the assessment of:

- The borrower's identity, background and demonstrated willingness to service their debt obligations on a timely basis (Principle 2);
- The borrower's capacity to service their debt obligations on a timely basis (Principle 3); and,
- The underlying property value/collateral and management process (Principle 4).

These three principles are evaluated by TPC using a holistic, risk-based approach. The borrower's demonstrated willingness and capacity to service their debt obligations on a timely basis is generally the primary basis of TPC's credit decision. Undue reliance on collateral can pose challenges, as the process to obtain title to the underlying property security can be difficult and costly to the lender.

The fifth principle addresses the need for mortgage underwriting to be supported by effective credit and counterparty risk management.

II. Principles

Principle 1: Three Point Capital Corp., engaged in residential mortgage lending, has a comprehensive Residential Mortgage Underwriting Policy (TPC Policy) and detailed Lending Guidelines. Residential mortgage underwriting practices and procedures of Three Point Capital Management Corp. comply with the established TPC Policy and Lending Guidelines.

Residential Mortgage Underwriting Policy (TPC Policy) & Lending Guidelines

The Board-approved Lending Guidelines & Underwriting Policyestablishes limits regarding the level of risk that TPC is willing to accept with respect to residential mortgages, and this forms the basis for the TPC Policy. The TPC Policy further aligns with TPC's company-wide strategy and, in turn, is linked to the company's risk management framework.

The TPC Policy and Lending Guidelines reflect the size, nature and complexity of TPC's residential mortgage business and gives consideration to factors and metrics such as:

- Significant elements of TPC's business strategy and approach to residential mortgage underwriting (e.g., size of markets in Canada);
- At the portfolio level, risk management practices and processes with respect to residential mortgage loans and loan assets (e.g., geographic concentration limits);
- At the individual residential mortgage loan level, acceptable underwriting and acquisition standards, criteria and limits for all residential mortgage products (e.g., credit scores, loan-to-value ratios, capacity to pay, amortization period);
- Limits on any exceptions to residential mortgages underwritten and;
- Identification and escalation processes for residential mortgage underwriting exceptions, if any, including a process for approval by the Board and exception reporting; and
- The roles and responsibilities for those positions charged with overseeing and implementing the TPC Policy.

Board and Senior Management Oversight

Senior Management is responsible for the development and implementation of the TPC Policy. However, the Board of Directors (Board) of TPC has a critical role in providing high-level guidance to, and oversight of, Senior Management with respect to matters relating to mortgage underwriting and portfolio management.

The Board of Three Point Capital Corp. reviews and discusses the TPC Policy or any changes to the TPC Policy. The Board understands the decisions, plans and policies being undertaken by Senior Management with respect to residential mortgage underwriting, and their potential impact on TPC. It probes, questions and seeks assurances from Senior Management that these are consistent with the Board's own decisions and Board-approved business and risk strategy for TPC, and that the corresponding internal controls are sound and being implemented in an effective manner.

The Board is provided timely, accurate, independent and objective reporting on the related risks of the residential mortgage business, including the procedures and controls in place to manage the risks, and the overall effectiveness of risk management processes.

The Board is made aware of, and to be satisfied with, the manner in which material exceptions to policies and controls related to residential mortgages are identified, approved and monitored, the nature of reporting to the Board, and the consequences and processes when exceptions are identified.

Internal Controls, Monitoring and Reporting

Effective control, checklists, monitoring and reporting systems and procedures have been developed and maintained by TPC to ensure on-going operational compliance with the TPC Policy. TPC is able to identify, measure, monitor and report the risks in all residential mortgage lending operations on an on-going basis, and across all jurisdictions. TPC's residential mortgage risk appetite and tolerance profile is understood at all relevant levels of the organization.

TPC has adequate processes in place with respect to residential mortgages to independently and objectively:

- Identify, assess and analyze the key risks;
- Monitor risk exposures against the Board-approved risk appetite of TPC;
- Ensure that risks are appropriately controlled and mitigated, and provide assurances to the Board and Senior Management;
- Ensure that risk management policies, processes and limits are being adhered to, and provide assurances to the Board and Senior Management;
- Provide exception reporting, including the identification of patterns, trends or systemic issues within the residential mortgage portfolio that may impair loan quality or risk mitigation factors; and
- Report on the effectiveness of models.

Mortgage Underwriting Declaration

A senior officer of TPC will make an annual declaration to the Board and Shareholders at the AGM, confirming that TPC's residential mortgage underwriting practices and associated risk management practices and procedures meet, except as otherwise disclosed in the declaration, the standards set out in this Policy.

When a deviation from this Policy has taken place, the nature and extent of the deviation, and the measures taken or proposed to correct (and mitigate the risk associated with) the deviation, will be documented and disclosed to the Board in full.

Principle 2: Three Point Capital performs reasonable due diligence to record and assess the borrower's identity, background and demonstrated willingness to service his/her debt obligations on a timely basis.

Background and Credit History of Borrower

TPC ensures that it makes a reasonable enquiry into the background, credit history, and borrowing behavior of a prospective residential mortgage loan borrower as a means to establish an assessment of the borrower's reliability to repay a mortgage loan.

For example, a credit bureau score, offered by the major credit bureaus, is an indicator used to support credit granting. However, a credit score is not solely relied upon to assess borrower qualification, as such an indicator measures past behavior and does not immediately incorporate changes in a borrower's financial condition or demonstrated willingness to service their debt obligations in a timely manner.

Loan Documentation

Maintaining sound loan documentation is an important administrative function for TPC. It provides a clear record of the factors behind the credit granting decision, supports TPC's risk management functions, and permits independent audit/review by TPC.

Consequently, TPC maintains complete documentation of the information that led to a mortgage approval. This generally includes:

- A description of the purpose of the loan (e.g., purchase, refinancing, renovation, debt consolidation);
- Employment status and review of income (see Principle 3);
- LTV ratio, property valuation and appraisal documentation (see Principle 4);
- Credit bureau reports and any other credit enquiries;
- When requested by TPC, documentation verifying the source of the down payment;
- Purchase and sale agreements and other collateral supporting documents;
- An explanation of any mitigating criteria or other elements (e.g., "soft" information) for higher credit risk factors; and
- A clearly stated rationale for the decision (including exceptions).

The above documentation is obtained at the origination of the mortgage and for any subsequent refinancing of the mortgage. TPC updates the borrower analysis periodically (not necessarily at renewal) in order to effectively evaluate their credit risk. In particular, TPC reviews some of the aforementioned factors if the borrower's condition or property risk changes materially and applies this to TPC's internal checklist.

TPC believes that an independent third-party conducting a credit assessment of a TPC mortgage loan should be in a position to replicate all aspects of the underwriting criteria, based on TPC's sound documentation, to arrive at the derived credit decision.

Anti-Money Laundering/Anti-Terrorist Financing

As part of TPC's assessment of the borrower, if TPC is aware, or there are reasonable grounds to suspect, that the residential mortgage loan transaction is being used for illicit purposes, then the TPC will decline to make the loan and consider filing a suspicious transaction report to the Financial Transactions Reports Analysis Centre of Canada (FINTRAC) with respect to the attempted transaction.

Principle 3: Three Point Capital adequately assess the borrower's capacity to service his/her debt obligations on a timely basis.

Income Review

A borrower's income is a key factor in the assessment of their capacity to repay the mortgage loan, and review and/or verification of income helps detect and deter fraud. TPC makes reasonable inquiries and takes reasonable steps to review a borrower's underlying income. This includes substantiation of:

- Employment status; and
- The income history of the borrower when required and available.

For borrowers who are self-employed, TPC takes reasonable steps to obtain income verification (e.g., Notice of Assessment) and relevant business and CRA documentation. In determining the reasonableness of the documentation used to support the income, sound practice suggests that:

- The income amount is verified by an independent source;
- The verification source is difficult to falsify;
- The verification source directly addresses the amount of the declared income; and
- The income verification information/documentation does not contradict other information provided by the borrower in the underwriting process.

Guarantors and Co-Signors of Mortgages

Where TPC obtains a guarantee or co-signor supporting the mortgage, it will also undertake sufficient credit due diligence on the guarantor/co-signor. This includes review of the guarantor's/co-signor's income, as well as a credit bureau report and a net worth statement. The guarantor/co-signor will fully understand his/her legal obligations.

Debt Service

A fundamental component of prudent underwriting is an accurate assessment of the adequacy of a borrower's income and ability to pay, taking into account the relevant mortgage payments and all debt commitments. As part of this assessment, TPC reviews debt serviceability and calculates each borrower's estimated debt serviceability for the purposes of assessing affordability.

While this is not done using the traditional Gross Debt Service (GDS) ratio and the Total Debt Service (TDS) ratio, given the nature and business of MIC mortgage lenders, internal metrics and checklists have been established.

Additional Assessment Criteria

In addition to income and debt service capacity, TPC takes into consideration other factors that would not ordinarily be captured by debt serviceability metrics, such as the borrower's assets (e.g., savings), other living expenses and recurring payment obligations (e.g., condominium fees).

To the extent possible, income assessments also reflect the stability of the borrower's income, including possible negative outcomes (e.g., variability in the salary/wages of the borrower). Conversely, temporarily high incomes (e.g., overtime wages, irregular commissions and bonuses) are suitably normalized or discounted if known.

Amortization

The mortgage amortization period for the loan is an important factor in the credit lending decision, as it affects the required debt service for the borrower, the speed of repayment of the mortgage and the growth of borrower equity in the underlying property. TPC has a stated maximum 30 year amortization period for all residential mortgages that are underwritten, unless specific exception is made.

Principle 4: Three Point Capital has sound collateral management and appraisal processes for the underlying mortgage properties.

General

Generally, mortgage loans are granted on the basis of the borrower's demonstrated willingness and capacity to service his/her debt obligations because the process to obtain title to the underlying property security can be costly. However, to the extent that the lender would ever need to realize on the underlying property serving as security, it is important to have sound collateral practices and procedures.

Property Appraisals

A significant amount of leverage is often involved in residential mortgage lending and there is general reliance on collateral to provide adequate recourse for repayment of the debt if the borrower defaults. As such, a proper and thorough assessment of the underlying property is essential to the residential mortgage business and key to adequately mitigating risks. TPC has clear and transparent valuation policies and procedures in this regard.

In assessing the value of a property, TPC takes a risk-based approach, and considers a combination of valuation tools and appraisal processes appropriate to the risk being undertaken. The valuation process can include various methods, including Realtor opinions, third-party appraisals and/or online valuation tools.

Realtor Opinion – TPC, when deemed appropriate, will have a local Real Estate Agent provide an opinion of value and estimated length of time on market to sell the underlying property. Beyond the valuation of the property, a Realtor Opinion is beneficial in the process of validating the surrounding market and real estate activity.

Third-party appraisal – TPC uses pre-approved and thoroughly vetted third-party appraisers on every mortgage file and ensures that appraisals are prepared with the appropriate professional appraisal skill and diligence, and that appraisers are designated, licensed or certified, and meet qualification standards. As well, these appraisers are always independent from the mortgage acquisition, loan processing and loan decision process.

Online valuation tools – Online valuation tools include the Matrix database, Google Maps, Google Street View, CMHC housing and economic reports, BC Assessment and various publications that aid in the due diligence and underwriting at the national level, the Provincial and Municipal level as well as the specific underlying property.

In general, TPC does not rely on any single method for property valuation. TPC undertakes a more comprehensive and prudent approach to collateral valuation for higher-risk transactions, such as residential mortgage loans with a relatively high LTV ratio.

Realistic, substantiated and supportable valuations are conducted to reflect the current price level and the property's function as collateral over the term of the mortgage. Consistent with Principle 2 above, comprehensive documentation in this regard is maintained.

TPC ensures that the claim on collateral is legally enforceable and can be realized in a reasonable period of time. When extending loans to borrowers, TPC imposes contractual terms and conditions that secure their full protection under the laws applicable in the relevant jurisdiction, and seek to preserve an appropriate variety of recourses (including, where applicable, actions on personal covenant) should the borrower default. In addition, TPC has the necessary action plans in place to determine the best course of action upon borrower default. Such action plans are:

- The likely recourses/options available to TPC upon default in all relevant jurisdictions;
- The identification of the parties against whom these recourses may be exercised; and
- A strategy for exercising these options in a manner that is prudentially sound.

Loan-to-Value (LTV) Ratio

General

The commonly-used LTV ratio is an evaluation of the amount of collateral value that can be used to support the loan. Past experience suggests it is highly correlated with credit risk. Those residential mortgage loans with higher LTV ratios generally perform worse than those with a lower LTV ratio (i.e., higher proportion of equity).

TPC adheres to an appropriate maximum LTV ratio. The maximum LTV ratio is 75% but is based on current and expected market conditions, as well as other risk factors that may impact borrowers' ability to service their debt and/or lenders' ability and cost to realize on their security.

Traditional Residential Mortgages

By Policy, residential mortgages underwritten for the purpose of purchasing, renovating or improving a property must not be greater than 75% loan to value (LTV).

The LTV ratio is re-calculated upon any refinancing, and whenever deemed prudent, given changes to a borrower's risk profile or delinquency status, using an appropriate valuation/appraisal methodology.

TPC does not structure a mortgage or combination of a mortgage and other lending products (secured by the same property) in any form that facilitates circumvention of the maximum LTV ratio limit it establishes in its TPC Policy. Further, the LTV ratio is not relied upon solely as an alternative to assessing the borrower's demonstrated willingness and capacity for repayment of the loan (see Principles 2 and 3).

<u>Property Value used for the LTV Ratio</u>

TPC assesses, and adjusts as appropriate, the value of the property for the purposes of calculating the LTV by considering appropriate risk factors that make the underlying property more vulnerable to a significant house price correction or that may significantly affect the marketability of the property. These factors would include, but are not limited to, the location of the property, the type of property, its current market price and the expected use of the property for which the loan is granted.

Principle 5: Three Point Capital has effective credit and counterparty risk management practices and procedures that support residential mortgage underwriting and loan asset portfolio management.

Model Validation and Stress Testing

TPC has an underwriting validation process (underwriting score card & checklist) at both inception and on a regular basis. This includes the regular review and recalibration of risk parameters with respect to the mortgage portfolio.

Additionally, TPC has a periodic stress-testing regime and internal audits that considers unlikely, but plausible, scenarios and their potential impact on the residential mortgage portfolio. The results of such stress testing are considered in the on-going mortgage underwriting and overall portfolio review.

Higher-Risk Underwriting

Heightened Prudence

TPC has the flexibility to underwrite a wide range of residential mortgages (up to 75% LTV) with varying risk profiles. However, for residential mortgages that constitute greater credit risks or dollar exposure, TPC exercises heightened prudence through:

- Greater Board and senior management oversight on files over $500,000;
- Increased reporting and monitoring of the residential mortgage portfolio by management;
- Stronger internal controls (i.e., additional substantiation of credit qualification information, enhanced credit approval processes, greater scrutiny by the risk management oversight function, etc.);
- Stronger default management and collections capabilities; and
- Increased allowance for doubtful account levels backstopping the impact of portfolio risk

Adequacy of Allowance for Doubtful Accounts

TPC maintains adequate allowance for doubtful account levels to properly reflect the risks being undertaken through the underwriting and/or acquisition of residential mortgages.

Conclusion

Should interested parties or stakeholders wish to review the TPC Lending Guidelines and Policies, underwriting checklist or internal audits, please contact TPC Office to arrange an in-office meeting to review.

Three Point Capital Corp.

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