



# Q4 2019 - 2020 QUARTERLY REPORT

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RESCO MORTGAGE INVESTMENT CORPORATION



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“ RESPONSIBLE STEWARDSHIP  
of our investors’ hard-earned money

E XCELLENCE AND ACCOUNTABILITY  
in everything we do

S OCIALY RESPONSIBLE  
to our community and stakeholders

C ONSERVATIVE AND PRUDENT  
in our approach

O PEN AND TRANSPARENT  
in our dealings

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RESCO GROUP OF FUNDS

MESSAGE FROM  
**THE COO**

♦  
*Chris Cheng*

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We are about a month away from Christmas, one of my favourite times of the year. In past years, I would already be in the midst of shopping, writing Christmas cards, setting dates for gatherings with friends and family and planning the dinner menu. However, I have yet to start preparing this year due to pandemic restrictions. Large social or family gatherings will be unlikely and most shopping will be done online instead of at the shopping malls.

Looking beyond the 2020 holiday season that is going to be very different, emerging trends indicate much will be the same when it comes to the mortgage investment landscape for 2021.

**Interest rates will stay low until 2023:** The Bank of Canada has issued a guidance on maintaining its overnight rate at 0.25% until at least 2023 and reinforced its commitment to keep interest rates at historical lows to support economic recovery over the next few years. This bodes well for the overall real estate market as existing borrowers with variable-rate mortgages can rest assured their rates will not rise and more potential buyers would be motivated to purchase. This will continue to fuel the already robust real estate demand and prices, and indirectly increase the demand for RESCO mortgages whose interest rates are based on market demand and not tied to the Bank of Canada rate.

**Stock market volatility is here to stay:** The 2020 stock market can be described in one word: volatile. The second wave of COVID-19 is here and pandemic restrictions will continue to have a negative impact on certain segments of the economy. This, along with uncertainties surrounding a smooth transition of power after the U.S. election means that the stock market volatility is likely to continue. The CBOE Volatility Index, or VIX, is a real-time market index representing volatility over the coming 30 days. It has remained above 20 (VIX values below 20 generally indicate stable, stress-free periods in the markets) even as the market has steadily rebounded from its panic selloffs in February and March of 2020.

**Canadian real estate will continue to be resilient:** At the beginning of the pandemic, there were fears of a major real estate market crash. In May, the Canada Mortgage and Housing Corporation made grim predictions about housing prices falling between 9% and 18% within the year. Fast forward a few months, the Canadian real estate market managed to experience unprecedented growth despite many buyers deciding to hold off on purchases amid uncertain economic conditions. Assisted by remote working technology and arrangements, more people are working from home and looking for more reasonably-priced housing outside dense cities. Demand is especially high for suburban and rural areas which offer extensive amenities, more space and higher affordability as alternatives away from the downtown cores of major cities. We expect that there will continue to be a strong demand for suburban and rural areas that offer more space to live, work and play.

**RESCO Group of Funds offers consistent rate of returns and peace of mind:** We now offer two alternative investment options catering to investors with different investment timelines and objectives. Each is invested in a well-diversified mortgage portfolio secured by residential property in Canada:

- RESCO Mortgage Investment Corporation (RESCO MIC) invests in both residential first and second mortgages and has been delivering a consistent rate of return of 8% per year since 2014 with interest payable monthly. There is a four-year hold period for this registered funds eligible investment, which makes this suitable for medium- to long-term investing.
- RESCO First Mortgage Fund LP (RESCO LP) invests only in residential first mortgages with a weighted maximum loan to value of 75% or less. It offers a targeted annual return of 5.25% to 6.00% commensurate with the more conservative portfolio. The investment timeframe is only one year, which makes this an ideal short-or medium-term investment.

The holidays season offers us the opportunity to show gratitude, reflect, reframe and most importantly, to recharge. Worrying about your investments should be the last thing on your mind. Investing with RESCO offers peace of mind so you can spend more valuable time connecting with your friends and family or taking a well-deserved break from a very unusual and stressful year!

I hope you and your family will stay safe during the holidays by finding new and creative ways to celebrate responsibly. Merry Christmas and Happy New Year.

CHRIS CHENG  
*Chief Operating Officer*



### DID YOU KNOW...?

We have found that many investors hold a mistaken belief that their RESCO investments must be redeemed when they mature.

The confusion may have arisen from the hold period (four years for RESCO MIC Preferred Shares and one year for RESCO LP Units), whereby penalties would be levied if the investment were redeemed prior to the expiry of the hold period.

In fact, RESCO MIC Preferred Shares and RESCO LP Units have no maturity date. Beyond the hold period, an investor can request a redemption at any time and without penalty, but there is certainly no requirement to do so. For as long as you remain a RESCO investor, your investment will continue to receive dividends as and when declared.

# RESCO MIC Q4

## FINANCIAL HIGHLIGHTS

*Michelle Hoang, CPA, Finance Manager*  
*Mia Wu, Senior Accountant*

- Investment portfolio grew by 4.4% year-over-year
- Interest revenue increased by 8.7% over Q3 and by 10.6% year-over-year
- Operating expenses decreased by 9.7% over Q3
- Dividends to Preferred Shareholders maintained at 8% per annum
- Working capital totaled \$7.5M in cash and cash equivalent

By closely monitoring economic conditions and changes in the real estate market resulting from the COVID-19 pandemic, RESCO was able to deliver strong financial results for the fourth quarter of the 2019-2020 Financial Year (August 1 – October 31, 2020).

We are extremely proud of the dedication of our management team, our employees and all our business partners who have spared no efforts to maintain safe operations and continue to drive the RESCO's profitable growth.

Despite the turmoil in stock markets and sharp fluctuations in other investment products, investors continue to have rock-solid confidence in RESCO. Redemptions during Q4 decreased by close to 60% compared to Q3 and new capital contribution sharply increased by over 45%. As a result, our investment portfolio grew to \$52.76M as of the end of Q4, representing a 4.4% increase year-over-year.

Perhaps the most obvious metric from an investor's perspective is that RESCO maintained our annualized 8% dividend to our Preferred Shareholders throughout Q4 – a streak which we have maintained since founding. However, there are many more metrics which speaks of RESCO's successful Q4.

Mortgage origination in Q4 remained strong at \$13.02M, representing an average increase of 13.15% over the first two quarters of the financial year. This increase was organic growth of the mortgage portfolio thanks to creative lending strategies and our extensive broker networks built over the years. Our lending pipeline remains strong going forward.

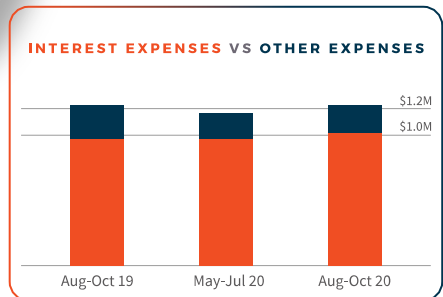
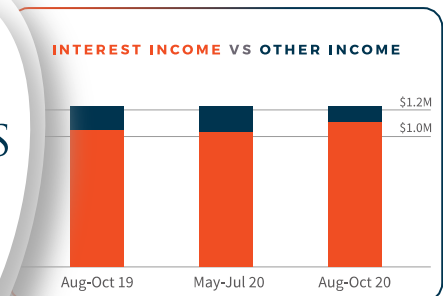
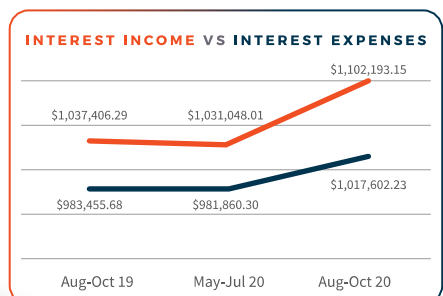
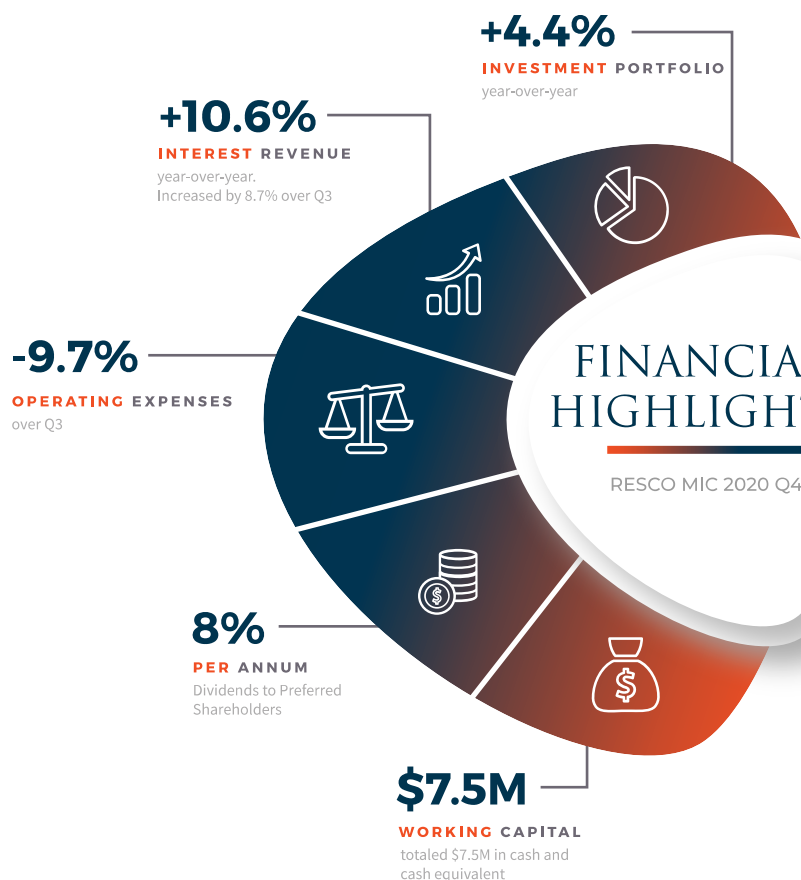
We continued to lend significantly on first mortgages to minimize portfolio risk, and our mortgage portfolio's sub-70% weighted average loan-to-value ratio (LTV) by the end of fiscal year is

Term	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Funded volume	\$9,389,140	\$8,289,530	\$15,035,015	\$13,028,743
# of deals funded	51	44	38	41
% of first mortgage	56%	51%	87%	73%
% of second mortgage	44%	49%	13%	27%

extremely healthy. Despite the greater share of first mortgages, RESCO's total interest revenue for Q4 was more than \$1.1M, representing an increase of 8.7% over the previous quarter.

The increase in mortgage portfolio interest revenue combined with decrease in operating expenses enabled RESCO to boost total retained earnings by an additional 20% by the end of Q4. These retained earnings are intended to serve as a buffer against delinquencies and bad debts. However, there has not been any foreclosures or power of sales during the entire financial year.

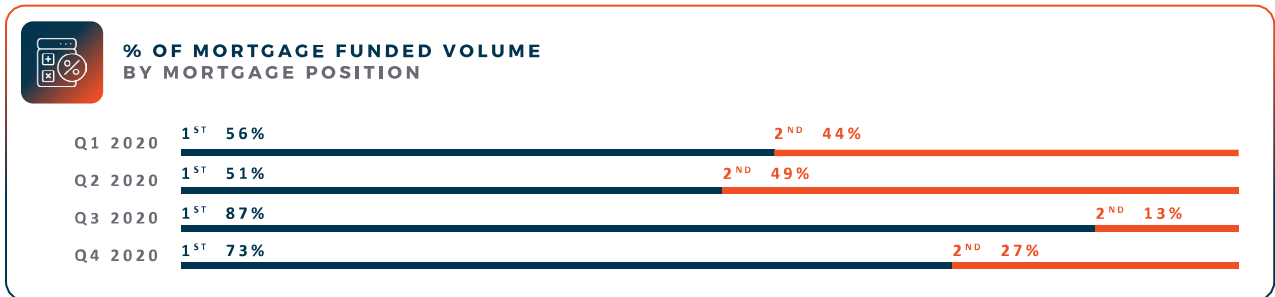
Our strong financial performance in the fourth quarter has proved RESCO's strong financial foundation and our business resiliency. We are confident in our continued capability to execute our business strategy and to secure solid financial results in the future.



**PORTFOLIO SIZE**  
**\$52,744,282.65**

**NUMBER OF MORTGAGES**  
**252**

**YTD DIVIDEND YIELD PER ANNUM**  
**8.00%**



**MORTGAGE POSITION \$**

1 <sup>ST</sup> MORTGAGE	41%
2 <sup>ND</sup> MORTGAGE	57%

**AVERAGE LOAN-TO-VALUE**  
**69.05%**

OCT 31, 2019	71.58%
SEPT 30, 2020	68.74%



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## FROM THE UNDERWRITING DESK

*Phoebe Lam, Director of Risk Management*

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- Demand for alternative mortgage lending remains strong
- Our typical borrowers have good or very good credit
- Prudent and conservative underwriting has produced a strong mortgage portfolio

The year of 2020 presented a constantly evolving and fluid landscape for RESCO and for borrowers. With this in mind, we remained committed to helping to fulfil the mortgage needs of fellow Canadians, without deviating from our prudent and stringent underwriting practices.

### **STRONG DEMAND**

The demand for alternative mortgage lending remains strong due to growing restrictions in the major banks' mortgage lending guidelines. Over the last decade, the minimum down payment for uninsured mortgages was raised from 5 percent to 10 percent, the maximum amortization period was shortened from 35 years to 30 years, and then again to 25 years. The most aggressive tightening was brought on by The Office of the Superintendent of Financial Institutions (OSFI) "Stress Test" on repayment ability in 2018.

These ever-tightening rules mean that many borrowers are rejected by the major banks for various reasons and need funding from private lenders to finance their property purchase. We will profile a few typical cases in this report.

### **OUR TYPICAL BORROWERS**

It is a common misconception that only people with bad credit turn to private lenders like RESCO as a last resort. In fact, changes in mortgage lending regulations have left many borrowers with good credit outside the major banks' lending criteria. RESCO provides mortgage solutions to fill this void especially for borrowers in a few major categories:



- **Real Estate Investors:** One of the biggest demands for private lending is from real estate investors. These investors are typically high net worth individuals, but they do not qualify for bank financing because they simultaneously own multiple properties. They typically do not keep the properties for long periods of time. Especially where the investment is in a newly constructed property, the property is usually listed immediately after closing. As a result, their requested mortgage term is short (1-3 months). For example, a recent mortgage was discharged only after one month because the property was sold one day after closing.
- **Transitional Ownership:** For various reasons, many homeowners purchase a new home but do not want to sell the current home yet. Because the banks' Stress Test looks solely at the carrying costs of two homes without considering other factors, these homeowners do not qualify. RESCO provides a bridge loan with security registered on both the existing and new properties. Once they sold the existing home, the homeowner repays RESCO and in turn qualify under the bank's Stress Test.
- **Self-employed:** Self-employment has increased by approximately 40% over the past 15 years. Banks prefer level income that can be documented by paystubs and employment letters, whereas fluctuations in income is part of the nature of being self-employed. As a result, many self-employed individuals, even self-employed professionals, cannot qualify at the bank. RESCO is an equity-based lender and provides mortgage solutions to self-employed individuals.

Overall, our borrowers have historically had an excellent repayment record and the idea that only people with bad credit turn to private lenders like RESCO as a last resort is simply false.

## FURTHER MINIMIZING RISKS

The key statistics all suggest that the Canadian housing market is expected to remain strong and active for the rest of 2020, and predictions of widespread market correction appear unfounded.

Nevertheless, we have implemented a number of strategies to further reduce the risk profile of our mortgage portfolio, which was already conservative to begin with:

- We have been lending on a lot of shorter-term mortgages with terms of six months or less. This allows us to quickly adapt to the changing market conditions and give us flexibility to fine-tune our mortgage portfolio more frequently.
- The loan-to-value ratio (LTV) of the mortgage portfolio has decreased from 69.46% in Q3 to 69.05% in Q4. The LTV ratio is a key metric of possible exposure to price corrections – the higher the LTV, the more sensitivity there is to price corrections. The LTV of RESCO's mortgage portfolio is comparatively very low in the industry.
- We have been lending on more first mortgages to lower our risk exposure. Of the total mortgages funding volume in Q4, 73% were in first position.
- We have been obtaining additional collateral as security for our lending. For example, when financing rental properties, we also require security over the owner-occupied home. This strategy makes a borrower less likely to default; and gives us more equity in the event that happens.
- We engage in continuous training and relationship building with brokers to improve the quality of applications.

We believe that our approach strikes the right balance between offering flexible mortgage solutions needed by borrowers and minimizing risks for the benefit of RESCO's investors.



## RESCO MIC MORTGAGE DELINQUENCIES

*Jeffrey Shek, Barrister and Solicitor, Chief Legal Officer  
Clement Vaccaro, Client Relationship Officer*

- Delinquency rate has been negligible and virtually identical to pre-pandemic levels
- There are no mortgages in legal enforcement
- Nearly all previously deferred payments have been repaid

The COVID-19 pandemic posed an unprecedented challenge to the Canadian economy. At the onset of the pandemic, it was feared that there would be widespread layoffs and unemployment, triggering substantial mortgage defaults and a collapse of real estate prices.

Thankfully, we are not anywhere close to this grim scenario and there have been no dramatic mortgage defaults across the board. As you have read elsewhere in this report, real estate demand and prices remain strong, especially in Ontario where the majority of our mortgage portfolio is based.

RESCO has kept our stakeholders closely informed on this potential area of concern. As a whole, we have not seen any spikes in delinquencies. Of the months spanning March to October 2020, the instances of payment default have been minimal and virtually identical to pre-pandemic levels. Of the handful of instances of payment default per month, replacement payments were usually tendered by the borrower before the next payment was due. (Please see the Case Study below)

### CASE STUDY AUGUST 2020 DELINQUENCY REPAYMENT

Whether due to temporary cashflow issues, inattention, bank errors or a myriad of other reasons, mortgage delinquencies inevitably occur.

RESCO actively monitors and manages delinquencies by persistently following up with borrowers to obtain timely repayment. After the arrears are repaid in full, the mortgage is back in good standing.

These time-lapse pie charts show the progress of delinquency repayment over the course of August, 2020 where we had 8 delinquencies. By the end of the month, there was only 1 outstanding delinquency which has since been put back in good standing.

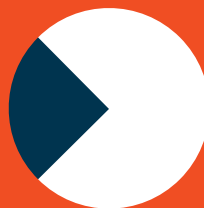
*As of August 10, 2020*



Delinquent: 4

Repaid: 4

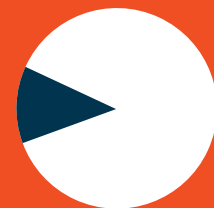
*As of August 20, 2020*



Delinquent: 2

Repaid: 6

*As of August 31, 2020*



Delinquent: 1

Repaid: 7

\*All arrears repaid by date of this report

With the addition of a Chief Legal Officer during this Financial Year, RESCO's procedures and internal knowledge base in dealing with delinquencies have been significantly strengthened. As a result, we have been more effective in pursuing repayment and shortening the length of delinquencies.

We are proud to report that the delinquency rate is negligible and there are no mortgages in legal enforcement in our mortgage portfolio of over 250 mortgages as at the end of Q4 and Financial Year End.

Aside from dealing with delinquencies as they arise, we also proactively curbed delinquencies by being one of the first private lenders to introduce an accommodation program to assist borrowers in financial hardship. The program creative options based on the borrower's circumstances, including payment deferral, extending the mortgage term and/or principal, and prepayment of monthly payments.

The accommodation program has proved to be extremely successful and almost all deferred payments have been repaid. As at Financial Year End, only two mortgages have outstanding deferred payments with the amount of deferred payments being equivalent to less than 0.005% of the entire mortgage portfolio.

As an extension of the accommodation program, we have often waived NSF fees and penalties in recognition of difficult circumstances faced by borrowers. RESCO's revenue model has never been premised on imposing predatory fees on borrowers who default – a practice which is unfortunately common in the private lending industry. While protecting the interests of our investors through diligent and persistent mortgage enforcement is always our first priority, doing so in a fair, compassionate and socially responsible manner is a source of pride for us, and we hope for our investors as well.



## ABOUT RESCO GROUP OF FUNDS

At RESCO, our investment objective is to generate sustainable and stable income for our investors while preserving investment capital through making prudent investments in mortgages secured against Canadian real estate.

RESCO is led by a group of experienced professionals with expertise in banking, mortgage lending, real estate, law, land development, mutual funds, financial planning and risk management.

### *It's Time to Consider the Alternatives.*

Stock market performance is likely to remain volatile due to a possible COVID-19 "second wave". At the same time, deposit and GIC rates are at historical lows.

Instead of letting your investable funds sit on the sidelines, **It's Time to Consider the Alternatives** offered by the RESCO Group of Funds:

	RESCO First Mortgage Fund Limited Partnership	RESCO Mortgage Investment Corporation
Established	2019	2013
Hold Period	1 year (12 months)	4 years (48 months)
Investment Timeline	Short to Medium Term	Medium to Long Term
Minimum Investment	\$150,000	\$10,000
Target Return	5.25%-6.00% per annum	8.00% per annum
Historical Return	5.25% per annum	8.00% per annum
Registered Funds Eligible	No	Yes (RRSP, TFSA, RRIF, etc.)
Distribution Frequency	Quarterly	Monthly
Distribution Reinvestment	Available	Available
Primary Lending Criteria	Residential First Mortgages Only	Residential First and Second Mortgages
Loan-To-Value Ceiling	75%	85%

If you haven't already, now is a good time to meet with your financial advisor and review how your investments align with your long-term objectives.

Please feel free to contact our offices in Ontario or B.C. and one of our associates will be glad to assist you.

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