

ATRIUM MORTGAGE INVESTMENT CORPORATION  
CANADA'S PREMIER NON-BANK LENDER™

# FINANCIAL STATEMENTS

(UNAUDITED)

THREE MONTHS ENDED  
MARCH 31, 2014



**ATRIUM**  
MORTGAGE INVESTMENT  
CORPORATION

**CONDENSED INTERIM STATEMENTS OF FINANCIAL POSITION**  
**(UNAUDITED)**

(Expressed in Canadian dollars)	<u>Notes</u>	<u>March 31</u> <u>2014</u>	<u>December 31</u> <u>2013</u>
<b>Assets</b>			
Mortgages receivable	5	\$ 344,301,413	\$ 281,708,139
Prepaid expenses		<u>299,210</u>	<u>272,615</u>
		<u>\$ 344,600,623</u>	<u>\$ 281,980,754</u>
<b>Liabilities</b>			
Bank indebtedness	6	\$ 203,586	\$ 325,930
Operating line	6	67,600,000	35,910,000
Accounts payable and accrued liabilities		472,978	459,209
Accrued convertible debenture interest		600,815	–
Dividends payable	7	1,452,080	2,473,437
Due to related party	8	214,781	182,437
Convertible debentures	9	<u>60,811,555</u>	<u>30,610,763</u>
		<u>131,355,795</u>	<u>69,961,776</u>
<b>Shareholders' equity</b>			
Share capital		211,189,916	210,659,880
Contributed surplus and other equity		956,396	898,827
Equity component of convertible debentures		550,280	397,539
Retained earnings		<u>548,236</u>	<u>62,732</u>
		<u>213,244,828</u>	<u>212,018,978</u>
		<u>\$ 344,600,623</u>	<u>\$ 281,980,754</u>

*Commitments* 5, 6

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

Approved on behalf of the board of directors:

“Rob Goodall”  
Rob Goodall, Director

“Mark Silver”  
Mark Silver, Director

**CONDENSED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****(UNAUDITED)****(Expressed in Canadian dollars)**

	<b>Notes</b>	<b>Common shares</b>		<b>Contributed surplus and other equity</b>	<b>Equity component of convertible debentures</b>	<b>Retained earnings</b>	<b>Total</b>
		<b>Number</b>	<b>Amount</b>				
Balance, December 31, 2012		21,078,537	\$ 209,383,307	\$ 693,199	\$ –	\$ 33,419	\$ 210,109,925
Shares issued under dividend reinvestment plan	10	24,068	258,759	–	–	–	258,759
Share-based payments	11	–	–	36,132	–	–	36,132
Earnings and comprehensive income		–	–	–	–	4,189,667	4,189,667
Dividends declared	7	–	–	–	–	(4,218,664)	(4,218,664)
Balance, March 31, 2013		21,102,605	209,642,066	729,331	–	4,422	210,375,819
Shares issued under dividend reinvestment plan		92,697	958,720	–	–	–	958,720
Shares issued under employee share purchase plan		3,328	34,921	–	–	–	34,921
Shares issued under deferred share incentive plan		2,203	24,173	(24,183)	–	–	(10)
Share-based payments		–	–	168,116	–	–	168,116
Shares subscribed		–	–	25,563	–	–	25,563
Equity component of convertible debentures issued	9	–	–	–	418,606	–	418,606
Issue costs attributable to equity component of convertible debentures issued	9	–	–	–	(21,067)	–	(21,067)
Earnings and comprehensive income		–	–	–	–	13,810,221	13,810,221
Dividends declared		–	–	–	–	(13,751,911)	(13,751,911)
Balance, December 31, 2013		21,200,833	210,659,880	898,827	397,539	62,732	212,018,978
Shares issued under dividend reinvestment plan	10	46,849	504,473	–	–	–	504,473
Shares issued under employee share purchase plan	10	2,368	25,563	(25,563)	–	–	–
Share-based payments	11	–	–	62,071	–	–	62,071
Shares subscribed	10	–	–	21,061	–	–	21,061
Equity component of convertible debentures issued	9	–	–	–	160,549	–	160,549
Issue costs attributable to equity component of convertible debentures issued	9	–	–	–	(7,808)	–	(7,808)
Earnings and comprehensive income		–	–	–	–	4,837,933	4,837,933
Dividends declared	7	–	–	–	–	(4,352,429)	(4,352,429)
Balance, March 31, 2014		21,250,050	\$ 211,189,916	\$ 956,396	\$ 550,280	\$ 548,236	\$ 213,244,828

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

**CONDENSED INTERIM STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME  
(UNAUDITED)**

(Expressed in Canadian dollars)	<u>Notes</u>	<u>Three months ended March 31</u>	
		<u>2014</u>	<u>2013</u>
<b>Revenues</b>			
Mortgage interest and fees		\$ 7,644,818	\$ 5,089,468
<b>Operating expenses</b>			
Mortgage servicing and management fees	8	716,702	518,005
Transfer agent, regulatory fees and investor relations		87,694	85,800
Share-based payments	8, 11	62,071	36,132
Audit and legal fees		38,867	83,632
Directors' fees	8	43,750	28,454
Administration and general		26,099	18,356
Provision for mortgage losses	5	464,347	—
		<u>1,439,530</u>	<u>770,379</u>
Income before financing costs		<u>6,205,288</u>	<u>4,319,089</u>
<b>Financing costs</b>			
Interest on convertible debentures		705,562	—
Interest and other bank charges		661,793	129,422
		<u>1,367,355</u>	<u>129,422</u>
Earnings and comprehensive income for the period		<u>\$ 4,837,933</u>	<u>\$ 4,189,667</u>
Earnings per common share			
Basic	12	<u>\$ 0.23</u>	<u>\$ 0.20</u>
Diluted	12	<u>\$ 0.23</u>	<u>\$ 0.20</u>

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

**CONDENSED INTERIM STATEMENTS OF CASH FLOWS  
(UNAUDITED)**

(Expressed in Canadian dollars)	<b>Three months ended March 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash provided by (used in):</b>		
<b>Operating activities</b>		
Earnings and comprehensive income for the period	\$ 4,837,933	\$ 4,189,667
Add (subtract) non-cash items		
Share-based payments	62,071	36,132
Interest capitalized on mortgages	(1,217,708)	(656,457)
Amortization of mortgage discount	(51,548)	(48,942)
Amortization of mortgage origination fees	(242,066)	(167,489)
Non-cash portion of interest on convertible debentures	99,114	–
Provision for mortgage losses	464,347	–
	<u>3,952,143</u>	<u>3,352,911</u>
Changes in operating assets and liabilities		
Accrued interest receivable	(116,864)	(770,732)
Accounts receivable	–	(164,375)
Prepaid expenses	(26,595)	(22,230)
Accounts payable and accrued liabilities	13,769	(167,550)
Accrued convertible debenture interest	600,815	–
Additions to mortgage origination fees	420,278	280,451
	<u>891,403</u>	<u>(844,436)</u>
Cash provided by operating activities	<u>4,843,546</u>	<u>2,508,475</u>
<b>Investing activities</b>		
Advances of mortgages receivable	(95,987,564)	(47,373,736)
Repayment of mortgages receivable	34,137,851	26,162,219
Cash used by investing activities	<u>(61,849,713)</u>	<u>(21,211,517)</u>
<b>Financing activities</b>		
Bank indebtedness, net	(122,344)	51,148
Operating line advanced	161,755,000	38,377,000
Operating line repaid	(130,065,000)	(26,160,000)
Increase (decrease) in due to related party	32,344	186,382
Shares subscribed	21,061	–
Issuance of common shares	504,473	258,759
Issuance of convertible debentures	31,801,000	–
Convertible debenture issue costs	(1,546,581)	–
Dividends paid	(5,373,786)	(4,638,630)
Cash provided by financing activities	<u>57,006,167</u>	<u>8,074,659</u>
Increase (decrease) in cash	–	(10,628,383)
Cash, beginning of period	<u>–</u>	<u>10,628,383</u>
Cash, end of period	<u>\$ –</u>	<u>\$ –</u>
<b>Cash provided by operating activities includes:</b>		
Interest received	\$ 6,016,631	\$ 3,613,847
Interest paid	\$ 607,771	\$ 130,244

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

## 1. NATURE OF OPERATIONS

Atrium Mortgage Investment Corporation is a corporation domiciled in Canada, incorporated under the Ontario *Business Corporations Act*. The address of the company's registered head office and principal place of business is Suite 900, 20 Adelaide Street East, Toronto, Ontario M5C 2T6.

The company is a Mortgage Investment Corporation (MIC) as defined in Section 130.1(6) of the Canada *Income Tax Act* (ITA). Accordingly, the company is not taxed on income provided that its taxable income is paid to its shareholders in the form of dividends within 90 days after December 31 each year. Such dividends are generally treated by shareholders as interest income, so that each shareholder is in the same position as if the mortgage investments made by the company had been made directly by the shareholder.

The company's common shares are listed on the Toronto Stock Exchange (TSX) under the symbol "AI" and its convertible debentures are listed under the symbol "AI.DB" and "AI.DB.A".

## 2. BASIS OF PRESENTATION

### (a) Statement of compliance

These condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and follow International Accounting Standard 34 *Interim Financial Reporting* (IAS 34) as issued by the International Accounting Standards Board (IASB). These condensed interim financial statements should be read in conjunction with the company's audited financial statements for the year ended December 31, 2013. In particular, the company's significant accounting policies as presented in Note 3 of the financial statements for the year ended December 31, 2013, have been consistently applied in the preparation of these condensed interim financial statements. These condensed interim financial statements were authorized for issuance by the board of directors on April 24, 2014.

### (b) Basis of measurement

These condensed interim financial statements are prepared on the historical cost basis.

### (c) Functional and presentation currency

These condensed interim financial statements are presented in Canadian dollars, which is also the company's functional currency.

### (d) Use of estimates and judgements

The preparation of condensed interim financial statements in accordance with IFRS requires management to make estimates, assumptions and judgements that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the reporting date and the reported amounts of revenue and expenses during the reporting period. The most subjective of these estimates relates to: (a) valuation of mortgages receivable, which is affected primarily by the provision for mortgage losses which is determined by management's estimate as to the required general and specific provisions; and (b) the measurement of the liability and equity components of the convertible debentures which depend upon the estimated market interest rates for a comparable debenture without the convertibility feature. Management believes that its estimates are appropriate; however, actual results could differ from the amounts estimated. Estimates and underlying assumptions are reviewed each quarter. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The company's accounting policies and its standards of financial disclosure set out below are in accordance with IFRS and have been applied consistently.

#### (a) Revenue recognition

Mortgage interest and fees revenue are recognized in the statement of earnings and comprehensive income using the effective interest method. Mortgage interest and fees revenue includes the company's share of any fees received, as well as the effect of any discount or premium on the mortgage.

The effective interest method derives the interest rate that discounts the estimated future cash payments and receipts during the expected life of the mortgage receivable (or, where appropriate, a shorter period) to its carrying amount. When calculating the effective interest rate, future cash flows are estimated considering all contractual terms of the financial instrument, but not future credit losses (see note 3 (c)). The calculation of the effective interest rate includes all fees and transaction costs paid or received. Transaction costs include incremental costs that are directly attributable to the acquisition or issuance of the mortgage.

#### (b) Financial assets – classification, recognition and measurement

Classification of financial assets depends on the purpose for which the financial assets were acquired. Management determines the classification of financial assets at initial recognition. All of the company's financial assets are classified as loans and receivables.

All financial assets are subject to review for impairment quarterly, and written down when there is evidence of impairment.

##### *Loans and receivables*

###### *Classification*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Assets in this category consist of mortgages receivable.

###### *Recognition and measurement*

Loans and receivables are initially recognized at fair value plus transaction costs and subsequently carried at amortized cost using the effective interest method. At each reporting date, management considers whether any reserves for credit impairment or due to changes in market interest rates are required.

#### (c) Mortgages receivable

A mortgage receivable, carried at amortized cost, is considered impaired when there is objective evidence that there has been a deterioration of credit quality subsequent to its initial recognition to the extent that the company no longer has reasonable assurance as to the timely collection of the full amount of principal and interest. The company assesses mortgages receivable for objective evidence of impairment both individually and collectively. The specific and general provisions for mortgage losses are determined by taking into account the following factors:

- Delays in the collection of interest and principal
- The point at which management considers a loan to be in default (which is defined as 90 days for single family residence mortgages and 30 days for all other mortgages)
- Other known factors specific to the property, the borrower or the guarantor
- Economic and other real estate market conditions in the geographic area in which a borrower's project is located
- Management's judgement as to whether current economic and credit conditions are such that the inchoate or potential losses at the reporting date are likely to be higher or lower than the amounts suggested by historic experience
- Any other factors that apply to a particular mortgage or group of mortgages

### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (c) Mortgages receivable (continued)

Several of these factors above involve estimates and judgements on the part of management in determining provisions for mortgage losses. The other key estimates used for quantifying the specific and general provisions for mortgage losses are:

- The period of time expected to elapse between the contractual maturity or interest and principal repayment dates and the date at which recovery is estimated
- The amount expected to be ultimately recovered on impaired loans, taking into account the probability of different outcomes, where necessary
- The value of underlying security, and whether Atrium expects to take possession of the property
- The amount of any legal and other third party costs estimated to be incurred

Provisions for mortgage losses represents management's best estimate of impairment of mortgages receivable at each reporting date. Judgement is required as to the timing of designating a mortgage as impaired and the amount of any provision required which is reported as a specific provision. If there is no objective evidence of impairment for an individual mortgage receivable, it is included in a group of mortgages with similar credit risk characteristics and collectively assessed for impairment for losses incurred but not identified, and reported as a general provision. For the purpose of determining the group of mortgages with similar credit characteristics, we group mortgages by their mortgage category: commercial/mixed use, house and apartment, low rise residential, high rise residential, construction, mid-rise residential, and other.

The company reviews mortgages receivable quarterly for impairment. An impairment loss is calculated as the difference between the carrying amount of the mortgage receivable and the present value of the estimated future cash flows discounted at the original effective interest rate. Losses are charged to the statements of earnings and comprehensive income and are reflected in the provision for mortgage losses.

#### (d) Convertible debentures

The convertible debentures can be converted into common shares of the company at the option of the investor. They are compound financial instruments with two components: a financial liability, and a call option which is an equity instrument. The fair value of the liability component is measured as of the date that the debentures were issued, and the equity instrument is valued on that date based upon the difference between the fair value of the convertible debenture and the fair value of the liability component. The measurement of the fair value of the liability component is based upon market rates of interest on similar debt instruments without the conversion feature. Expenses of issue are allocated between the two components on a pro-rata basis. The book value of the debt is accreted up to its face value over the life of the debentures using the effective interest method, which provides for the application of a constant interest rate over the life of the debenture. The value of the equity component is not remeasured subsequent to its initial measurement date.

#### (e) Other financial liabilities

Other financial liabilities are non-derivative liabilities recognized initially at fair value, net of transaction costs, and are subsequently stated at amortized cost using the effective interest method. The company has classified bank indebtedness, operating line, accounts payable and accrued liabilities, dividends payable, due to related party and the liability component of convertible debentures as other financial liabilities.

#### (f) Income taxes

The company qualifies as a Mortgage Investment Corporation under the ITA, and as such is not taxed on income provided that its taxable income is distributed to its shareholders in the form of dividends within 90 days after December 31 each year. It is the company's policy to pay such dividends to remain non-taxable. Accordingly, no provision for current or future income taxes is required.



**3. SIGNIFICANT ACCOUNTING POLICIES (continued)****(g) Earnings per common share**

Basic earnings per common share is calculated by dividing earnings during the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting the earnings attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive items such as convertible debentures and deferred share incentive plans.

**(h) Share-based payments**

The company has an equity-settled share-based compensation plan for grants to eligible directors, officers, and senior management under its deferred share incentive plan. Grants are measured based upon the fair value of the awards granted, based on the volume weighted average trading share price for the five trading days prior to date of the grant.

**4. RECENT ACCOUNTING PRONOUNCEMENTS**

Certain pronouncements have been issued by the IASB (International Accounting Standards Board) or IFRIC (IFRS Interpretations Committee) that will be effective for future accounting periods. Many of these are not applicable to the company and so are not listed below. A brief summary of the new standard follows.

IFRS 9 – Financial Instruments: Classification and measurement is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 has two measurement categories: amortized cost and fair value. All equity instruments are measured at fair value. A debt instrument is recorded at amortized cost only if the entity is holding the instrument to collect contractual cash flows and the cash flows represent principal and interest. Otherwise it is recorded at fair value through profit or loss. The effective date of the new standard has tentatively been set to be effective for our year ended December 31, 2018. The potential impact of the new standard on the company's financial statements is in the process of being analyzed.

**5. MORTGAGES RECEIVABLE****(a) Mortgage portfolio**

<b>Mortgage category</b>	<b>March 31, 2014</b>			<b>December 31, 2013</b>		
	<b>Number</b>	<b>Outstanding amount</b>	<b>% of Portfolio</b>	<b>Number</b>	<b>Outstanding amount</b>	<b>% of Portfolio</b>
Commercial/mixed use	30	117,974,716	34.2%	27	89,475,297	31.7%
House and apartment	66	80,687,198	23.4%	59	69,484,828	24.6%
Low rise residential	18	74,938,928	21.7%	17	58,465,947	20.7%
High rise residential	5	33,236,336	9.6%	5	32,966,568	11.7%
Construction	12	28,179,028	8.2%	9	22,093,399	7.8%
Midrise residential	3	7,440,000	2.2%	3	7,440,000	2.6%
Condominium corporation	11	2,390,306	0.7%	11	2,433,526	0.9%
Mortgage portfolio	<u>145</u>	<u>344,846,512</u>	<u>100.0%</u>	<u>131</u>	<u>282,359,565</u>	<u>100.0%</u>
Accrued interest receivable		1,679,037			1,562,173	
Mortgage discount		(286,931)			(338,480)	
Mortgage origination fees		(902,664)			(724,452)	
Provision for mortgage losses		(1,034,540)			(1,150,667)	
Mortgages receivable		<u>\$ 344,301,414</u>			<u>\$281,708,139</u>	

The aggregate portfolio has a weighted average effective interest rate (which includes lender fees paid to the company) of 9.28% (December 31, 2013 – 9.35%) and maturity dates between 2014 and 2024 with a weighted average term to maturity of 14.8 months at March 31, 2014 (December 31, 2013 – 13.5 months).

**5. MORTGAGES RECEIVABLE (continued)****(b) Provision for mortgage losses**

	<u>March 31, 2014</u>	<u>December 31, 2013</u>
Specific provision	\$ –	\$ 590,593
General provision	<u>1,034,540</u>	<u>560,074</u>
Provision for mortgage losses	<u>\$ 1,034,540</u>	<u>\$ 1,150,667</u>

**Three months ended March 31, 2014**

	<u>Specific provision</u>	<u>General provision</u>	<u>Total</u>
Balance, beginning of period	\$ 590,593	\$ 560,074	\$ 1,150,667
Mortgage settled during the period	(580,474)	–	(580,474)
Released to general provision	(10,119)	10,119	–
Increase in general provision for the period	–	<u>464,347</u>	<u>464,347</u>
Balance, end of period	<u>\$ –</u>	<u>\$ 1,034,540</u>	<u>\$ 1,034,540</u>

**Three months ended March 31, 2013**

	<u>Specific provision</u>	<u>General provision</u>	<u>Total</u>
Balance, beginning of period	\$ 527,593	\$ 560,074	\$ 1,087,667
Balance, end of period	<u>\$ 527,593</u>	<u>\$ 560,074</u>	<u>\$ 1,087,667</u>

Three mortgages are in default at March 31, 2014 (two mortgages were in default at December 31, 2013, one of which was subsequently settled). Management does not expect to incur losses on the mortgages in default at March 31, 2014 taking into account market conditions, the value of real property securing the mortgages, and other factors. The increase in the general provision for mortgage losses during the period is based upon management's assessment of factors described in note 3(c).

**(c) Commitments**

The company has committed to advance additional funds under existing mortgages aggregating \$70,811,555 and new mortgages aggregating \$12,651,000 at March 31, 2014 (December 31, 2013 – \$51,436,540, \$46,727,500). Generally, outstanding commitments are expected to be funded within the next 24 months. However, the experience of the company has been that a portion of the unfunded amounts on existing mortgages will never be drawn.

Principal repayments based on contractual maturity dates are as follows:

Nine months ended December 31,	2014	\$ 107,911,355	31.3%
Years ended December 31,	2015	127,419,504	36.9%
	2016	93,352,790	27.1%
	2017	13,940,495	4.1%
	2018	64,449	0.0%
	Thereafter	<u>2,157,919</u>	<u>0.6%</u>
		<u>\$ 344,846,512</u>	<u>100.0%</u>

Of the principal repayments due in the nine month period ended December 31, 2014, between April 1 and April 24, 2014, \$5,818,000 have been renegotiated in the normal course of business to be due in the year ended 2015.

## 6. CREDIT FACILITY

At March 31, 2014, the company had a credit facility from a syndicate of two Canadian financial institutions of \$80,000,000 (December 31, 2013 – \$80,000,000). Drawings under the credit facility may be by way of a bank loan (including an overdraft of up to \$500,000), bankers' acceptances or letters of credit (LCs). The committed credit facility was effective October 10, 2013, has a term of one year, and is subject to certain conditions of drawdown and other covenants.

On January 31, 2014, the company obtained a \$30 million short-term increase in its operating credit facility, which was cancelled February 27, 2014 subsequent to issuance of convertible debentures (see Note 9 – Convertible debentures). On April 21, 2014, the company obtained a \$30 million short-term increase in its operating credit facility; any amounts drawn thereunder are to be repaid on the earlier of July 21, 2014 and the closing of any public equity or convertible debt issuance by the company (see Note 16 – Subsequent events).

The credit facility is secured by a lien over all of the company's assets by means of a general security agreement. The amount that may be drawn down under the credit facility is determined by the aggregate value of mortgages that are acceptable to the lender. Under the terms of the credit facility, covenants must be met in respect of shareholders' equity, debt to total assets and interest coverage. At March 31, 2014 and December 31, 2013, the company was in compliance with these covenants.

Under the credit facility, LCs committed to clients outstanding at March 31, 2014 aggregate \$2,679,631 (December 31, 2013 – \$2,679,631). The LCs reduce the maximum availability under the credit facility by the amounts drawn. LCs represent irrevocable assurances that the company's bank will make payments in the event that a customer cannot meet its obligations to third parties. LCs carry the same credit risk, recourse and collateral security requirements as mortgages extended to customers.

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Credit facility</b>		
Bankers' acceptances	56,000,000	\$ 20,000,000
Bank loan	<u>11,600,000</u>	<u>15,910,000</u>
Operating line	67,600,000	35,910,000
Bank indebtedness	<u>203,586</u>	<u>325,930</u>
Total borrowing under credit facility	67,803,586	36,235,930
Letters of credit	<u>2,679,631</u>	<u>2,679,631</u>
Total credit facility utilization	<b><u>\$ 70,483,217</u></b>	<b><u>\$ 38,915,561</u></b>

## 7. DIVIDENDS

The company follows a dividend policy so that it is non-taxable under the provisions of the *Income Tax Act* related to Mortgage Investment Corporations. Dividends aggregated \$0.205 per share for the three months ended March 31, 2014 (three months ended March 31, 2013 – \$0.200).

	<b>Three months ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Dividends payable, beginning of the period	\$ 2,473,437	\$ 1,826,813
Dividends declared	4,352,429	4,218,664
Dividends paid	<u>(5,373,786)</u>	<u>(4,638,630)</u>
Dividends payable, end of period	<b><u>\$ 1,452,080</u></b>	<b><u>\$ 1,406,847</u></b>

**8. RELATED PARTY TRANSACTIONS**

The company pays management and mortgage servicing fees to Canadian Mortgage Servicing Corporation (“CMSC”), a subsidiary of Canadian Mortgage Capital Corporation (“CMCC”) the manager of the company, which is responsible for the day to day management of the company. The majority beneficial owner and CEO of the manager is also CEO of the company. The company incurred management and mortgage servicing fees from CMSC of \$712,555 for the period ended March 31, 2014 (March 31, 2013 – \$515,149). The management agreement between the company and CMCC contains provisions for the payment of termination fees to the manager in the event that the management agreement is terminated in certain circumstances. Unpaid amounts are in the normal course of business, non-interest bearing and due on demand. Balances due to related parties are due to CMCC and its subsidiaries and were paid within 30 days of each period end.

Guarantees aggregating \$4,542,000 at March 31, 2014 (December 31, 2013 – \$4,542,000) have been provided on mortgages owned by the company from a major development company of which one of the directors of the company is a director and officer. All of these loans are in good standing.

Key management includes directors and officers of the company. Compensation expenses for key management personnel include:

	<b>Three months ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Directors’ fees	\$ 43,750	\$ 28,454
Share-based payments to directors (note 11)	25,201	17,646
Share-based payments to officers (note 11)	<u>26,012</u>	<u>18,486</u>
	<u>\$ 94,963</u>	<u>\$ 64,586</u>

Related party transactions are recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

**9. CONVERTIBLE DEBENTURES**

	<b>Three months ended March 31, 2014</b>		
	<b>Convertible debenture 6.25%</b>	<b>Convertible debenture 5.25%</b>	<b>Total</b>
Maturity date	March 31, 2019	June 30, 2020	<u>          </u>
Convertible debentures, beginning of period	\$ –	\$ 30,610,763	\$ 30,610,763
Issued	31,801,000	–	31,801,000
Equity component	(160,549)	–	(160,549)
Issue costs	(1,546,581)	–	(1,546,581)
Issue costs attributed to equity component	<u>7,808</u>	<u>–</u>	<u>7,808</u>
Convertible debentures	30,101,678	30,610,763	60,712,441
Accretion for the period	<u>28,525</u>	<u>70,589</u>	<u>99,114</u>
Convertible debentures, end of period	<u>\$ 30,130,203</u>	<u>\$ 30,681,352</u>	<u>\$ 60,811,555</u>

**9. CONVERTIBLE DEBENTURES (continued)**

	<u>Year ended December 31, 2013</u>	
	<u>Convertible debenture 5.25%</u>	<u>Total</u>
Maturity date	June 30, 2020	
Convertible debentures, beginning of period	\$ –	\$ –
Issued	32,500,000	32,500,000
Equity component	(418,606)	(418,606)
Issue costs	(1,640,544)	(1,640,544)
Issue costs attributed to equity component	<u>21,067</u>	<u>21,067</u>
Convertible debentures	30,461,917	30,461,917
Accretion for the period	<u>148,846</u>	<u>148,846</u>
Convertible debentures, end of period	<u>\$ 30,610,763</u>	<u>\$ 30,610,763</u>

During the quarter, the company completed a public offering of \$30,000,000 and an overallotment option of \$1,801,000 that were closed February 27, 2014 and March 5, 2014, respectively, of 6.25%, unsecured convertible debentures due March 31, 2019. The interest on the debentures is payable on March 31 and September 30 each year. Debentures are convertible into common shares at the option of the holder at any time prior to their maturity at a conversion price of \$13.30 per share, subject to various adjustments in accordance with the trust indenture. The debentures may not be redeemed by the company before March 31, 2017. After March 31, 2017 and prior to March 31, 2018, the debentures may be redeemed, in whole or in part, from time to time at the company's option at par plus accrued interest provided that the weighted average trading price of the common shares is not less than 125% of the conversion price. After March 31, 2018, the company may, at its option, redeem the debentures, in whole or in part, at par plus accrued and unpaid interest.

On issuance, the company recorded a liability of \$30,101,678, net of equity component of \$160,549, total issue costs of \$1,546,581 and issue costs attributable to debt of \$1,538,773.

**10. SHARE CAPITAL**

The company is authorized to issue an unlimited number of common shares without par value. Common shares rank equally with each other and have no preference, conversion, exchange or redemption rights. Common shares participate pro rata with respect to any dividends paid, including distributions upon termination and dissolution.

The company has an optional dividend reinvestment plan (DRIP) for shareholders, whereby participants may reinvest cash dividends in additional common shares of the company at the volume weighted average price for five days prior to distribution, less a 2% discount. Shares issued under the DRIP are issued by the company from treasury.

Under the employee share purchase plan (ESPP), each participant may contribute up to an annual maximum to the ESPP, and CMCC (the manager) will match 50% of the participant's contribution. Thus, the company does not bear any of the cost of the ESPP, but is reimbursed by CMCC and the participants. As at March 31, 2014, 1,888 common shares had been subscribed for aggregating \$21,061 but were unissued.

**10. SHARE CAPITAL (continued)**

	<b>Common shares</b>	
	<b>Number</b>	<b>Amount</b>
<b>Three months ended March 31, 2014</b>		
Shares issued –		
ESPP, January 1, 2014	2,368	25,563
DRIP, January 14, 2014	12,543	130,828
DRIP, February 13, 2014	12,859	133,995
DRIP, March 5, 2014	8,841	98,582
DRIP, March 13, 2014	12,606	141,068
Total shares issued in period	<u>49,217</u>	<u>\$ 530,036</u>
DRIP	46,849	504,473
ESPP	2,368	25,563
Total shares issued in period	<u>49,217</u>	<u>\$ 530,036</u>
<b>Three months ended March 31, 2013</b>		
Shares issued –		
DRIP, January 29, 2013	6,580	\$ 70,801
DRIP, February 26, 2013	6,814	73,732
DRIP, March 21, 2013	1,785	19,106
DRIP, March 27, 2013	8,889	95,120
Total shares issued in period	<u>24,068</u>	<u>\$ 258,759</u>
DRIP	24,068	258,759
Total shares issued in period	<u>24,068</u>	<u>\$ 258,759</u>

There were no issue costs for common shares issued during the periods ended March 31, 2014 and 2013.

**11. SHARE-BASED PAYMENTS**

	<b>August 30, 2013 grant</b>	<b>August 29, 2012 grant</b>	<b>Total</b>
Deferred shares granted	\$ 23,000	\$ 21,500	\$ 44,500
Value of grant	232,900	236,500	469,400
Income deferred shares issuable	–	740	740
Share compensation expense:			
Period ended March 31, 2014	41,625	20,446	62,071
Period ended March 31, 2013	–	36,132	36,132
	<u>\$ 41,625</u>	<u>\$ 56,578</u>	<u>\$ 98,203</u>

Grants are provided to certain directors and employees under the company's deferred share incentive plan. The deferred share units vest annually over three years. Common shares are issued to participants on the vesting date of each tranche of deferred share units, unless a participant elects to defer the issuance. In addition, income deferred share units are credited to holders of deferred share units based upon dividends paid on common shares. The fair value of share-based compensation was based upon the volume weighted average market price of the common shares five days prior to the grant date of \$10.13 (August 30, 2013) and \$11.00 (August 29, 2012).

**12. EARNINGS PER SHARE**

	<b>Three months ended March 31,</b>	
	<b><u>2014</u></b>	<b><u>2013</u></b>
Basic earnings per share –		
Numerator		
Earnings for the period	\$ 4,837,933	\$ 4,189,667
Denominator		
Weighted average common shares outstanding	<u>21,227,782</u>	<u>21,086,089</u>
Basic earnings per share	<u>\$ 0.23</u>	<u>\$ 0.20</u>
	<b><u>2014</u></b>	<b><u>2013</u></b>
Diluted earnings per share –		
Numerator		
Earnings for the period	\$ 4,837,933	\$ 4,189,667
Interest on convertible debentures	<u>705,562</u>	<u>–</u>
Earnings for diluted earnings per share	<u>5,543,495</u>	<u>4,189,667</u>
Denominator		
Weighted average common shares outstanding	21,227,782	21,068,089
Convertible debentures	3,248,533	–
Deferred share incentive plan	42,500	21,890
Income deferred share units	<u>3,121</u>	<u>–</u>
Weighted average common shares outstanding – diluted basis	<u>24,521,936</u>	<u>21,107,979</u>
Diluted earnings per share	<u>\$ 0.23</u>	<u>\$ 0.20</u>

**13. FINANCIAL INSTRUMENTS****(a) Classification of financial instruments**

Financial assets comprise mortgages receivable. All financial assets are classified as loans and receivables. Financial liabilities comprise bank indebtedness, operating line, accounts payable and accrued liabilities, dividends payable, due to related party and the liability component of convertible debentures. All financial liabilities are classified as other financial liabilities.

**(b) Fair value**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between arm's length market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data or other means.
- Level 3 inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. All financial assets are classified as loans and receivables and are recorded at amortized cost. Their carrying values approximate their fair value due to their relatively short-term maturities and because market interest rates have not fluctuated significantly since the date at which the loans were entered into. The fair value of the operating line approximates book value since it bears interest at floating rates. Mortgages receivable mature between 2014 and 2024 with a weighted average term to maturity at March 31, 2014 of 14.8 months (December 31, 2013 – 13.5 months). Fair value of mortgages receivable is established by level 3 inputs.

The fair value of convertible debentures is established using level 1 inputs. Other financial liabilities are established using level 3 inputs. The fair value of convertible debentures has been determined based on the closing prices of the convertible debentures on the TSX on the respective dates.

**13. FINANCIAL INSTRUMENTS (continued)****(b) Fair value (continued)**

<b>Convertible debentures</b>	<u><b>March 31, 2014</b></u>	<u><b>December 31, 2013</b></u>
Fair value	\$ 64,604,785	\$ 30,225,000
Less book value of equity component	<u>(550,280)</u>	<u>(397,539)</u>
	<u><u>\$ 64,054,505</u></u>	<u><u>\$ 29,827,461</u></u>
Book value	<u><u>\$ 60,811,555</u></u>	<u><u>\$ 30,610,763</u></u>

**(c) Credit risk**

The following asset is exposed to credit risk: mortgages receivable. Credit risk is the risk that a counterparty to a financial instrument will fail to discharge its obligation or commitment, resulting in a financial loss to the company.

The company controls the credit risk of mortgages receivable by maintaining strict credit policies including due diligence processes, credit limits, and documentation requirements, review and approval of new mortgages by the board of directors or a subgroup thereof, quarterly review of the entire portfolio by the board of directors, and other credit policies approved by the board of directors. Credit risk is approved by the board of directors. No single borrower accounts for more than 12.1% (December 31, 2013 – 14.6%) of mortgages receivable.

**(d) Liquidity risk**

Liquidity risk is the risk that the company will not be able to meet its obligations when due. The primary sources of liquidity risk are the requirements to fund commitments for new mortgages, advances on existing mortgages, as well as obligations under the company's credit facility. The company's liquidity risk is managed on an ongoing basis by CMCC in accordance with the policies and procedures in place that reduce the risk to an acceptable level. The company's significant financial liabilities include bank indebtedness, operating line, accounts payable and accrued liabilities, dividends payable, due to related party and liability component of convertible debentures. The bank indebtedness and operating line are drawn upon as required to discharge accounts payable and accrued liabilities as well as to pay out dividends on a monthly basis. The company's agreement with the lender is that the operating line will not be called provided that all covenants are met and that any significant excess cash is used to pay down the bank loan and indebtedness.

As at March 31, 2014, management considers that the company does not have significant exposure to liquidity risk as the credit facility is not fully utilized and the company is in compliance with all covenants.

<u><b>Obligations at March 31, 2014</b></u>	<u><b>Total</b></u>	<u><b>Less than 1 year</b></u>	<u><b>1-2 years</b></u>	<u><b>3-7 years</b></u>
Bank indebtedness	\$ 203,586	\$ 203,586	\$ –	\$ –
Operating line	67,600,000	67,600,000		
Accounts payable and accrued liabilities	477,978	477,978	–	–
Accrued convertible debentures interest	600,815	600,815		
Dividends payable	1,452,080	1,452,080	–	–
Due to related party	214,781	214,781	–	–
Convertible debentures	<u>60,811,555</u>	<u>–</u>	<u>–</u>	<u>60,811,555</u>
Total	<u><u>\$ 131,355,795</u></u>	<u><u>\$ 70,544,240</u></u>	<u><u>\$ –</u></u>	<u><u>\$ 60,811,555</u></u>



**13. FINANCIAL INSTRUMENTS (continued)****(e) Interest rate risk**

The company is exposed to interest rate risk in that an increase in interest rates will result in increased interest expense due to its operating line and indebtedness being set at a variable rate but all mortgages being set at fixed rates. The financial structure of the company results in relatively moderate interest rate risk because most of the company's financing is through common shares and convertible debentures, with a moderate amount of borrowings under the credit facility that bear floating interest rates.

If interest rates on debt had been one percentage point higher (lower) during the quarter ended March 31, 2014, earnings would have been reduced (increased) by approximately \$620,000 during the quarter, assuming that no changes had been made to the interest rates at which new mortgage loans were entered into. However, if new mortgage loans had been entered into at higher (lower) interest rates, the resulting reduction of earnings would have been less than (greater than) \$620,000.

**(f) Currency risk**

Currency risk is the risk that the value of financial assets and liabilities will fluctuate due to changes in foreign exchange rates. The company is not currently exposed to significant currency risk as all assets and liabilities are denominated in Canadian funds.

**(g) Changes to risk exposure and management of risk exposure**

During the quarter ended March 31, 2014, the company issued 6.25% convertible debentures with a face value of \$31,801,000 (see note 9), which had the effect of altering its risk exposure profile to be less sensitive to changes in general market interest rates. The effect will be favourable if general interest rates increase, and adverse if general interest rates decline.

**14. CAPITAL MANAGEMENT**

The company defines capital as total debt plus shareholders' equity, as shown below:

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Bank indebtedness	\$ 203,586	\$ 325,930
Operating line	<u>67,600,000</u>	<u>35,910,000</u>
Total bank line	67,803,586	36,235,930
Convertible debentures	<u>60,811,555</u>	<u>30,610,763</u>
Total debt	128,618,141	66,846,693
Shareholders' equity	<u>213,244,828</u>	<u>212,018,978</u>
Capital employed	<u>\$ 341,859,969</u>	<u>\$ 278,865,671</u>

The company's objectives for managing capital are to:

- preserve shareholders' equity
- provide shareholders with stable dividends
- use leverage in a conservative manner to improve return to shareholders

The company manages capital by using conservative amounts of financial leverage to improve its return to shareholders. The company finances growth of its portfolio by issuing common shares and debt. In addition, a small amount of equity is raised every month through a dividend reinvestment plan for shareholders.

As bank borrowings increase, the company could expect to raise further funds through public offering of convertible debentures and/or common shares. The company's bank indebtedness, bankers' acceptances and bank loan are subject to external covenants as set out in note 6. There has been no change in the company's capital management objectives since the prior period.

**15. SUBSEQUENT EVENTS**

On April 1, 2014, the company issued 1,888 common shares subscribed for under the ESPP for proceeds of \$21,061.

On April 14, 2014, the company issued 13,287 common shares (\$145,630) under its dividend reinvestment plan.

On April 21, 2014, the company obtained a \$30 million short-term increase in its operating credit facility; any amounts drawn thereunder are to be repaid on the earlier of July 31, 2014 and the closing of any public equity or convertible debt issuance by the company.

Of the principal repayments due in the nine month period ended December 31, 2014, between April 1 and April 24, 2014, \$5,818,000 have been renegotiated to be due in the year ended 2015.

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