MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of February 28, 2023. This discussion should be read in conjunction with the audited consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2022. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These other measures, such as "Pre-FMV Income" and "After-tax Pre-FMV Dividend Payout Ratio", should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with IFRS as an indicator of performance or as a measure of liquidity and cash flow. These measures do not have standard meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Company is available in First National Financial Corporation's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

General Description of the Company

First National Financial Corporation is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With more than $131 billion in mortgages under administration ("MUA"), First National is one of Canada's largest non-bank originators and underwriters of mortgages and is among the top three lenders in market share in the mortgage broker distribution channel.

2022 Results Summary

First National's performance in 2022 reflected rapidly changing market conditions, the result of abrupt increases in Bank of Canada (BoC) policy interest rate increases. With slowing housing activity across Canada, the Company's single-family origination was 17% lower year over year but about 44% ahead of 2019 (the most recent pre-pandemic period). Commercial segment originations increased by 1% on continued strength in its insured mortgage products. Total combined new origination was lower by 12% year over year. Mortgages Under Administration (MUA), the source of most of the Company's earnings, continued to grow and reached another record high. Operating profitability was lower as mortgage origination fell while headcount growth and inflationary pressures meant employee costs increased. The rapid pace of increases in short-term interest rates created gains on financial instruments but negatively affected the Company's securitization margins.

The following summarizes the performance of the Company's significant metrics:

- MUA grew to $131.0 billion at December 31, 2022 from $123.9 billion at December 31, 2021, an increase of 6%; the growth from September 30, 2022, when MUA was $129.3 billion, was 5% on an annualized basis.
- Total new single-family mortgage origination was $19.5 billion in 2022 compared to $23.4 billion in 2021, a decrease of 17%. The Company attributes this to a slowing real estate market together with a more competitive marketplace. Commercial segment origination of $9.6 billion was 1% lower than the $9.7 billion originated in 2021. Total new origination decreased by 12% in 2022 compared to 2021.
- The Company took advantage of available opportunities in the year to renew $6.8 billion of single-family mortgages, 8% higher than $6.3 billion a year ago. For the commercial segment, renewals were lower by 19% ($2.2 billion compared to $2.7 billion a year ago).
- Revenue for 2022 increased by 13% to $1.57 billion from $1.39 billion in 2021. This change was largely the result of higher interest rates. 2022 featured a rapidly rising interest rate environment with bond yields and mortgage rates increasing as monetary policy tightened to counteract inflation risks. These changes led to higher interest revenue earned on securitized mortgages, higher interest revenue earned on mortgages accumulated for securitization and higher interest earned on mortgage investments. These increases in revenue were partially offset by lower placement fees as residential origination volumes were lower by 17% comparing the two years.
- Income before income taxes was $269.1 million in 2022 compared to $263.8 million in 2021. The increase included the effect of changing capital market conditions in both years. Excluding gains and losses related to financial instruments, the Company's earnings before income taxes and gains and losses on financial instruments ("Pre-FMV Income" [(1)]) for 2022 decreased by 19% to $208.8 million from $257.3 million in 2021. This change was largely the result of a 17% drop in new residential origination and a competitive marketplace. As mortgage rates rose over the past nine months, housing transactions slowed across the country. With the ensuing competition from other lenders in a smaller market, the Company increased broker incentives to boost the referral of residential mortgage transactions. Together with tight funding spreads for securitized floating rate mortgages and employee head count at levels designed to underwrite higher volumes, profitability was lower.

In the fourth quarter of 2022, the Company's Board of Directors announced an increase to the regular monthly dividend to $2.40 per common share from $2.35 on an annualized basis, effective with the dividend paid on December 15, 2022.

(1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

Selected Quarterly Information

Quarterly Results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net Income for the Period	Pre-FMV Income for the Period (1)	Net Income per Common Share	Total Assets
2022					
Fourth quarter	$414,785	$42,669	$59,492	$0.70	$43,763,672
Third quarter	$392,413	$40,145	$48,219	$0.66	$42,392,225
Second quarter	$416,774	$61,281	$55,864	$1.01	$42,927,449
First quarter	$350,321	$53,637	$45,187	$0.88	$42,386,708
2021					
Fourth quarter	$339,292	$41,971	$57,045	$0.69	$42,274,158
Third quarter	$353,704	$47,614	$64,867	$0.78	$40,763,169
Second quarter	$365,118	$52,401	$71,218	$0.86	$41,727,249
First quarter	$336,492	$52,575	$64,146	$0.87	$40,586,601

Reconciliation of Quarterly Determination of Pre-FMV Income

($000s, except per share amounts)

	Income before income tax for the Period	Add/ deduct Realized and unrealized losses (gains)	Deduct (losses), add gains related to mortgage and loan investments	Pre-FMV Income for the Period (1)
2022				
Fourth quarter	$58,269	1,353	($130)	$59,492
Third quarter	$54,645	($5,846)	($580)	$48,219
Second quarter	$83,081	($27,217)	$—	$55,864
First quarter	$73,087	($27,900)	$—	$45,187
2021				
Fourth quarter	$57,111	$71	($137)	$57,045
Third quarter	$65,134	$383	($650)	$64,867
Second quarter	$70,101	$1,217	($100)	$71,218
First quarter	$71,475	($7,486)	$157	$64,146

(1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on mortgages pledged under securitization. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization, as well as mortgage rates. Recently MUA has increased, and revenue followed. Net income is partially dependent on conditions in bond markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the Company's core business. By removing this volatility and analyzing Pre-FMV Income, management believes a more appropriate measurement of the Company's performance can be assessed.

In the past eight quarters, the Company experienced a relatively volatile economic environment. 2021 began with strong origination and profit metrics as the pandemic-based era of low interest rates and wide spreads continued. Competition accelerated in mid 2021 on signs of an improving economy and a risk-on environment, such that over the final six months of 2021, spreads returned to pre-pandemic levels. Spread tightening reduced profitability for the Company in the third and fourth quarters of 2021 compared to the periods of exceptional profitability in most of 2020 and early 2021. To start 2022, the economic outlook was positive and there was a surplus of liquidity for investment in financial assets. However, late in the first quarter, risks associated with inflation became evident as wages and prices increased and companies competed for employees. The Bank of Canada moved quickly and continuously beginning on March 2, 2022, in an attempt to stem inflation and short-term interest rates rose by 400 basis points between March and December 2022. While spreads on new mortgage originations widened somewhat, the Company faced the headwinds of a slowing housing market, and strong competition for employees and customers such that it earned comparatively lower Pre-FMV income.

Outstanding Securities of the Corporation

At December 31, 2022, and February 28, 2023, the Corporation had 59,967,429 common shares; 2,984,835 Class A preference shares, Series 1; 1,015,165 Class A preference shares, Series 2; 200,000 November 2024 senior unsecured notes; and 200,000 November 2025 senior unsecured notes outstanding.

Selected Annual Financial Information and Reconciliation to Pre-FMV Income[(1)]

($000s, except per share amounts)

	2022	2021	2020
For the Year Ended December 31, Income Statement Highlights			
Revenue	1,574,293	1,394,606	1,380,294
Interest expense – securitized mortgages	(739,295)	(630,279)	(708,162)
Brokerage fees	(173,290)	(201,786)	(159,018)
Salaries, interest and other operating expenses	(392,626)	(298,720)	(254,385)
Add (deduct): realized and unrealized losses (gains) on financial instruments	(59,610)	(5,815)	67,355
Deduct: unrealized losses regarding mortgage investments	(710)	(730)	(3,076)
Pre-FMV Income[(1)]	208,762	257,276	323,008
Add (deduct): realized and unrealized gains (losses) on financial instruments excluding those on mortgage investments	60,320	6,545	(64,279)
Provision for income taxes	(71,350)	(69,260)	(68,500)
Net income	197,732	194,561	190,229
Common share dividends declared	141,423	210,885	148,419
Per Share Highlights			
Net income per common share	3.25	3.20	3.12
Dividends per common share	2.36	3.52	2.47
At Year End Balance Sheet Highlights Total assets	43,763,672	42,274,158	39,488,527
Total long-term financial liabilities	399,222	398,888	398,554

Notes:

(1) Pre-FMV Income is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV Income may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV Income should not be construed as an alternative to net income or loss determined in accordance with IFRS as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

Vision and Strategy

The Company provides mortgage financing solutions to the residential and commercial mortgage markets in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is a leading non-bank mortgage lender. The Company intends to continue leveraging these strengths to lead the non-bank mortgage lending industry in Canada, while appropriately managing risk. The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions for Canadian single-family and commercial customers; growing assets under administration; employing technology to enhance business processes and service to mortgage brokers and borrowers; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. The Company is considered by most of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

Key Performance Drivers

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of mortgages;
- Raising capital for operations; and
- Employing innovative securitization transactions to minimize funding costs.

Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, create longer-term value from servicing rights, renewals and growth in the customer base for marketing initiatives. As at December 31, 2022, MUA totalled $131.0 billion, up from $123.9 billion at December 31, 2021, an increase of 6%. The growth of MUA in the fourth quarter of 2022, was 5% on an annualized basis.

Growth in Origination of Mortgages

Direct Origination by the Company

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. Increased origination satisfies demand from its institutional customers and produces volume for the Company's own securitization programs. In 2022, the Company's single-family origination decreased by 17% compared to 2021. The Company believes this is the result of slowing real estate markets following the unsustainable growth experienced early in the pandemic when interest rates were at historical lows. As mortgage interest rates rose beginning in the first quarter of 2022, housing affordability diminished, and housing activity declined significantly. The commercial segment performed relatively well despite the changing market conditions. Total commercial volumes were $9.6 billion compared to $9.7 billion in 2021, a decrease of 1%. On a combined basis (residential and commercial, overall new origination in 2022 decreased 12% year over year.

Third-Party Mortgage Underwriting and Fulfilment Processing Services

In 2015, the Company launched its third-party underwriting and fulfilment processing services business with a large Canadian schedule I bank ("Bank"). This business is designed to adjudicate mortgages originated by the Bank through the single-family residential mortgage broker channel. First National employs a customized software solution based on its industry-leading MERLIN technology to accept mortgage applications from the Bank in the mortgage broker channel and underwrite these mortgages in accordance with the Bank's underwriting guidelines. The Bank funds all the mortgages underwritten under the agreement and retains full responsibility for mortgage servicing and the client relationship. Management considers the agreement a way to leverage the capabilities and strengths of First National in the mortgage broker channel and add some diversity to the Company's service offerings. In late 2019, the Company entered into a similar agreement with another Canadian bank.

Excalibur Mortgage Products

The Company originates alternative single-family ("Excalibur") mortgage products. Alternative lending describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. These mortgages generally have higher interest rates than prime mortgages. First National's relationships with mortgage brokers and its underwriting systems allow for cost effective origination of significant volumes. The product is originated primarily for placement with institutional investors, but beginning in April 2019, the Company finalized an agreement with a bank-sponsored securitization conduit to fund a portion of Excalibur origination. In early 2020, an agreement was reached with another bank-sponsored conduit to provide additional funding for this product. Excalibur was rolled out gradually, beginning in Ontario. Currently the program originates the majority of its mortgages in Ontario with small but growing volumes in Western Canada.

Raising Capital for Operations

Bank Credit Facility

The Company has a $1.5 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In the second quarter of 2022, the Company extended the term of the facility by another year to March 2027. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than senior unsecured notes, which are fully drawn during their term; (3) the four-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Note Issuance

In November 2020, the Company issued 200,000 2.961% Series 3 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. These notes added to the Company's 2019 issuance of 200,000 3.582% Series 2 senior unsecured notes. The net proceeds of both offerings, after broker commissions, were invested in FNFLP. On settlement, the proceeds were used to pay down a portion of the indebtedness under the bank credit facility. The Company's medium-term debt capital now stands at approximately $400 million.

Preferred Share Issuance

Effective April 1, 2021, pursuant to the original prospectus, the Company reset the annual dividend rate on the outstanding Class A Series 1 preference shares to 2.895% for a five-year term to March 31, 2026. After the exercise of shareholder conversion rights in March 2021, there were 2,984,835 Class A Series 1 shares outstanding and 1,015,165 Class A Series 2 outstanding. The Series 2 shares bear a floating rate dividend calculated quarterly based on the 90-day T-Bill rate. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Directors approval, and are redeemable at the discretion of the Company such that after each five-year term ending on March 31, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (and vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital.

Employing Securitization Transactions to Minimize Funding Costs

Approval as Both an Issuer of NHA-MBS and Seller to the Canada Mortgage Bonds Program

In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA-MBS and as a seller into the Canada Mortgage Bonds ("CMB") program. Issuer status provides the Company with direct and independent access to reliable and low-cost funding. Insured mortgage spreads can be illustrated by comparing insured posted five-year fixed single-family mortgage rates to a similar-term Government of Canada bond as listed in the table below.

Period	Average Five-Year Insured Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009–2016	1.77%
2017–2019	1.38%
2020	1.76%
2021	1.17%
2022	1.59%

Generally, when this spread is wider, the Company can earn higher returns from its securitization activities, although credit spreads and program fee observed in securitization markets also affect profitability. In early 2020, fears of a global pandemic led to a dramatic and sudden decrease in bond yields as central banks cut overnight rates significantly. Credit spreads, including those on mortgages, widened. Later in 2020, as financial systems began to normalize, mortgage coupons remained elevated as other credit spreads, including those on NHA-MBS, narrowed. The resulting spreads had positive impacts on 2020 results and increased the profitability inherent in the Company's securitization portfolio. In 2021, mortgage spreads narrowed, to levels not seen since before the 2008 financial crisis as competition increased. In 2022, spreads widened in response to the Bank of Canada's interest rate policy announcements. If such spreads persist, it will be favorable to the Company in future quarters. In 2022, the Company originated and renewed approximately $12.6 billion of single-family and multi-unit residential mortgages for securitization purposes.

The Company is subject to various regulations put in place by CMHC. These rules include the amount of CMHC guarantees issued which are required to issue a pool. Currently there is a tiered NHA-MBS guarantee fee pricing structure, such that any guarantees issued to one issuer over $9.0 billion of issuance have a higher price. The tiered limit of $9.0 billion remains unchanged for 2023. In July 2022, CMHC announced new rules related to the allocation of NHA-MBS guarantee fees between Lenders and Aggregators. These rules commence in 2023 and may have an impact on the Company's ability to place mortgages with some institutions.

Canada Mortgage Bonds Program

The CMB program is an initiative where Canada Housing Trust ("CHT") issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. As a seller into the CMB, the Company is able to make direct sales into the program. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations. In recent years, the Company was able to increase capacity for its participation in the 10-year CMB by including affordability-linked mortgages in the program. CMHC has indicated there may be modifications as early as 2024 which may reduce the Company's access to 10-year CMB capacity.

Key Performance Indicators

The principal indicators used to measure the Company's performance are:

- Earnings before income taxes and losses and gains on financial instruments, with the exception of any losses related to mortgage investments ("Pre-FMV Income"[1]); and

- Dividend payout ratio.

Beginning in 2012, the Company used Pre-FMV EBITDA as a key performance indicator. This non-IFRS measure was used to adjust the Company's earnings by excluding gains and losses related to the fair value of financial instruments and adding back depreciation and amortization. The addbacks of amortization ended in 2016 when IPO-related intangible assets were fully amortized. Accordingly, effective January 1, 2020, the Company elected to simplify the non-IFRS measure it presents to adjust only for fair value-related gains and losses. This measure is reported as "Pre-FMV Income."Pre-FMV Income is not recognized under IFRS. However, management believes that Pre-FMV Income is a useful measure that provides investors with an indication of income normalized for capital-market fluctuations. Pre-FMV Income should not be construed as an alternative to net income determined in accordance with IFRS or to cash flows from operating, investing and financing activities. The Company's method of calculating Pre-FMV Income may differ from other issuers and, accordingly, Pre-FMV Income may not be comparable to measures used by other issuers.

	Quarter Ended		Year ended	
	December 31, 2022	**December 31, 2021**	**December 31, 2022**	**December 31, 2021**
For the Period		($000s)		
Revenue	414,785	339,292	1,574,293	1,394,606
Income before income taxes	58,269	57,111	269,082	263,821
Pre-FMV Income [1]	59,492	57,045	208,762	257,276
At Period End				
Total assets	43,763,672	42,274,158	43,763,672	42,274,158
Mortgages under administration	131,000,635	123,907,627	131,000,635	123,907,627

(1) This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been considered a high-yielding, dividend-paying company. With a large MUA that generates continuing income and cash flow and a business model that is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders that represent a relatively large ratio of its earnings. The Company calculates the dividend payout ratio as dividends declared on common shares over net income attributable to common shareholders. This measure is useful to shareholders, as it indicates the percentage of earnings paid out as dividends. Similar to the performance measurement for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV Income.

Determination of Common Share Dividend Payout Ratio

	Quarter Ended		Year Ended	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
For the Period		($000s)		
Net income attributable to common shareholders	41,785	41,287	194,693	191,866
Total dividends paid or declared on common shares	35,730	110,190	141,423	210,885
Dividends paid or declared on common shares, excluding special dividends	35,730	35,231	141,423	135,926
Total common share dividend payout ratio	86%	267%	73%	110%
Regular common share dividend payout ratio (1)	86%	85%	73%	71%
After-tax Pre-FMV dividend payout ratio (2)	84%	85%	94%	73%

Note:

(1) This ratio is calculated by excluding the payment of the special dividends declared at the end of the periods presented.

(2) This non-IFRS measure adjusts the net income used in the calculation of the "Regular common share dividend payout ratio" to after tax Pre-FMV income so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. The Company uses its aggregate effective tax rate to tax affect the impact of the valuation of financial instruments on this ratio.

For the year ended December 31, 2022, the regular common share payout ratio (excluding the special dividend declared in 2021) was 73% compared to 71% for the year ended December 31, 2021. However, in 2022 and 2021, the Company recorded gains and losses on account of the changes in fair value of financial instruments. Gains and losses are recorded in the period in which the prices on Government of Canada bonds change; however, the offsetting economic impact is generally reflected in narrower or wider spreads in the future once the mortgages have been pledged for securitization. Accordingly, management does not consider such gains and losses to affect its dividend payment policy in the short term. If the gains and losses on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2022 would have been 94% compared to 73% in 2021.

The Company also paid $3.0 million of dividends on its preferred shares in 2022 compared to $2.7 million in 2021.

Revenues and Funding Sources

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through securitization conduits, in each case with retained servicing. In general, originations are allocated from one funding source to another depending on different criteria, including type of mortgage and securitization limits, with an overall consideration related to maintaining diversified funding sources. The Company retains servicing rights on virtually all the mortgages it originates. This provides the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2022, new origination volume decreased to $29.1 billion from $33.2 billion, or about 12% compared to 2021.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA-MBS, CMB and asset-backed commercial paper (“ABCP”). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for sale recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company’s $38.1 billion of new originations and renewals in 2022, $12.6 billion was originated for its own securitization programs.

Placement Fees and Gain on Deferred Placement Fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as “placement fees”. The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a “deferred placement fee”. A deferred placement fee arises when mortgages with spreads in excess of a base spread are placed. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time, as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a “deferred placement fee receivable” that is amortized as the fees are received by the Company. Of the Company’s $38.1 billion of new originations and renewals in 2022, $24.4 billion was placed with institutional investors.

For all institutional placements, the Company earns placement fees. Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. In addition, under certain circumstances, additional revenue from institutional placements may be recognized as “gain on deferred placement fees” as described above.

Mortgage Servicing and Administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company’s overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrowers’ property tax escrows, reserve escrows and mortgage payments. As acknowledged in the Company’s agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant additional servicing revenue.

In addition to the interest income earned on securitized mortgages and deferred placement fees receivable, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale or securitization, mortgage and loan investments and purchased mortgage servicing rights.

The Company provides underwriting and fulfilment processing services to two mortgage originators using the mortgage broker distribution channel. The Company earns a fee based on the dollar value of funded mortgages. These fees are recognized at the time a mortgage funds and are included in “Mortgage servicing income” in the consolidated statement of income.

Results of Operations

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

	Quarter Ended		Year Ended	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
	($ millions)			
Mortgage Originations by Segment				
New single-family residential	3,594	5,218	19,479	23,414
New multi-unit and commercial	2,277	3,045	9,634	9,747
Sub-total	5,871	8,263	29,113	33,161
Single-family residential renewals	1,908	1,491	6,840	6,306
Multi-unit and commercial renewals	689	902	2,163	2,658
Total origination and renewals	8,468	10,656	38,116	42,125
Mortgage Originations by Funding Source				
Institutional investors	5,028	6,863	24,553	27,813
NHA-MBS/CMB/ABCP securitization	3,231	3,475	12,570	12,923
Internal Company resources	209	318	1,203	1,389
Total	8,468	10,656	38,326	42,125
Mortgages under Administration				
Single-family residential	88,590	84,896	88,590	84,896
Multi-unit residential and commercial	42,411	39,012	42,411	39,012
Total	131,001	123,908	131,001	123,908

Total new mortgage origination volumes decreased in 2022 compared to 2021 by 12%. This reflected a 17% decrease in single-family volumes and a 1% decrease in commercial segment volumes year over year. Management believes the decrease in the single-family segment was due to a slowing housing market which was the result of higher mortgage rates. The Company's MERLIN technology continues to support its mortgage origination platform allowing it to underwrite efficiently across the country. In the commercial segment, where the Company's expertise in underwriting multi-unit mortgages is a fundamental competency, 2022 volumes reflected demand for insured mortgages, offset by lower conventional mortgage activity as higher interest rates began to impact real estate valuations. When combined with renewals, total production inclusive of both business segments decreased by 10% to $38.1 billion in 2022 from $42.1 billion in 2021. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy, with volume of almost $12.6 billion in 2022.

Net Interest – Securitized Mortgages

Comparing the year ended December 31, 2022, to the year ended December 31, 2021, "net interest – securitized mortgages" (NIM) increased by about 4% to $169.3 million from $163.2 million. The portfolio of mortgages pledged under securitization grew 5% from about $35.4 billion at December 31, 2021 to $37.2 billion at December 31, 2022. This reflected growth of 14% in the multi-residential program portfolio and an increase of 1% in single-family programs. Accordingly, commercial segment earnings were up by $8.6 million while residential segment NIM was lower by $2.5 million year over year. The significant factors which contributed to this decrease were: (1) comparatively tighter securitized margins on fixed rate mortgages; and (2) spread compression on floating rate pools as short-term interest rates rose. These unfavorable variances were offset by slower rates of prepayment. Although nominal spreads were wider during 2022, the measurement of NIM was affected by the results of the Company's economic hedging program and resulting accounting treatment. In the first and second quarters of 2022, bond yields rose significantly, and the value of the Company's short bond interest rate hedges on its residential commitment pipeline increased in value. The Company recorded gains on financial instruments of $66.7 million in its statement of income. As the underlying mortgages closed and were securitized, the mortgages had lower mortgage rates relative to the interest rate on the MBS debt arranged to fund them. Effectively, some of the spread otherwise earned on such transactions was recorded as a gain on financial instruments as opposed to future securitization NIM. While difficult to calculate precisely, management believes this treatment reduced comparative NIM in 2022 by about $10 million. Securitization NIM was also affected negatively by the rapid rise of short-term interest rates. As rates rise, there is a temporary compression between the Company's prime lending rate and its short-term CDOR-based funding costs. Because the Company adjusts its floating mortgage rates for its borrowers in the month subsequent to changes in short-term interest rates, interest spreads are generally tighter in months when CDOR increases in tandem with BoC rate announcements. The Company estimates that residential segment NIM was lower year over year by about $6.0 million because of such NIM compression on its floating rate MBS pools. This negative variance was offset somewhat by a tempering of prepayment speeds. In 2021 prepayment speed was higher than expected as borrowers took advantage of historically low mortgage rates to refinance mid term. With higher mortgage rates in 2022, prepayment speeds returned to traditional levels. Although the Company received prepayment fees on the prepaying mortgages in both years, in 2021 the fees received by the Company were offset by indemnities paid to NHA MBS bondholders. In 2022 with higher interest rates, there were virtually no indemnities to pay as bondholders could reinvest proceeds from prepayment at more profitable risk-free rates. Accordingly, in 2022 the Company retained $12.1 million of prepayment fees compared to 2021 when there was a net payout of $1.8 million to fund indemnities.

Placement Fees

Placement fee revenue decreased by 12% to $268.6 million from $303.7 million in the comparative year. The decrease was the result of a 12% decrease in origination volumes sold to institutional investors. Generally, per-unit fees were marginally lower for residential origination than in the comparable year as product mix changed between investors. In the commercial segment, placement fees increased by 37% as the Company placed comparatively more insured mortgages with institutional investors as opposed to through its own securitization programs.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue decreased 7% to $15.0 million from $16.1 million. These gains related primarily to multi-unit residential mortgages originated and sold to institutional investors. Volumes for these transactions increased by 33% from 2021 as the Company's insured origination grew. However, spreads on these mortgages were narrower in 2022 compared to 2021.

Mortgage Servicing Income

Mortgage servicing income increased 2% to $216.8 million from $211.6 million. This increase was attributable to growing MUA and interest earned on funds held in escrow as a result of higher overnight interest rates. The increase was offset by lower third-party underwriting fees which was the outcome of a decline in volumes processed. Like the Company's own origination experience in 2022, slower housing activity across the country affected the Company's customers in this business line.

Mortgage Investment Income

Mortgage investment income increased 65% to $105.7 million from $63.9 million. The increase was due primarily to the interest rate environment. Interest rates rose steadily through 2022 as the market reacted to a cycle of rate hikes by the Bank of Canada to address inflation risks. The impact was such that 5-year bond yields increased by about 200 basis points between December 31, 2021 and December 31, 2022. This directly affected mortgage rates offered by the Company such that it earned comparatively more interest income on its mortgage and loan investment portfolio and mortgages accumulated for securitization.

Realized and Unrealized Gains (Losses) on Financial Instruments

This financial statement line item consists of three primary components: (1) gains and losses related to the Company's economic hedging of single-family commitments, (2) gains and losses related to holding a portfolio of mortgage and loan investments at fair value, and (3) gains and losses on interest rate swaps used to mitigate interest rate risk on its CMB activity. With the adoption of IFRS 9, a significant portion of the Company's interest rate management program qualifies as "hedging" for accounting purposes. The Company has elected to document hedging relationships for virtually all of the multi-residential commitments and mortgages it originates for its own securitization programs. It has also done the same for funded single-family mortgages and the swaps used in its ABCP programs. This decision has reduced the volatility of gains and losses on financial instruments otherwise recorded in the Company's regular earnings, as gains and losses on hedged items are generally deferred and amortized into income over the term of the related mortgages. The Company has not documented a hedging relationship for its interest mitigation program for its single-family mortgage commitments. The Company believes, given the optional nature of these commitments, it is difficult to establish a valid hedging relationship. For financial reporting purposes, this means that there will still be gains and losses on financial instruments, but these should be limited to those on the bonds sold short used to mitigate such risk. The following table summarizes these gains and losses by category in the periods indicated:

	Quarter Ended		Year Ended	
Summary of Realized and Unrealized Gains (Losses) on Financial Instruments	**December 31, 2022**	**December 31, 2021**	**December 31, 2022**	**December 31, 2021**
		($000s)		
Gains (losses) on short bonds used for the economic hedging program	(844)	3,155	74,442	15,397
Losses on mortgages held at fair value	(130)	(137)	(710)	(730)
Losses on interest rate swaps	(379)	(3,089)	(14,122)	(8,852)
Net gains (losses) on financial instruments	(1,353)	(71)	59,610	5,815

2022 featured an inflationary environment in which bond yields rose significantly as central banks tightened monetary policies. This resulted in increases in both short and long-term interest rates. While interest rates rose in 2021, the scale of increase in 2021 was much smaller than in 2022 as the Bank of Canada raised its key overnight rate by 4.00% between March 2 and December 31, 2022. These changes and the tone of the Bank's announcements meant that 5- and 10-year term Government of Canada bond yields increased by about 200 basis points between the end of 2021 and the end of 2022. Accordingly, the impact on the Company's short-bond position used to mitigate interest rate risk on single-family commitments was larger in 2022 ($74.4 million of gains compared to $15.4 million of gains in 2021).

Brokerage Fees Expense

Brokerage fees expense decreased 14% to $173.3 million from $201.8 million. This decrease reflected an 18% year-over-year decrease in origination volumes of single-family mortgages for institutional investors, which decreased by about 18% year over year. The Company increased broker incentives during 2022 in order to grow volumes in a slow and competitive market. These incentives increased average per-unit broker fees by about 5%, otherwise total brokerage fee expenses would have been even lower in 2022 than in 2021. These increases where apparent particularly in the last six months of the year. Brokerage fees expense was also negatively affected by the under absorption of the higher per unit fees upon securitization. Effectively, higher fees related to the referral of securitized mortgages were expensed in the year. Lower mortgage default insurance fees also affected the change in this expense year over year.

Salaries and Benefits Expense

Salaries and benefits expense increased 9% to $193.0 million from $177.0 million. Salaries were higher as overall headcount increased by 7% (1,686 employees at December 31, 2022 compared to 1,579 at December 31, 2021). Headcount growth was highest in the residential underwriting departments. Commercial underwriting compensation was lower in the year by about $5.2 million due to the tighter origination spreads compared to 2021 (primarily related to the first two quarters of 2021). Management salaries were paid to the two senior executives (co-founders) who together control about 71% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO") in 2006.

Interest Expense

Interest expense increased 95% to $136.0 million from $69.7 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the investor or funding with a securitization vehicle. The Company used its $1.5 billion syndicated bank line together with repurchase agreements to fund mortgages during this period. The overall interest expense increased from 2021 due to higher prevailing interest rates on the Company's floating rate debt as short-term rates increased significantly with monetary tightening from central banks to address inflation. Interest expense also includes the cost of carry related to the Company's economic hedging program where costs increased by $8.6 million year over year.

Other Operating Expenses

Other operating expenses increased by 23% to $63.6 million from $51.9 million, primarily due to occupancy related costs and depreciation of computer equipment. The costs to occupy the Company's new Toronto headquarters, including the amortization of new leaseholds are higher than incurred at the previous head office. Other expenses including business travel and discretionary spending also increased as travel restrictions lifted as 2022 progressed.

Income before Income Taxes and Pre-FMV Income

Income before income taxes increased 2% to $269.1 million from $263.8 million in 2021. This increase was partially the result of changing capital markets. The Company's results include gains and losses on account of financial instruments used to economically hedge residential mortgage commitments. As described previously in this MD&A, the Company recorded $60.3 million of gains on financial instruments (excluding losses related to mortgage and loan investments) in 2022. Comparatively, in 2021, the Company recorded $6.5 million of gains on financial instruments (excluding the losses related to mortgage and loan investments). The change in these values accounted for a $53.8 million increase in comparative income before income taxes. Pre-FMV Income, which excludes these changes, decreased by 19% to $208.8 million from $257.3 million. This change was largely the result of a 17% drop in new residential origination and lower fees related to third-party underwriting. As mortgage rates rose over the past nine months, housing transactions slowed across the country. As lenders competed in a smaller market, the Company increased broker incentives to increase referrals. Together with tight funding spreads for securitized floating rate mortgages and employee headcount designed to underwrite higher volumes, profitability was lower. During the pandemic, the Company increased originations by a factor of about 30%. At the same time, the volumes that it processed in its third-party underwriting department also increased significantly. In 2021, the Company increased headcount to underwrite the large volumes originated particularly in the residential segment. Together with a competitive environment for skilled underwriters in an inflationary environment, salary costs per employee increased. In 2022, head count remained relatively constant while related revenues fell. These unfavorable changes were offset by favorable results in the commercial segment where originations increased, and the Company earned higher securitization NIM from the increased securitization activity in the past several years.

Income Tax Expense

The provision for taxes increased by 3% to $71.4 million from $69.3 million. The provision increased proportionately with net income before income taxes.

Other Comprehensive Income

For the commercial segment, the Company hedges the interest rate risk associated with insured multi-residential mortgages. This hedging begins on commitment and ends when the Company either securitizes the mortgages or places the mortgage with an institutional investor. As the Company determined that these cash flow hedges were effective, the Company recorded $123.3 million of pre-tax net gains on such hedges in OCI in 2022. In the year, the Company amortized a portion of the gains and losses in accumulated OCI into regular earnings in the amount of $30.5 million. The remaining OCI amount will be amortized into net income in future periods.

Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages), and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below:

	Operating Business Segments			
	Residential		**Commercial**	
	($000s except percent amounts)			
For the Year Ended	**December 31, 2022**	**December 31, 2021**	**December 31, 2022**	**December 31, 2021**
Originations and renewals	26,319,422	29,719,176	11,796,939	12,404,946
Percentage change	*(11%)*		*(5%)*	
Revenue	1,115,222	1,030,550	459,071	364,056
Percentage change	*8%*		*26%*	
Income before income taxes	172,541	199,366	96,541	64,455
Percentage change	*(13%)*		*50%*	
As at	**December 31, 2022**	**December 31, 2021**	**December 31, 2022**	**December 31, 2021**
Identifiable assets	28,923,269	28,813,695	14,810,627	13,430,687
Mortgages under administration	88,589,805	84,895,778	42,410,830	39,011,848

Residential Segment

Overall residential origination volumes including renewals decreased by 11% between 2022 and 2021 while residential revenues increased by 8%. Revenue benefitted from the impact of financial instruments. Excluding the impact of these revenues, adjusted revenue increased by 3%. Revenue was affected in 2022 by lower origination which translated into lower placement fees. However, higher interest earned on the securitized portfolio and mortgages accumulated for securitization offset the decrease in placement fees. Net income before tax was also affected by fair value-related revenues. Without the impact of these revenues, net income before tax decreased to $112.2 million in 2022 from $192.8 million in 2021, or by 42%. This is the outcome of lower revenues on placement activity, higher per-unit broker fees combined with higher headcount which created a comparatively more expensive operating environment. Identifiable assets increased from December 31, 2021, as the Company's pledged mortgages under securitization increased by about $300 million. This was offset with lower amounts of mortgages accumulated for securitization.

Commercial Segment

2022 commercial revenues were higher compared to 2021 and segment income before income taxes increased by 50% year over year. The increase in revenue is largely attributable to higher interest income generated by the securitized portfolio. Income growth reflected increased placement fees derived from funding a greater portion of mortgage origination through institutional investors in the year compared to 2021. Higher interest revenue earned on mortgage investments and escrow deposits were also favorable to both revenue and income. Identifiable assets increased from those at December 31, 2021, as the Company increased its portfolio of securitized mortgages by about $1.5 billion.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to originate and invest in prime Canadian mortgages. Management's belief has always been that these mortgages are attractive to investors and should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, and once again in the 2020 pandemic, when capital markets were disrupted and the demand for high-quality assets increased. As the Company's results in those years demonstrated, First National was able to attract investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of unsecured notes and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization (2) the origination costs associated with securitization and, (3) mortgage and loan investments. The Company has a credit facility with a syndicate of financial institutions for total credit of $1.5 billion. This facility was extended in April 2022 for a five-year term maturing in March 2027. As at December 31, 2022, the Company had entered into repurchase transactions with financial institutions to borrow $1.4 billion related to $1.4 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2022, outstanding bank indebtedness was $1,065.9 million (December 31, 2021 – $965.4 million). This debt was used to fund $833.2 million (December 31, 2021 – $951.3 million) of mortgages accumulated for sale or securitization. At December 31, 2022, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $64.6 million (December 31, 2021 – $64.4 million) and (2) mortgage and loan investments of $190.1 million (December 31, 2021 – $192.3 million). Company considers the portion of bank indebtedness and the senior unsecured notes that fund assets other than mortgages accumulated for sale or securitization a proxy for true leverage. This leverage has increased between December 31, 2021, and December 31, 2022, and now stands at $631.9 million (December 31, 2021 – $413.0 million). This represents a debt-to-equity ratio of approximately 0.90:1. This ratio is higher than the ratio of 0.72:1 at December 31, 2021. In general, the increase was the result of the investment of $143 million in cash collateral and subordinate notes for the Company's Alt-A securitization program. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

Since being approved as an issuer of NHA-MBS, the Company has funded the difference between the mortgages it uses to create NHA-MBS and the debt obligations it assumes upon issuance. In recent years, this requirement has generally been limited to mortgages in arrears where First National does not receive payments from the borrower but is obliged to pay the interest and amortizing principal on the NHA-MBS debt. However, due to 2020 related national unemployment pursuant to the COVID-19 pandemic, this funding requirement increased as borrowers requested mortgage payment deferrals. In such situations, the Company determined to grant mortgage payment deferrals. Qualifying borrowers received three months of payment deferral. In cases of extended hardship, the Company provided a second three-month deferral after the initial deferral period ended. During this deferral period, a portion of such mortgages ceased to amortize and interest otherwise payable was capitalized to the principal of the mortgage. The three mortgage default insurers approved these steps, permitting the deferrals to occur without any impact on subsequent claims under the mortgage insurance policies. In turn, First National has been required to make "timely payments" on the NHA-MBS securities. This means that despite not receiving payments from borrowers on the mortgages that support the NHA-MBS, the Company has been required to pay the interest and amortizing principal on the debt. In effect, the Company de-leveraged its balance sheet by paying off the debt while the related mortgages did not as amortize as quickly. At December 31, 2022, the Company estimates that it had reduced its NHA MBS debt by approximately $18 million (December 31, 2021 - $46 million) because of the impact of deferred payments. This has been funded by the Company's available cash resources.

The Company funds a portion of its mortgage originations for institutional placement on the same day as the advance of the related mortgage. The remaining originations are funded by the Company on behalf of institutional investors or pending securitization by the Company. On specified days, the Company aggregates all mortgages warehoused to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs prior to arranging for funding through securitization. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this warehouse period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for 6 to 18-month terms, to bridge existing borrowers in the interim period before long-term financing. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization, as well as other miscellaneous longer-term financing needs.

A portion of the Company's capital has been employed to support its ABCP and NHA-MBS programs, primarily to provide credit enhancements as required by rating agencies. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2022, the investment in cash collateral was $160.7 million (December 31, 2021 – $105.1 million).

The Company's Board of Directors has elected to pay dividends, when declared, on a monthly basis on the outstanding common shares and on a quarterly basis on the outstanding preference shares. For purposes of the enhanced dividend tax credit rules contained in the *Income Tax Act* (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by the Company to Canadian residents on both common and preference shares after June 30, 2010, are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as "eligible dividends" for the purposes of such rules.

Financial Instruments and Risk Management

The Company records mortgages accumulated for sale and a portion of mortgage and loan investments as financial assets measured at "fair value through profit or loss" such that changes in market value are recorded in the consolidated statement of income. The mortgages accumulated for sale are held for very short periods, and any change in value due to changing interest rates is the obligation of the ultimate institutional investor. Accordingly, the Company believes there will be little, if any, effect on its income related to the change in fair value of these mortgages. The majority of mortgages in mortgage and loan investments are uninsured commercial segment bridge loans. These are primarily floating rate loans that have mortgage terms of 18 months or less. As the mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. The Company estimates fair value based upon: benchmark interest rates, credit spreads for similar products, creditworthiness and status of the borrower, valuation of the underlying real property, payment history, and other conditions specific to the rationale for the loan. Any favourable or unfavourable amounts will be recorded in the statement of income each quarter.

The Company believes its hedging policies are suitably designed such that the interest rate risk of holding mortgages prior to securitization is mitigated. The Company designates hedging relationships such that the results of any effective hedging does not affect the Company's statement of income. See previous discussion in this MD&A under "Realized and Unrealized Gains (Losses) on Financial Instruments". As at December 31, 2022, the Company had $1.5 billion of notional forward bond positions related to its single-family programs.

For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund, and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages to be sold to the Company's other securitization vehicles. As at December 31, 2022, the Company had entered into $0.6 billion of notional value forward bond sales for this segment. The Company is also a party to three interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at December 31, 2022, the aggregate value of these swaps, maturing between December 2023 and September 2026, was a $13.4 million liability. During 2022, the fair value of these swaps decreased by $14.1 million.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company also takes on credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the ultimate date of placement or securitization. If credit spreads widen during this holding period, this is unfavourable for the Company. It means that the Company cannot fund the mortgages originated with a funding source as effectively as originally intended. Despite entering into effective interest rate hedges, the Company's exposure to credit spreads will remain. This risk is inherent in the Company's business model and the Company believes it cannot be economically hedged. As at December 31, 2022, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were approximately $2.3 billion of mortgages that were susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model is the origination and placement or securitization of financial assets. Generally, placement activities do not require any capital investment. Securitization transactions may require the investment of significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the "Liquidity and Capital Resources" section above. The business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the year ended December 31, 2022, the Company purchased new computer equipment and software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $10 million annually. 2021 expenditures were much higher as the Toronto head office moved to new premises and invested in new leasehold improvements.

Summary of Contractual Obligations

The Company's long-term obligations include leases of premises with terms up to 15 years for its offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully serviced basis and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

	Payments Due by Period				
	Total	0-1 Years	1-3 Years ($000s)	4-5 Years	After 5 Years
Lease Obligations	122,862	10,268	18,707	18,179	75,708

Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions that it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. The significant accounting policies of First National are described in Note 2 to the Company's annual consolidated financial statements as at December 31, 2022. The policies that First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement fees requires the use of estimates to determine the fair value of the retained interest in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The method of determining the assumptions underlying the estimates used for the year ended December 31, 2022, are consistent with those used for the year ended December 31, 2021 and quarters ended September 30, June 30 and March 31, 2022.

The Company elects to treat certain of its financial assets and liabilities, including mortgages accumulated for sale, mortgage and loan investments and bonds sold short, at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. A portion of the bonds sold short are designated as an effective hedge, and accordingly, a portion of the change in the short bonds' fair value may be recorded in Other Comprehensive Income or deferred against hedge assets. This accounting has reduced the volatility in earnings as changes in the value on short bonds have been matched to the recognition of the change in value of the hedged mortgages. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of the assets listed above are subject to Company estimates. The most significant would be implicit in the valuation of mortgage and loan investments. These are generally non-homogeneous mortgages where it is difficult to find independent valuation comparatives. The Company uses information in its underwriting files, regional real estate information and other internal measures to determine the fair value of these assets.

As a mortgage lender, the Company invests in uninsured mortgages. When it funds these mortgages through securitization debt, it continues to be liable for any credit losses. The key inputs in the measurement of any expected credit loss ("ECL") include probability of default, loss given default and forecast of future economic conditions, which involves significant judgment. Upon application of IFRS 9 with respect to impairment, there has been no impact on the Company's earnings. Because of the high proportion of government-insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends, just $2.7 million of credit losses were recorded in 2022.

Disclosure Controls and Internal Control over Financial Reporting

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2022, management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, management concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, were effective as of December 31, 2022.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with reporting standards; however, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

Management evaluated, under the supervision of and with the participation by the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and, based on that evaluation, concluded that the Company's internal control over financial reporting was effective as of December 31, 2022, and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2022. No changes were made in the Company's internal control over financial reporting during the year ended December 31, 2022, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ESG

The Company issued its initial Public Accountability Statement in the fall of 2021. In October 2022, it issued an updated report which explores First National's approach to sustainability and provides environmental, social and governance disclosure that has been reviewed and approved by the Board of Directors. It complements our Management Information Circular, Annual Information Form, Management Discussion and Analysis and Annual Report, all of which offer information about the financial position, priorities, responsibilities and commitments of the consolidated operations of First National.

Risks and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties and are affected by a number of factors outside the control of management of the Company. In addition to the risks addressed elsewhere in this discussion and the financial statements, these risks include: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors including third-party servicing customers, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination including the impact of trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance and CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, unfavourable litigation, and environmental liability. In addition, there are risks associated with the structure of the Company, including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends that are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions. The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. The total of one investor's activities with the Company account for approximately 13% of the Company's total revenues. In October 2019, the sale transaction involving an institution for which the Company administers a large portfolio of third-party originated mortgages was completed. The new owners of the institution may decide not to renew the existing contract with First National or to exercise termination clauses within the agreement. In the event of non-renewal or termination, the Company's MUA will decrease. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

The COVID-19 crisis was the cause of unemployment across the country and widespread economic hardship. During the duration of this crisis, the probability of the risks listed above having a negative impact on the Company increased. Although the virus has not been entirely eradicated, the Company no longer views this as a crisis. Recent rate hikes by the Bank of Canada have raised short-term interest rates by 425 basis points in the past ten months. In that same period mortgage rates for 5-year term mortgages have increased by approximately 300 basis points and bank prime lending rates have risen by 425 basis points with the latest change occurring in late January 2023. These are significant changes that have taken place over a short period of time. Higher borrowing rates will directly affect consumers across the country. Management believes these changes may impact the Company negatively in future periods. Related losses could be material.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", '"should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime, and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, and changes in interest rates as outlined in the "Risk and Uncertainties Affecting the Business" section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the "Risk and Uncertainties Affecting the Business" section, that may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of February 28, 2023, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

2022 was a year that featured a competitive marketplace and reduced origination activity which was largely the result of the Bank of Canada's ("BoC") policy decisions to reduce inflation by increasing overnight lending rates which, in turn, led to increased mortgage rates. Between March 2, 2022 and January 25, 2023, the overnight rate increased eight times from 0.25% at the beginning of March to 4.50% at the writing of this MD&A. Throughout most of these increases (except the most recent), the BoC's statements indicated the likelihood of more interest rate hikes to follow. The Company believes these increases contributed to significantly higher mortgage rates and reduced the affordability of housing across the country. Despite this uncertain business environment, the Company successfully grew MUA and continued to build its portfolio of mortgages pledged under securitization. First National will benefit from this growth in the future: earning income from mortgage administration, and net securitization margin and improving its position to capture increased renewal opportunities.

In the short term, the expectation for the start of 2023 is for lower origination as higher mortgage rates continue to dampen activity across the country, particularly in comparison to the first quarter of 2022 which was seasonally very strong. However, when it announced its latest interest rate increase in January 2023, the BoC indicated that it would now hold its policy rate at the current level while it assesses the cumulative impact of recent increases. This may signal the end to its rate hiking cycle designed to manage inflationary risks. In turn, the Company hopes this will provide confidence to prospective buyers that mortgage rates will not increase going forward such that home buying activity will return to traditional levels. Accordingly, the Company foresees improving origination volumes through the second half of 2023. This positive change will not likely represent a return to the unsustainable volumes recorded in most of 2020 and 2021, but instead a return to pre-pandemic activity exhibited in 2019. Higher immigration will also support the housing market. Management is confident that First National will remain competitive and a leader in the marketplace. Management anticipates commercial origination will also slow as the market digests changing property valuations given the new underlying financial environment.

During the pandemic, the value of First National's business model has been demonstrated. By designing systems that do not rely on face-to-face interactions, the Company's business practices have resonated with mortgage brokers and borrowers alike. The economic effects of COVID-19 are expected to slowly diminish although the duration and impact of the pandemic is unknown at this time, as is the long-term efficacy of the government and central bank interventions. It is still not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company and its operating subsidiaries in future periods.

First National is well prepared to execute its business plan. The Company expects to enjoy the value of its continued goodwill with broker partners earned over the last 35+ years and reinforced during the pandemic. With diverse relationships over an array of institutional investors and solid securitization markets, the Company has access to consistent and reliable sources of funding.

The Company is confident that its strong relationships with mortgage brokers and diverse funding sources will continue to set First National apart from its competition. The Company will continue to generate income and cash flow from its $37 billion portfolio of mortgages pledged under securitization and $91 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.