FIRST NATIONAL

FINANCIAL CORPORATION

Report to Shareholders

Period Ended September 30, 2015

100 University Avenue, Suite 700, North Tower, Toronto, ON M5J 1V6

www.firstnational.ca

Fellow Shareholders:

First National continued to experience significant growth in key metrics that drive shareholder value creation during the three months ended September 30, 2015.

Mortgages under administration ("MUA") increased 11% year over year to a record $92.6 billion. Total originations were up 7% as single family mortgage originations of $4.05 billion came within 1% of the record set in last year's third quarter and commercial originations grew 45% year over year to $1.3 billion.

As a result of portfolio growth, revenue increased 7% to $246.6 million and would have been higher except for the impact of volatility in the bond market that negatively affected the Company's economic hedging program. This negative impact is removed in calculating Pre-FMV EBITDA, a non-IFRS measure that serves as a proxy for normal course business performance. Pre-FMV EBITDA increased 22% to $61.0 million. The transition to profitability of the Company's new third-party underwriting and fulfillment processing services business in the third quarter also bolstered these results. Net income, which includes the impact of gains and losses on financial instruments, was 18% lower than last year at $28.9 million or $0.46 per common share.

Common Share Dividend Increase

The combination of growth in MUA, positive long-term trends in Pre-FMV EBITDA and the performance of the third-party underwriting and fulfillment processing services business provided good support for the Board of Directors to increase dividends for holders of the Company's common shares. Effective with the monthly payment on December 15, 2015, the new rate will be $1.55 per share per annum, an increase of 3.3%. We're pleased to note that this represents the 8th such increase since First National's IPO in 2006. The Company also paid its regular quarterly dividend of $0.290625 per share on the Company's 4.65% Class A Preference shares on October 15.

Outlook

The Company expects the low interest rate environment, which was reinforced with January and July 2015 Bank of Canada rate cuts, to continue for the remainder of 2015. The Company will focus on the significant value of renewal opportunities and its partnerships with institutional customers in order to maximize profitability. Management expects the Company to continue to generate cash flow from its $24 billion portfolio of mortgages pledged under securitization and $68 billion servicing portfolio that will maximize financial performance. First National also expects the underwriting and fulfillment processing services business to continue to add to earnings as mortgages processed increase in response to the Company's superior service levels to the mortgage broker distribution channel.

Sincerely,

Stephen Smith
Chairman and Chief Executive Officer

Moray Tawse
Executive Vice President

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis of financial condition and results of operations is prepared as of October 27, 2015. This discussion should be read in conjunction with the unaudited consolidated financial statements of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the three months (the "period") ended September 30, 2015 and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Company for the year ended December 31, 2014. The unaudited 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 EBITDA" 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 over $92 billion in mortgages under administration ("MUA"), First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the mortgage broker distribution channel.

Commencing in 2013, First National has consolidated its interest in First National Mortgage Investment Fund (the "Fund"), which it launched in late 2012. Although the Company only owns about 18% of the units issued by the Fund, because of its status as sole seller to the Fund and its rights as promoter, the application of IFRS suggests that First National exercises control over the Fund. The Fund was created to obtain economic exposure to a diversified portfolio of primarily commercial mezzanine mortgages. Through the Fund's consolidation, the Company has effectively taken on a portfolio of about $46 million (December 31, 2014 - $55 million) of mortgages. Because of the Company's small proportionate interest in the Fund's units, it has also recorded a $33 million (December 31, 2014 - $39 million) non-controlling interest in equity which offsets these assets.

Third Quarter 2015 Results Summary

The Company is pleased with the growth of its mortgage portfolio in the third quarter of 2015. Single-family origination suffered from a slower western economy and was off 1% compared to the third quarter of 2014; however new commercial origination increased by 44%. These volumes and consistent renewal rates enabled the Company to grow its MUA and build the value of its portfolio of securitized mortgages.

- MUA grew to $92.6 billion at September 30, 2015 from $83.2 billion at September 30, 2014, an increase of 11%; the growth from June 30, 2015, when MUA was $90.1 billion, represented an annualized increase of 11%;
- In the first nine months of 2015, the Canadian single-family real estate market has performed steadily despite the oil-related slowdown evident in western Canada. Despite a decrease in origination of 17% out of its Calgary office, the Company almost matched the record origination experienced in the third quarter of 2014. New single-family mortgage originations for the Company decreased by 1%, although with rounding, it remained at $4.1 billion in both the 2015 and 2014 third quarters. The commercial segment had a very strong quarter as volumes increased by 45%, from $911 million in the 2014 quarter to over $1.3 billion in the 2015 third quarter. Together, overall origination for the third quarter increased by 7% year over year;
- The Company also took advantage of opportunities in the quarter to renew $1.2 billion of single-family mortgages. In the third quarter of 2014 the Company renewed $1.1 billion of single-family mortgages. The growth is attributable to more renewal opportunities. For the commercial segment, renewals decreased to $192 million from $326 million on fewer opportunities;
- Revenue for the third quarter of 2015 increased to $246.6 million from $230.6 million in 2014. The 7% increase is attributable to higher revenues from the Company's underwriting and fulfillment business offset by losses on financial instruments which decreased revenue by $18.5 million year over year. Placement fee revenue and Interest revenue – securitized mortgages also grew as the Company increased the volume of mortgages placed with institutions and its portfolio of securitized mortgages;
- Income before income taxes for the third quarter decreased by 17% from $47.6 million in 2014 to $39.7 million in 2015. The decrease was due, in large part, to changes in the capital markets, which negatively affected the Company's interest rate hedges and mortgages held at fair value in the current quarter. Accordingly there were losses of $19.1 million on financial instruments recorded in the 2015 third quarter in contrast to a small loss on financial instruments of $0.5 million in the 2014 third quarter. The net change in losses on financial instruments between 2015 and 2014 decreased income before income taxes between the quarters by $18.5 million.
- Without the impact of gains and losses on financial instruments, the Company's earnings before income taxes, depreciation and amortization ("Pre-FMV EBITDA[1]") for the third quarter of 2015 increased by 22%**,** from $50.1 million in 2014 to $61.0 million in 2015. The increase was due to increased earnings from institutional placement and the transition to profitability in the new underwriting and fulfilment processing services business.

The Company was very pleased with these results and together with the transition to profitability in its underwriting and fulfillment business, First National announced that its Board of Directors has approved an increase in the dividend on its common shares. Effective with the dividend payable on December 15, 2015, the annual dividend rate will be increased from $1.50 per share to $1.55 per share, an increase of 3.3%.

Outstanding Securities of the Corporation

At September 30, 2015 and October 27, 2015, the Corporation had 59,967,429 common shares, 4,000,000 Class A preference shares, Series 1 and 175,000 April 2020 notes outstanding.

Selected Quarterly Information

Quarterly Results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net Income (Loss) for the period	Pre-FMV EBITDA for the period (1)	Net Income (Loss) per Common Share	Total Assets
2015					
Third Quarter	$246,641	$29,308	$60,955	$0.46	$27,624,359
Second Quarter	$251,206	$42,538	$52,012	$0.68	$27,585,945
First Quarter	$167,460	($3,499)	$38,439	($0.09)	$26,638,048
2014					
Fourth Quarter	$198,254	$17,856	$43,229	$0.27	$25,953,914
Third Quarter	$230,552	$35,331	$50,121	$0.56	$25,077,361
Second Quarter	$201,596	$28,217	$48,392	$0.44	$23,902,513
First Quarter	$172,705	$23,061	$41,388	$0.35	$21,683,307
2013					
Fourth Quarter	$200,928	$41,821	$53,401	$0.66	$20,569,217

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on the mortgages pledged under securitization. Servicing revenue will also change as the third-party portfolio of mortgages grows or contracts. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as weighted average mortgage rates. Although mortgage rates have declined recently, the Company has steadily increased MUA and its portfolio of securitized mortgages over the last 24 months. Net income is partially dependent on conditions in the debt 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 (primarily conditions in the bond markets). By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

Generally, in the last eight quarters, the Company has grown its origination volumes in order to build its servicing portfolio and to enable it to securitize larger amounts of mortgages in the NHA-MBS market. This longer-term strategy has been successful and Pre-FMV EBITDA grew steadily to over $197 million in 2013. Despite continued success in growing MUA and mortgage origination volume, tighter spreads in 2014 reduced the profitability of mortgages pledged for securitization and deferred placements fees. The table above shows a trend of growing income reflecting typical Canadian seasonality: slower first and fourth quarters and stronger mid-year quarters. In the first quarter of 2015, the surprise cut in the Bank of Canada's overnight rate on January 21, 2015, had a large, unfavourable effect on the Company's net income. Although the Company recorded growth in origination volumes and grew its MUA, the first quarter of 2015 featured large net losses on the fair value of financial instruments as bond yields fell. In the third quarter of 2015, the combination of steady origination and the successful realization of its strategy in underwriting and fulfillment business made for the highest quarterly Pre-FMV EBITDA since the Company began tracking this measure in 2012.

Selected Annual Financial Information

($000s, except per share amounts)

	2014	2013	2012
For the Year ended December 31, Income Statement Highlights			
Revenue	803,107	776,508	628,613
Interest expense – securitized mortgages	(434,726)	(323,236)	(246,736)
Brokerage fees	(77,105)	(84,420)	(115,978)
Salaries, interest and other operating expenses	(143,062)	(127,404)	(106,547)
Add (deduct): realized and unrealized (gains) losses on financial instruments	34,916	(43,866)	(6,153)
Pre-FMV EBITDA(1)	183,130	197,582	153,199
Amortization of capital assets	(2,909)	(2,374)	(2,059)
Amortization of intangible assets	(5,000)	(5,563)	(6,468)
Add (deduct): realized and unrealized gains (losses) on financial instruments	(34,916)	43,866	6,153
Provision for income taxes	(35,840)	(61,410)	(40,500)
Net Income	104,465	172,101	110,325
Dividends declared	93,602	90,294	80,859
Per Share Highlights			
Net income per common share	1.62	2.75	1.76
Dividends per common share	1.48	1.38	1.27
At Year End Balance Sheet Highlights Total assets	25,953,914	20,569,217	15,022,236
Total long-term financial liabilities	176,418	179,195	181,275

Notes:

(1) Pre-FMV EBITDA is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV EBITDA 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 virtually the entire mortgage market 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 the leading non-bank mortgage lender in the industry. Growth has been achieved while maintaining a relatively conservative risk profile. 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; growing assets under administration; employing leading-edge technology to lower costs and rationalize business processes; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. Although the Company places most of its originations with third parties, FNFLP is perceived 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;
- Lowering the costs of operations through the innovation of systems and technology; 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, longer-term value from servicing fees, mortgage administration fees, renewals and the growth of the customer base for marketing initiatives. As at September 30, 2015, MUA totalled $92.6 billion, up from $83.2 billion at September 30, 2014, an increase of 11%. This compares to $90.1 billion at June 30, 2015, representing an annualized increase of 11%.

Growth in Origination of Mortgages

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. By growing origination, not only can the Company satisfy demand from its institutional customers, but it can also produce volume for its own securitization programs.

Mortgage Underwriting and Fulfillment Processing Services

Early in the third quarter of 2014, the Company entered into an agreement with a large Canadian schedule I bank ("Bank") to provide underwriting and fulfillment processing services for mortgages originated by the Bank through the single-family residential mortgage broker channel. Under the strategic agreement, 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. The new business was launched in Ontario in early 2015, western Canada in April 2015, and finally in Quebec in July 2015. 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 the third quarter of 2015, this department transitioned to profitability as volumes of mortgages underwritten increased with the summer season and operations normalized.

Lowering Costs of Operations

Innovations in Systems and Technology

The Company has always used technology to provide for efficient and effective operations. This is particularly true for its MERLIN underwriting system, Canada's only web-based, real-time broker information system. By creating a paperless, 24/7 commitment management platform for mortgage brokers, the Company is now ranked among the top three lenders by market share in the broker channel. This has translated into increased single-family origination volumes and higher closing ratios (the percentage of mortgage commitments the Company issues that actually become closed mortgages).

Bank Credit Facility

The Company uses a $1 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the increasing amount of mortgages accumulated for securitization. The entire facility is floating rate and has a five-year term. The Company has elected to undertake this debt for a number of reasons: (1) the transaction increases the amount of debt available 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 the Senior Unsecured Notes, which are fully drawn during their term; (3) the five-year term extension 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

On April 6, 2015, the Company issued 175,000 4.01% Series 1 Senior Unsecured Notes due April 9, 2020 pursuant to a private placement under an offering memorandum. The net proceeds of the offering, after broker commissions, of $174.3 million were invested in FNFLP. On settlement, the proceeds were used to repay a portion of the outstanding amount drawn on the bank credit facility. On May 7, 2015, the Company drew on the bank credit facility to repay the maturing 5.07% $175 million debenture. Effectively the new note issuance has replaced the funding provided by the maturing debenture. Unlike the debenture which was secured on a pari passu basis with the bank syndicate, the newly issued notes are unsecured and can be invested in FNFLP such that the amount will qualify as "net worth" which allows the Company to increase the amount of NHA MBS it can issue under CMHC guidelines. Accordingly, the Company considers these funds to represent a source of capital to fund the upfront investment required by its securitization program. The old 5.07% debenture was used primarily to fund mortgages in the holding period prior to securitization.

Employing Securitization Transactions to Minimize Funding Costs

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

The Company has been involved in the issuance of NHA-MBS since 1995. 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 CMB program. Issuer status has provided the Company with a funding source that it can access independently. Perhaps more importantly, seller status for the CMB gives the Company direct access to the CMB. Generally, the demand for high-quality fixed and floating rate investments increased significantly with the economic turmoil in 2009. This demand has continued into 2015 and allowed the Company to issue more than $1.5 billion of mortgages through the NHA-MBS and CMB programs during the third quarter. In August 2013, CMHC announced that it would be limiting the amount of guarantees it would issue on NHA-MBS pools created for sale to the "market". CMHC indicated that the amount of guarantees it was providing for such market pools (generally any pool not sold to the Canada Housing Trust ("CHT") for the CMB) was growing significantly. In order to better control the absolute amount of risk that it takes on in this respect, CMHC has implemented policies to allocate the amount of guarantees to issuers. The current amount being allocated to each issuer is approximately the amount that First National used in 2014. These rules are similar to the CMB allocation rules described below, which have been in place since 2008 and are subject to change each year.

Mortgage spreads can be illustrated by comparing 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 Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009	1.76%
2010	1.75%
2011	1.76%
2012	1.92%
2013	1.75%
2014	1.57%
First Quarter 2015	1.93%
Second Quarter 2015	1.69%
Third Quarter 2015	1.79%

The table shows an average spread of 1.12% in 2006. With the credit crisis, this spread ballooned to as high as 3.46% in 2008. Between 2009 and 2011, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In mid-2011, the United States credit rating was downgraded and interest rates fell significantly, accounting for wider mortgage spreads in 2012 which tightened again in 2013. In 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels. To begin 2015, mortgage spreads quickly widened as a slowdown in economic growth and the Bank of Canada rate cut have reduced bond yields dramatically. Competitive pressures over the next six months acted to reduce mortgage rates so that as at September 30, 2015, the spread narrowed to 1.79%. While funding spreads have also moved out, spreads are still greater than in 2014 and there is a strong case for the Company to continue to securitize. In the third quarter of 2015, the Company originated and renewed for securitization purposes approximately $ 1.2 billion of single-family mortgages and $0.4 billion of multi-unit residential mortgages in order to take advantage of these spreads. In the quarter, the Company securitized through NHA-MBS approximately $547 million of floating rate single-family mortgages, $1.2 billion of fixed rate single-family mortgages and $121 million of fixed rate multi-unit residential mortgages.

Canada Mortgage Bonds Program

The CMB program is an initiative sponsored by CMHC whereby the CHT issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. Pursuant to the Company's approval as a seller into the CMB, the Company is able to make direct sales into the program. Because of the similarities to a traditional Government of Canada bond (both have five- and 10-year non-amortizing terms and a federal government guarantee), the CMB trades in the capital markets at a modest premium to the yields on Government of Canada bonds. 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. The Company also enjoys demand for mortgages from investment dealers who sell directly into the CMB. Because of the effectiveness of the CMB, there have been requests from approved CMB sellers for larger issuances. CHT has indicated that it will not unduly increase the size of its issuances and 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.

Key Performance Indicators

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

- Earnings before income taxes, depreciation and amortization, and losses and gains on financial instruments ("Pre-FMV EBITDA" (1)) ; and

- Dividend payout ratio.

Pre-FMV EBITDA is not a recognized measure under IFRS. However, management believes that Pre-FMV EBITDA is a useful measure that provides investors with an indication of income normalized for capital market fluctuations and prior to capital expenditures. Pre-FMV EBITDA 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 EBITDA may differ from other issuers and, accordingly, Pre-FMV EBITDA may not be comparable to measures used by other issuers.

	Quarter ended		Nine months ended	
	September 30, 2015	**September 30, 2014**	**September 30, 2015**	**September 30, 2014**
For the Period		**($ 000's)**		
Revenue	246,641	230,552	665,307	604,853
Income before income taxes	39,653	47,621	92,292	117,099
Pre-FMV EBITDA (1)	60,955	50,121	151,406	139,901
At Period end				
Total assets	27,624,359	25,077,361	27,624,359	25,077,361
Mortgages under administration	92,630,375	83,190,530	92,630,375	83,190,530

Note:

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments 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. Over this period, the Company has paid over $750 million of dividends/distributions to common shareholders/ unitholders. With a large MUA which generates continuing income and cash flow and a business model which is designed to make an efficient use of capital, the Company has been able to pay distributions to its shareholders which 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 which have been paid out in dividends. Similar to the performance measure for earnings, the Company also calculates the dividend payout ratio on a basis using Pre-FMV EBITDA.

Determination of Common Share Dividend Payout Ratio

	Quarter ended		Nine months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
For the Period	($ 000's)			
Net income attributable to common shareholders	27,686	33,528	63,081	81,042
Dividends paid or declared on common shares	22,488	22,488	67,464	66,464
Common Share Dividend Payout Ratio	81%	67%	107%	82%
After tax Pre-FMV Dividend Payout Ratio (1)	52%	64%	63%	68%

Note:

(1) This non-IFRS measure adjusts the net income used in the calculation of the dividend payout ratio to after tax Pre-FMV earnings so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments 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 quarter ended September 30, 2015, the common share payout ratio was 81% compared to 67% in the comparative 2014 quarter. However, in the 2015 third quarter, the Company's incurred a $19.1 million loss on account of the fair value of financial instruments. In the same quarter in 2014, there were losses totalling just $0.6 million incurred. These amounts are recorded in the period in which the bond yields change; however, the offsetting economic impacts are reflected in wider spreads on the mortgages pledged for securitization and will be generally realized in net interest margin over the terms of the mortgages. If the losses on financial instruments in both quarters are excluded from the above calculations, the dividend payout ratio for the third quarter of 2015 would have been 52% compared to 64% in the 2014 comparative quarter.

The Company also paid $1.162 million of dividends on its preferred shares in the third quarter of 2015.

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. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the quarter ended September 30, 2015, new origination volume increased from $5.0 billion to $5.4 billion, or about 7%, compared to the third quarter of 2014.

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 $6.7 billion of new originations and renewals for the quarter ended September 30, 2015, $1.6 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 sold. 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 $6.7 billion of new originations and renewals in the third quarter of 2015, $4.9 billion was placed with institutional investors.

For all institutional placements and mortgages sold to institutional investors for the NHA-MBS market, 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 and NHA-MBS 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 a mortgage originator 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 is included in “Mortgage servicing income” in the statement of comprehensive 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		Nine months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
	($ millions)			
Mortgage Originations by Segment				
New Single-family residential	4,053	4,085	9,959	9,665
New Multi-unit and commercial	1,317	911	3,154	2,506
Sub-total	5,370	4,996	13,113	12,171
Single-family residential renewals	1,151	1,102	3,041	2,542
Multi-unit and commercial renewals	192	326	602	978
Total origination and renewals	6,713	6,424	16,756	15,691
Mortgage Originations by Funding Source				
Institutional investors – new residential	3,324	2,513	6,126	4,889
Institutional investors – renew residential	540	559	1,391	1,328
Institutional investors – multi/commercial	1,014	773	2,471	2,252
NHA-MBS/ CMB/ ABCP securitization	1,624	2,390	6,311	6,847
Internal Company resources /CMBS	211	189	457	375
Total	6,713	6,424	16,756	15,691
Mortgages under Administration				
Single-family residential	72,649	64,827	72,649	64,827
Multi-unit residential and commercial	19,981	18,364	19,981	18,364
Total	92,630	83,191	92,630	83,191

Total new mortgage origination volumes increased in the third quarter of 2015 compared to the same quarter in 2014 by 7%. Single-family volumes decreased by 1% and commercial segment volumes increased by 45% year over year as demand for housing and commercial real estate continued and the Company increased its share in the mortgage broker channel. The third quarter of 2015 reflected a typical seasonal uplift in housing activity during the summer. The growth rate was mitigated by lower volumes originated from the Company's Calgary office. These volumes were lower by 17% year over year as the turmoil associated with the rapid decline in the price of oil slowed the housing market in Alberta and Saskatchewan. When combined with renewals, total production increased from $6.4 billion in the 2014 quarter to over $6.7 billion in the third quarter of 2015, or by 5%. The low interest rate environment which existed for most of 2014 continued in 2015, highlighted by the Bank of Canada's two reductions to its overnight rate. Low mortgage rates, which stimulate increased real estate transactions, together with the Company's expertise in underwriting insured mortgages, drove higher origination volumes. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volumes of $1.6 billion in the third quarter of 2015, lower than the $2.4 billion originated in the 2014 comparative quarter. The Company used more institutional placements in the 2015 quarter as demand from investors increased and securitization became comparatively less profitable.

Net Interest - Securitized Mortgages

Comparing the quarter ended September 30, 2015 to the quarter ended September 30, 2014, "net interest – securitized mortgages" increased by 13% to $32.5 million from $28.8 million. The increase was due to a larger portfolio of securitized mortgages offset by tighter weighted-average spreads on the portfolio year over year. The portfolio of mortgages funded through securitization increased by 15% from $21.1 billion as at September 30, 2014 to $24.3 billion as at September 30, 2015; however, the market for prime mortgages became more competitive as the Company grew this portfolio. Between September 30, 2014 and September 30, 2015, tighter mortgage spreads and marginally higher origination costs decreased margins by approximately 3%. Generally as higher-spread securitizations have amortized down, new securitizations have been entered into at tighter spreads. Net interest is also affected by the amortization of deferred origination and other costs that are capitalized on securitized mortgages.

Placement Fees

Placement fee revenue increased by 29% to $60.7 million from $47.1 million in the third quarter of 2014. New residential origination volume for institutional customers, excluding renewals, increased from $2.5 billion in 2014 to $3.3 billion in 2015 or by 32%. The change was also affected by lower renewal related placement fees and product mix considerations.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue increased 4% to $2.5 million from $2.4 million. The gains relate to multi-unit residential mortgages originated and sold to institutional NHA-MBS issuers. Although volumes for these transactions decreased by 11% from the 2014 third quarter to the 2015 third quarter, spreads on these transactions widened so that the Company realized higher per unit gains.

Mortgage Servicing Income

Mortgage servicing income increased 36% to $32.0 million from $23.5 million. This increase was due to revenue earned on the new underwriting and fulfillment processing services business which the Company commenced in January 2015. Without this revenue, mortgage servicing income grew at a lower rate year over year corresponding to 1) the growth in the third-party MUA of 11% between the third quarters and 2) a decline in the average per unit servicing fee initiated for some of the largest residential investors late in 2013.

Mortgage Investment Income

Mortgage investment income decreased 9% to $ 14.0 million from $15.4 million. The change is largely due to the Company's securitization program. As the Company elects to securitize, it funds mortgages accumulated for securitization and earns the mortgage interest rate income in the warehousing period prior to securitization. Generally mortgage rates have fallen between 2014 and 2015. Prevailing interest rates on five year closed mortgages were about 3.50% in the summer of 2014 compared to 2.65% in 2015. This implies a 24% decrease in revenue on such mortgages. The decrease has been offset partially by greater revenue on the Company's mortgage and loan investments which have grown by $64 million between September 2014 and 2015.

Realized and Unrealized Gains (Losses) on Financial Instruments

For First National, this financial statement line item typically consists of two components: (1) gains and losses related to the Company's economic hedging activities, and (2) gains and losses related to holding term assets derived using discounted cash flow methodology. Much like the short bonds that the Company uses for hedging, the term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to price the Company's deferred placement fees receivable, and mortgages designated as held for trading). The following table summarizes these gains and losses by category in the periods indicated:

Summary of realized and unrealized gains (losses) on financial instruments	**Quarter ended September 30, 2015**	**Quarter ended September 30, 2014**	**Nine months ended September 30, 2015**	**Nine months ended September 30, 2014**
		($ 000's)		
Losses on short bonds used for the economic hedging program	(7,993)	(703)	(34,342)	(24,936)
Gains (losses) on mortgages held at fair value	(5,732)	1,366	17,592	17,181
Losses on interest rate swaps	(5,562)	(1,193)	(36,444)	(9,224)
Gains (losses) on deferred placement fees receivable	241	(50)	708	81
Other gains (losses)	(17)	38	13	(30)
Total losses on financial instruments	(19,063)	(542)	(52,473)	(16,928)

For the third quarter of 2014, positive economic news meant 5-year bond yields increased by 0.10% in the course of the quarter. In contrast, the third quarter of 2015 featured poor global economic news and 5-year bond yields fell by 0.15%. For the Company, this meant the value of holding short bond positions as a hedge against its mortgages pending securitization decreased in the 2015 quarter. Accordingly, the Company recorded significant net losses related to the valuation of these financial instruments in 2015 compared to the losses recorded in the third quarter of 2014.

The Company uses short Government of Canada bonds (including CHT-issued bonds) together with repurchase agreements to create forward interest rate contracts to hedge the interest rate risk associated with fixed rate mortgages originated for its own securitization programs. For accounting purposes, these do not qualify as interest rate hedges as the bonds used are not derivatives but cash-based financial instruments. These gains or losses are recorded in the period in which the bond yields change; however, the offsetting economic gains or losses are not recorded in the same period. Instead, the resulting economic gain (or loss) will be reflected primarily in wider or narrower spreads on the mortgages pledged for securitization and will be realized in net interest margin over the terms of the mortgages and the related debts. In the third quarter of 2015, the Company recorded losses on these hedges of $8.0 million (2014 – $0.7 million). While these losses decreased the net income earned in the 2015 quarter, the gross spread on the related portfolio of securitized mortgages going forward will be proportionally wider as the Company issues securitization-related debt at lower relative interest rates than it would have prior to the movement in bond yields. In order to adequately hedge its interest rate exposure, the Company had more than $750 million of bonds sold short as at September 30, 2015.

The portion of the Company's mortgages which is held at fair value (primarily those funded through ABCP), was affected positively by the change in bond yields; however, these gains were offset by the widening of mortgage funding credit spreads experienced which negatively impacted these mortgages to a greater extent in the quarter such that these mortgages lost $5.7 million in value. The valuation of interest rate swaps, which were used to hedge all fixed-rate mortgages in the ABCP portfolio, was negatively affected by lower bond yields and an unrealized loss of $5.6 million was recorded in the quarter.

Brokerage Fees Expense

Brokerage fees expense increased 34% to $40.2 million from $30.0 million. This increase is explained almost entirely by higher origination volumes of single-family mortgages for institutional investors, which increased by 32%. The expense is also affected by changes in commercial brokerage fees and volume bonus and other loyalty incentives awarded to residential brokers which increased per unit fees.

Salaries and Benefits Expense

Salaries and benefits expense increased 29% to $21.9 million from $17.0 million. The increase is due primarily to an increase in headcount and higher employee costs associated with the new third party underwriting business. The Company hired 117 employees during the fourth quarter of 2014 and the first half of 2015 for this business. Accordingly, the Company had over $2.4 million of direct salary-related expenses for this division in the third quarter of 2015 which it did not have in the 2014 comparative quarter. The increase is also the result of higher employee costs associated with commercial segment origination. The Company compensates its commercial sales staff with commissions based on the profitability of originated mortgages. Commercial origination, excluding renewals, increased by 45% from third quarter of 2014 and the compensation to sales staff increased by $2.1 million year over year. As at September 30, 2015, the Company had 883 employees, compared to 728 as at September 30, 2014. The growth in head count, excluding employees hired for the new third-party underwriting processing business, is 3%. This growth is largely to meet the administrative demand associated with increased MUA, which grew by 11% year over year. Management salaries were paid to the two senior executives (Co-founders) who together control about 77% 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").

Interest Expense

Interest expense decreased 13% to $9.0 million from $10.3 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 ultimate investor or funding with a securitization vehicle. The Company used the senior unsecured note together with a $1 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense has decreased from the prior period due to falling interest rates as the prime lending rate of most banks was lowered from 3.0% to 2.70% as a result of the cuts made by the Bank of Canada during 2015.

Other Operating and Amortization of Intangibles Expenses

Other operating and amortization of intangibles expenses increased 2% to $11.9 million from $11.7 million. The amortization of intangible assets recognized on the IPO was $1.25 million in each of the comparative third quarters. Other operating expenses increased by $1.1 million related to the costs of running the new third party underwriting department which had not commenced in the third quarter of 2014. These expenses and general growth in operating costs associated with a larger MUA were offset by $1.5 million of lower hedge costs as a consequence of lower bond yields which generally decrease the costs of carrying such instruments.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes decreased 17% to $39.7 million from $47.6 million. The decrease was due in large part to changes in the capital markets, which negatively affected the Company's interest rate hedges and carrying values of certain mortgage assets. Income before income taxes was comparatively lower in 2015 than 2014 by $18.5 million because of the unfavourable change in losses on financial instruments. Pre-FMV EBITDA, which eliminates the impact of gains and losses on financial instruments, increased 22% to $61.0 million from $50.1 million. The increase was due primarily to 1) the Company's decision to place more of its origination with institutional customers; and 2) the transition to profitability in its new underwriting and fulfillment services business. The Company earned more placement fees which translated to increased earnings as there is a fixed cost of operating the origination departments. With respect to the new third party underwriting services business, the third quarter confirmed the successful implementation of the Company's business model. With strong seasonal origination for this business, the Company surpassed break even volumes and the division contributed earnings to overall corporate profitability. In prior quarters, the start-up losses related to this business represented drag on the Company's consolidated earnings.

Provision for Income Taxes

The provision for taxes decreased by 16% to $10.3 million from $12.3 million. The provision is lower due to the lower income earned in the third quarter of 2015 compared to the income recorded in the third quarter of 2014.

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	
	($000's except percent amounts)			
Quarter ended	**September 30, 2015**	**September 30, 2014**	**September 30, 2015**	**September 30, 2014**
Originations and renewals	5,204,117	5,187,038	1,509,373	1,237,803
Percentage change	*0.3%*		*22%*	
Revenue	194,278	179,695	52,363	50,857
Percentage change	*8.1%*		*3.0%*	
Income before income taxes	28,734	35,175	10,919	12,446
Percentage change	*(18.3%)*		*(12.3%)*	
Period ended	**September 30, 2015**	**December 31, 2014**	**September 30, 2015**	**December 31, 2014**
Identifiable assets	22,277,138	21,112,421	5,317,445	4,811,717
Mortgages under administration	72,649,115	66,991,706	19,981,260	18,897,855

Residential Segment

Overall residential origination including renewals increased by 0.3% between the third quarters of 2015 and 2014 while residential revenues increased by about 8%. Part of the change in revenue is due to the change in gains and losses on financial instruments. Excluding these changes, revenue increased by 17% as the securitized mortgage portfolio grew and produced higher interest revenue. The 17% increase in normalized revenue also includes revenue from the new third party underwriting business which benefited from a strong summer season. The net change in gains and losses on financial instruments of $15.4 million also affected net income before income taxes. Without the impact of this fair value change, net income before income taxes for the residential segment would have increased by 26% year over year, indicative of higher net placement fee revenue as the Company placed a greater portion of its origination with institutional customers. Together with the profits earned by the third party underwriting services business, income grew faster than revenue. Identifiable assets increased from December 31, 2014, as the Company added about $1.7 billion of net single-family mortgages to mortgages pledged under securitization. This increase was offset by decreases of $63 million related to mortgages accumulated for securitization and almost $0.5 billion of government bonds purchased for hedging purposes as the Company has elected to place more of its origination and accordingly reduced its short bond position.

Commercial Segment

Commercial revenues increased by 3% from the prior year's quarter, and increased by 9% if the impact of changes in gains and losses on the fair value of financial instruments are excluded. This growth is due to higher placement fees on the higher new origination. Higher revenue from the securitized mortgage portfolio in the Company's commercial segment and better spreads on deferred placement fees also contributed to the increase. Without fair value amounts, net income before tax increased by 10% year over year, as higher placement fees and net interest on securitized mortgages revenue flowed through to net income. Identifiable assets increased since December 31, 2014, as the Company added about $220 million of net commercial mortgages to mortgages pledged under securitization, increased the amount of government bonds purchased for hedging purposes by about $200 million and mortgages accumulated for securitization by almost $42 million.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and will always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets retreated and only the highest-quality assets were bid. As the Company's results in those years demonstrated, First National had little trouble finding 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 the $175 million unsecured note 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 eleven financial institutions for a total credit of $1 billion. This facility was extended in May 2015 for a five-year term maturing in May 2020. Bank indebtedness may also include borrowings obtained through overdraft facilities. At September 30, 2015, the Company entered into repurchase transactions with financial institutions to borrow $684 million related to $697 million of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At September 30, 2015, outstanding bank indebtedness (excluding bank indebtedness at the Fund level) was $618.7 million (December 31, 2014 - $601.9 million). Together with the unsecured notes of $175 million (December 31, 2014 – debenture of $175 million), this "combined debt" was used to fund $651.6 million (December 31, 2014 - $690.2 million) of mortgages accumulated for sale or securitization. At September 30, 2015, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $37.3 million (December 31, 2014 – $34.6 million) and (2) mortgage and loan investments of $288.6 million (December 31, 2014 - $230.4 million). The difference between "combined debt" and the mortgages accumulated for sale or securitization funded by it, which the Company considers a proxy for true leverage, has increased between December 31, 2014 and September 30, 2015, and now stands at $141.5 million (December 31, 2014 – $86.7). This represents a debt-to-equity ratio of approximately 0.35 to 1, which the Company believes is conservative. This ratio increased from December 31, 2014 when it was 0.21 to 1 as the Company invested $22 million in net new mortgage securitizations, and $58 million in new mortgage and loan investments.

The Company funds a large 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 on the day of the advance of the mortgage. On specified days, sometimes daily, 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 term 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 six- to 18-month terms, to bridge existing borrowers in the interim period between long-term financing solutions. 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.

The Company has used ABCP as a funding source for twenty years. In the May 2013 federal budget, the government announced it was going to take steps to limit the securitization of government insured mortgages to CMHC sponsored programs. As ABCP is not sponsored by CMHC, such a limitation would have some impact for the Company. Almost two years after the announcement, legislation was passed and detailed transition information was published. The regulations make insurance invalid for non-CMHC sponsored securitizations (the "ban") after December 31, 2015. The legislation has other clauses including a requirement for existing insured mortgages in ABCP conduits to be refinanced or paid down in the two year period following December 31, 2015. This regulation uses the balance of insured mortgages as at June 30, 2015 as a "high water mark" such that 50% of these mortgages must be removed from ABCP funding by December 31, 2017. The Company has been using ABCP as an efficient source of funding primarily for short term insured mortgages. The Company is still awaiting the rules to be incorporated into the National Housing Act, however if enacted as described, the new legislation will mean the Company must find other funding sources for such mortgages. The Company is considering various alternatives including whole loan sales and creating short term NHA-MBS pools. The Company may also fine tune its renewal offering to incent borrowers to take five year terms. These alternatives may not be as economical to the Company as ABCP. 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 September 30, 2015, the investment in cash collateral was $19.9 million (December 31, 2014 - $19.0 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 December 31, 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. For the preference shares, the Company has elected to pay any tax under Part VI.1 of the *Income Tax Act*, such that corporate holders of the shares will not be required to pay tax under Part VI.1 of the *Income Tax Act* on dividends received on such shares.

Financial Instruments and Risk Management

The Company has elected to treat deferred placement fees receivable, certain mortgages pledged under securitization that have been funded with ABCP and NHA-MBS debt and several mortgages within 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 statement of income. Effectively, these assets are treated much like bonds earning the Company a coupon at the discount rates used by the Company. The discount rates used represent the interest rate associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the asset's residual cash flows. As rates in the bond market change, the carrying values of these assets will change. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company enters into fixed-for-float swaps to manage the interest rate exposure of fixed mortgages sold to ABCP conduits. These instruments will also be treated as fair value through profit or loss. While the Company has attempted to exactly match the principal balances of the fixed mortgages over the next five-year period to the notional swap values for the same period, there will be differences in these amounts. Any favourable or unfavourable amounts will be recorded in the statement of earnings 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. From an accounting perspective, any gains or losses on these instruments are recorded in the current period, as the Company's economic hedging strategy does not qualify as hedging for accounting purposes. The Company uses bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is transferred to the securitization vehicle and the matched term debt is arranged. As interest rates change, the value of these short bonds will vary inversely with the value of the related mortgages. As interest rates increase, a gain will be recorded on the bonds, which should be offset by a tighter interest rate spread between the interest rates on mortgages and the securitization debt. This spread will be earned over the term of the related mortgages. For single-family mortgages, primarily mortgages for the Company's own securitization programs, only some of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at September 30, 2015, the Company had $513 million 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 for transfer to the Company's other securitization vehicles. As at September 30, 2015, the Company had entered into $256 million of notional value forward bond sales for this segment. The total net value of realized and unrealized gains and losses on account of all notional hedges pertaining to the period July 1, 2015 to September 30, 2015 was a $8.0 million loss. This amount has been included in revenue in the statement of comprehensive income.

The Company is party to three amortizing fix-for-float rate swaps that economically hedge the interest rate exposure related to certain mortgages held on the balance sheet that the Company has originated as replacement assets for its CMB activities. As at September 30, 2015, the aggregate notional value of these swaps was $27.2 million. During the quarter the value of these swaps did not change significantly. The swaps mature between December 2016 and September 2021.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company takes some 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 date of sale or securitization. This can be illustrated by the Company's experience with commercial mortgages originated for the CMBS market in the spring of 2007. These mortgages were originated at credit spreads designed to be profitable to the Company when sold to a bank-sponsored CMBS conduit. Unfortunately for the Company, when these mortgages funded, the CMBS market had shut down. The alternative to this channel was more expensive as credit spreads elsewhere in the marketplace for this type of mortgage had widened. The Company adjusted for market-suggested increases in credit spreads in 2007 and 2008, adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from what it was at the end of 2008. Overall credit spreads stopped widening such that the Company applied the same spreads to these mortgages and the Company did not record any additional unrealized losses or gains related to credit spread movement. Despite entering into effective economic interest rate hedges, the Company's exposure to credit spreads remained. This risk is inherent in the Company's business model and cannot be economically hedged.

The same exposure to risk is inherent in the Company's securitization through ABCP. The Company is exposed to the risk that 30-day ABCP rates are greater than 30-day BA rates. Prior to the financial crisis, the Company considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the Company and the strong covenant of the bank-sponsored conduits with which the Company transacted. In 2008, 30-day ABCP traded at approximately 1.10 percentage points over BAs; but by the end of March 2011 and continuing until the current period, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. The success of this approach has been demonstrated through the increase in volume and profitability of the NHA-MBS program and significant increases in gains on deferred placement fees from the sale of prime insured mortgages. As at September 30, 2015, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were almost $1.3 billion of mortgages that are susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model consists of the origination and placement or securitization of financial assets. Generally, placement activities do not require much capital investment as the Company acts primarily in the capacity of a broker. On the other hand, the undertaking of securitization transactions may require 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. For fixed assets, the business requires capital expenditures on technology (both software and hardware), leasehold improvements and office furniture. During the quarter ended September 30, 2015, the Company purchased new computers and office and communications equipment. In the long term, the Company expects capital expenditures on fixed assets will be approximately $4.0 million annually.

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year premises leases for its five 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.

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, 2014. The policies which 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 (derived from the present value of expected future cash flows) 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 uses different rates for its various programs, which average approximately 11% for single-family mortgages. 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 assumptions underlying the estimates used for the quarter ended September 30, 2015 continue to be consistent with those used for the year ended December 31, 2014 and the quarters ended June 30 and March 31, 2015.

The Company has elected to treat its financial assets and liabilities, including deferred placement fees receivable, specific mortgages pledged under securitization, some 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. 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 its securitized mortgages has a significant impact on earnings. The Company uses different prepayment rates for its various programs, which average approximately 10% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed rate mortgages. Actual prepayment experience has been consistent with these assumptions. The Company has also assumed discount rates based on Government of Canada bond yields plus a spread that the Company believes would enable a third party to purchase the mortgages and make a normal profit margin for the risk involved.

Future Accounting Changes

In July 2014, the IASB issued the final version of IFRS 9 – Financial Instrument, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a logical model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. Under this standard, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The accounting model for financial liabilities is largely unchanged from IAS 39 except for the presentation of the impact of own credit risk on financial liabilities which will be recognized in OCI, rather than in profit and loss as under IAS 39. The new general hedge accounting principles under IFRS 9 are aimed to align hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness; however it is expected to provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

IFRS 9 is mandatorily effective for annual periods beginning on or after January 1, 2018. The Company is in process of evaluating the impact of IFRS 9 on the Company's financial statements.

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, replacing IAS 11 - Construction Contracts, IAS 18 - Revenue, IFRIC 13 - Customer Loyalty Programs, IFRIC 15 - Agreements for the Construction of Real Estate, IFRIC 18 - Transfer of Assets from Customers, and SIC 31 Revenue – Barter Transactions Involving Advertising Services. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step revenue recognition process to determine the nature, amount, timing and uncertainty of revenue and cash flows from the contracts with customers.

IFRS 15 is effective for fiscal years ending on or after December 31, 2018. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2018 and is currently analyzing the impact on the Company's financial statements.

Disclosure Controls and Internal Controls 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.

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.

No changes were made in the Company's internal controls over financial reporting during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including the policies set for mortgage default insurance companies), 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, and environmental liability. In addition, risks associated with the structure of the Company include those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with FNFLP's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company and contractual restrictions, and income tax matters. 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. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

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 under ''Risk and Uncertainties Affecting the Business''. In evaluating this information, the reader should specifically consider various factors, including the risks outlined under ''Risk and Uncertainties Affecting the Business'', which 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 October 27, 2015, 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

Management is pleased with both the MUA and origination growth in the third quarter of 2015. With higher origination levels and renewal volume, the Company was able to increase the volume it placed with institutional investors, and only reduce slightly the amount it retained for its securitization activities. Management is particularly pleased with the results from its underwriting and fulfillment processing services business which transitioned to profitability in the third quarter thanks to strong seasonal volumes and the execution of its business plan.

Looking forward, the Company expects the low interest rate environment, which was reinforced with January and July 2015 Bank of Canada rate cuts, to continue for the remainder of 2015. Low rates will keep mortgage affordability at favourable levels and allay refinancing risk. The Company will focus on the significant value of renewal opportunities and its partnerships with institutional customers in order to maximize profitability. Management expects the Company to continue to generate cash flow from its $24 billion portfolio of mortgages pledged under securitization and $68 billion servicing portfolio that will maximize financial performance. First National also expects the underwriting and fulfillment processing services business to continue to add to earnings as mortgages processed increase in response to the Company's superior service levels to the mortgage broker distribution channel.

Interim Condensed Consolidated Financial Statements

First National Financial Corporation

[Unaudited]

Third Quarter 2015

First National Financial Corporation

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

[Unaudited – in thousands of Canadian dollars]

As at

	Notes	**September 30, 2015** $	**December 31, 2014** $
ASSETS			
Restricted cash	3	**402,308**	496,733
Accounts receivable and sundry		**80,690**	71,160
Securities purchased under resale agreements and owned		**1,065,285**	1,331,615
Mortgages accumulated for sale or securitization	5	**1,349,108**	1,369,778
Mortgages pledged under securitization	3	**24,329,330**	22,337,378
Deferred placement fees receivable	4	**37,332**	34,644
Cash held as collateral for securitization	3	**23,164**	18,973
Mortgage and loan investments	6	**288,567**	230,388
Income taxes recoverable		**—**	10,539
Other assets		**48,575**	52,706
Total assets		**27,624,359**	25,953,914
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	8	**623,736**	609,870
Obligations related to securities and mortgages sold under repurchase agreements		**683,684**	660,360
Accounts payable and accrued liabilities		**130,235**	94,524
Securities sold under repurchase agreements and sold short		**1,065,175**	1,330,699
Debt related to securitized and participation mortgages	9	**24,447,968**	22,573,362
Debenture loan payable	11	**—**	176,418
Senior unsecured notes	11	**174,386**	—
Income taxes payable		**2,048**	—
Deferred tax liabilities		**56,000**	57,400
Total liabilities		**27,183,232**	25,502,633
Equity attributable to shareholders			
Common shares	10	**122,671**	122,671
Preferred shares	10	**97,394**	97,394
Retained earnings		**188,288**	192,669
		408,353	412,734
Non-controlling interests		**32,774**	38,547
Total equity		**441,127**	451,281
Total liabilities and equity		**27,624,359**	25,953,914

See accompanying notes

On behalf of the board

John Brough

Robert Mitchell

First National Financial Corporation

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

[Unaudited – in thousands of Canadian dollars, except earnings per share]

		Three months ended		Nine months ended	
		September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
	Notes	$	$	$	$
REVENUE					
Interest revenue – securitized mortgages		**156,511**	142,806	**461,435**	402,642
Interest expense – securitized mortgages		**(123,991)**	(114,018)	**(367,740)**	(317,412)
Net interest – securitized mortgages	3	**32,520**	28,788	**93,695**	85,230
Placement fees		**60,681**	47,058	**121,368**	100,931
Gains on deferred placement fees	4	**2,528**	2,351	**8,044**	7,676
Mortgage investment income		**13,958**	15,412	**41,376**	41,249
Mortgage servicing income		**32,026**	23,467	**85,557**	69,283
Realized and unrealized losses on financial instruments		**(19,063)**	(542)	**(52,473)**	(16,928)
		122,650	116,534	**297,567**	287,441
EXPENSES					
Brokerage fees		**40,160**	29,975	**77,620**	61,180
Salaries and benefits		**21,902**	16,952	**62,921**	49,357
Interest		**9,031**	10,271	**27,757**	25,873
Other operating		**10,654**	10,465	**33,227**	30,182
Amortization of intangible assets		**1,250**	1,250	**3,750**	3,750
		82,997	68,913	**205,275**	170,342
Income before income taxes		**39,653**	47,621	**92,292**	117,099
Income tax expense		**10,345**	12,290	**23,945**	30,490
Net income and comprehensive income for the period		**29,308**	35,331	**68,347**	86,609
Net income and comprehensive income attributable to:					
Shareholders		**28,849**	34,691	**66,569**	84,530
Non-controlling interests		**459**	640	**1,778**	2,079
		29,308	35,331	**68,347**	86,609
Earnings per share					
Basic	10	**0.46**	0.56	**1.05**	1.35

See accompanying notes

First National Financial Corporation

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

[Unaudited – in thousands of Canadian dollars]

	Common shares $	Preferred shares $	Retained earnings $	Non-controlling interests $	Total equity $
Balance as at January 1, 2015	**122,671**	**97,394**	**192,669**	**38,547**	**451,281**
Comprehensive income	**—**	**—**	**66,569**	**1,778**	**68,347**
Dividends paid or declared	**—**	**—**	**(70,950)**	**(1,776)**	**(72,726)**
Redemptions by fund unitholders	**—**	**—**	**—**	**(5,775)**	**(5,775)**
Balance as at September 30 ,2015	**122,671**	**97,394**	**188,288**	**32,774**	**441,127**

	Common shares $	Preferred shares $	Retained earnings $	Non-controlling interests $	Total equity $
Balance as at January 1, 2014	122,671	97,394	184,561	45,285	449,911
Comprehensive income	—	—	84,530	2,079	86,609
Dividends paid or declared	—	—	(69,952)	(2,090)	(72,042)
Redemptions by fund unitholders	—	—	—	(6,780)	(6,780)
Balance as at September 30, 2014	122,671	97,394	199,139	38,494	457,698

See accompanying notes

First National Financial Corporation

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Nine months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
	$	$	$	$
OPERATING ACTIVITIES				
Net income for the period	**29,308**	35,331	**68,347**	86,609
Add (deduct) items not affecting cash				
Deferred income taxes	**(3,000)**	3,800	**(1,400)**	6,200
Non-cash portion of gains on deferred placement fees	**(2,564)**	(2,214)	**(7,904)**	(7,136)
Changes in restricted cash	**223,014**	(30,847)	**94,425**	(48,681)
Net investment in mortgages pledged under securitization	**(438,909)**	(914,560)	**(1,974,361)**	(3,403,324)
Net increase in debt related to securitized mortgages	**218,686**	926,818	**1,871,534**	3,408,751
Amortization of deferred placement fees receivable	**2,165**	2,138	**5,924**	7,135
Amortization of purchased mortgage servicing rights	**299**	198	**748**	599
Amortization of property, plant and equipment	**989**	708	**2,891**	2,124
Amortization of intangible assets	**1,250**	1,250	**3,750**	3,750
Unrealized (gains) losses on financial instruments	**7,574**	(7,652)	**15,437**	(2,030)
	38,812	14,970	**79,391**	53,997
Net change in non-cash working capital balances related to operations	**383,293**	21,592	**21,623**	(535,257)
Cash provided by (used in) operating activities	**422,105**	36,562	**101,014**	(481,260)
INVESTING ACTIVITIES				
Additions to property, plant and equipment	**(283)**	(2,261)	**(3,258)**	(5,743)
Investment in cash held as collateral under securitization	**(511)**	(7,672)	**(4,191)**	(7,943)
Investment in mortgage and loan investments	**(79,336)**	(69,493)	**(144,072)**	(131,870)
Repayment of mortgage and loan investments	**40,214**	49,633	**85,893**	91,617
Cash used in investing activities	**(39,916)**	(29,793)	**(65,628)**	(53,939)
FINANCING ACTIVITIES				
Dividends paid	**(24,180)**	(24,273)	**(72,726)**	(71,541)
Changes in obligations related to securities and mortgages sold under repurchase agreements	**(194,319)**	159,035	**23,324**	270,128
Changes in debt related to participation mortgages	**(20)**	(1,647)	**3,072**	3,473
Securities purchased under resale agreements and owned, net	**(178,358)**	(218,301)	**266,330**	(453,198)
Securities sold under repurchase agreements and sold short, net	**177,203**	223,467	**(262,829)**	451,849
Repayment of debenture loan	**—**	—	**(175,000)**	—
Issuance of senior unsecured notes	**—**	—	**174,352**	—
Redemptions by fund unitholders	**—**	(6,780)	**(5,775)**	(6,780)
Cash provided by (used in) financing activities	**(219,674)**	131,501	**(49,252)**	193,931
Net decrease (increase) in bank indebtedness during the period	**162,515**	138,270	**(13,866)**	(341,268)
Bank indebtedness, beginning of period	**(786,251)**	(754,022)	**(609,870)**	(274,484)
Bank indebtedness, end of period	**(623,736)**	(615,752)	**(623,736)**	(615,752)
Supplemental cash flow information				
Interest received	**189,400**	170,510	**555,569**	476,692
Interest paid	**128,429**	119,103	**381,151**	327,103
Income taxes paid	**6,016**	9,437	**12,758**	35,167

See accompanying notes

First National Financial Corporation

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2015

1. GENERAL ORGANIZATION AND BUSINESS OF FIRST NATIONAL FINANCIAL CORPORATION

First National Financial Corporation [the "Corporation" or "Company"] 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 over $92 billion in mortgages under administration, FNFLP is an originator and underwriter of mortgages and a significant participant in the mortgage broker distribution channel.

The Corporation is incorporated under the laws of the Province of Ontario, Canada and has its registered office and principal place of business located at 100 University Avenue, Toronto, Ontario. The Corporation's common and preferred shares are listed on the Toronto Stock Exchange under the symbols FN and FN.PR.A, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The interim condensed consolidated financial statements have been prepared in accordance with IAS 34 – *Interim Financial Reporting* under International Financial Reporting Standards, as issued by the International Accounting Standards Board. The interim condensed consolidated financial statements have been prepared using the same accounting policies used in the preparation of the audited annual consolidated financial statements for the year ended December 31, 2014.

These interim condensed consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and are presented in Canadian dollars with all values rounded to the nearest thousand, except when otherwise indicated. The interim condensed consolidated financial statements were authorized for issue by the Board of Directors on October 27, 2015.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

3. MORTGAGES PLEDGED UNDER SECURITIZATION

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as Asset-backed Commercial Paper [“ABCP”], NHA-MBS, and the Canada Mortgage Bonds [“CMB”] program. In these securitizations, the Company transfers the assets to structured entities for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the structured entities and other securitization vehicles have no recourse to the Company’s other assets for failure of the mortgages to make payments when due.

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes as required by the rating agencies. Credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid to the Company by the structured entities monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA-MBS securitizations may also require cash collateral in some circumstances. As at September 30, 2015, the cash held as collateral for securitization was $23,164 [December 31, 2014 – $18,973].

The following table compares the carrying amount of mortgages pledged for securitization and the associated debt:

	September 30, 2015		**December 31, 2014**	
	Carrying amount of securitized mortgages $	**Carrying amount of associated liabilities** $	**Carrying amount of securitized mortgages** $	**Carrying amount of associated liabilities** $
Securitized mortgages at face value	**24,145,690**	**24,489,976**	22,170,195	22,612,160
Mark to market adjustment	**38,480**	**—**	41,859	—
Capitalized origination costs	**145,160**	**—**	125,324	—
Debt discounts	**—**	**(62,763)**	—	(56,481)
	24,329,330	**24,427,213**	22,337,378	22,555,679
Add:				
Principal portion of payments held in restricted cash	**357,295**	**—**	455,003	—
Participation debt	**—**	**20,755**	—	17,683
	24,686,625	**24,447,968**	22,792,381	22,573,362

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

The principal portion of payments held in restricted cash represents payments on account of mortgages pledged under securitization which have been received at period end but have not been applied to reduce the associated debt. This cash is applied to pay down the debt in the month subsequent to period end. In order to compare the components of mortgages pledged under securitization to securitization debt, this amount is added to the carrying value of mortgages pledged under securitization in the above table.

The changes in capitalized origination costs for the three months ended September 30 are as follows:

	2015 $	**2014** $
Opening balance, July 1	**143,223**	101,552
Add: new origination costs in the period	**19,108**	21,180
Less: amortization in the period	**(17,171)**	(11,256)
Ending balance, September 30	**145,160**	111,476

Mortgages pledged under securitization have been classified as loans and receivables, except for approximately $3.3 billion [December 31, 2014 – $3.4 billion] of fair valued mortgages included in fair value through profit and loss ["FVTPL"] mortgages. The mortgages classified as loans and receivables are carried at par plus adjustment for unamortized origination costs.

Within mortgages pledged under securitization, the Company's exposure to credit loss is limited to uninsured mortgages with principal balances totaling $76,326 [December 31, 2014 – $185,139], before consideration of the value of underlying collateral. $912 of these mortgages have principal and interest payments in arrears as at September 30, 2015 [December 31, 2014 – $1,436]. All such mortgages are conventional prime single-family mortgages, with 80% or less loan to value, and with verification of borrower income. Accordingly, the Company considers there to be a very small risk of loss, therefore no provision for credit loss was provided.

The Company uses various assumptions to value the FVTPL mortgages, which are set out in the table below, including the rate of unscheduled prepayment. Accordingly, FVTPL mortgages are subject to measurement uncertainty. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income. Key economic weighted average assumptions and the sensitivities of the current carrying values to immediate 10% and 20% adverse changes in those assumptions are as follows:

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

	September 30, 2015	
	Commercial mortgages	**Residential mortgages**
FVTPL mortgages	**$113,423**	**$3,139,147**
Average life [in months] [1]	**29**	**19**
Prepayment speed assumption [annual rate]	**0.3%**	**11.5%**
Impact on fair value of 10% adverse change	—	**$383**
Impact on fair value of 20% adverse change	—	**$763**
Discount rate [annual rate]	**1.9%**	**1.7%**
Impact on fair value of 10% adverse change	**$553**	**$7,286**
Impact on fair value of 20% adverse change	**$1,099**	**$14,538**

	December 31, 2014	
	Commercial mortgages	**Residential mortgages**
FVTPL mortgages	$152,542	$3,249,160
Average life [in months] [1]	30	23
Prepayment speed assumption [annual rate]	0.4%	11.5%
Impact on fair value of 10% adverse change	$1	$477
Impact on fair value of 20% adverse change	$1	$951
Discount rate [annual rate]	2.2%	2.0%
Impact on fair value of 10% adverse change	$819	$10,152
Impact on fair value of 20% adverse change	$1,626	$20,248

[1] The weighted average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments], which might magnify or counteract the sensitivities.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

4. DEFERRED PLACEMENT FEES RECEIVABLE

The Company enters into transactions with institutional investors to sell primarily fixed rate mortgages in which placement fees are received over time as well as at the time of the mortgage placement. These mortgages are derecognized when substantially all of the risks and rewards of ownership are transferred and the Company has minimal exposure to the variability of future cash flows from these mortgages. The investors have no recourse to the Company's other assets for failure of mortgagors to make payments when due.

During the three months ended September 30, 2015, $431,392 [2014 – $482,352] of mortgages were placed with institutional investors which created gains on deferred placement fees of $2,528 [2014 – $2,351]. Cash receipts on deferred placement fees receivable for the three months ended September 30, 2015 were $2,732 [2014 – $2,311].

The Company uses various assumptions to value the deferred placement fees receivable, which are set out in the table below, including the rate of unscheduled prepayments. Accordingly, the deferred placement fees receivable are subject to measurement uncertainty. As at September 30, 2015, the fair value of deferred placement fees receivable is $37,332 [December 31, 2014 – $34,644]. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment speed for the commercial segment was used, as borrowers cannot refinance for financial advantage without paying the Company a fee commensurate with its investment in the mortgage. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income. Key economic weighted average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are summarized as follows. Note that there is no deferred placement fee receivable balance outstanding related to the residential segment as at September 30, 2015.

	September 30, 2015
	Commercial mortgages
Average life [in months] [1]	**62**
Residual cash flows discount rate [annual rate]	**3.5%**
Impact on fair value of 10% adverse change	**$329**
Impact on fair value of 20% adverse change	**$653**

[Unaudited – in thousands of Canadian dollars, except per share amounts
or unless otherwise noted]

	December 31, 2014	
	Commercial mortgages	**Residential mortgages**
Average life [in months] [1]	60	26
Prepayment speed assumption [annual rate]	—	15.0%
Impact on fair value of 10% adverse change	—	$2
Impact on fair value of 20% adverse change	—	$5
Residual cash flows discount rate [annual rate]	4.4%	4.0%
Impact on fair value of 10% adverse change	$380	$1
Impact on fair value of 20% adverse change	$752	$1

[1] The weighted average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments], which might magnify or counteract the sensitivities.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

5. MORTGAGES ACCUMULATED FOR SALE OR SECURITIZATION

Mortgages accumulated for sale or securitization consist of mortgages the Company has originated for its own securitization programs together with mortgages funded in advance of settlement with institutional investors.

Mortgages originated for the Company's own securitization programs are classified as loans and receivables and are recorded at amortized cost. Mortgages funded for placement with institutional investors are designated as FVTPL and are recorded at fair value. The fair values of mortgages at FVTPL approximate their carrying values due to their short-term nature. The following table summarizes the components of mortgages according to their classification:

	September 30, 2015 $	**December 31, 2014** $
Mortgages accumulated for securitization	**1,312,091**	1,354,572
Mortgages accumulated for sale	**37,017**	15,206
	1,349,108	1,369,778

The Company's exposure to credit loss is limited to $312,635 [December 31, 2014 – $419,297] in principal balances of uninsured mortgages within mortgages accumulated for sale or securitization, before consideration of the value of underlying collateral. These are conventional prime single-family mortgages similar to the mortgages described in note 3. For the same rationale the Company has not provided any provision for credit loss.

[Unaudited – in thousands of Canadian dollars, except per share amounts
or unless otherwise noted]

6. MORTGAGE AND LOAN INVESTMENTS

Mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within one year.

Mortgage and loan investments consist of the following:

	September 30, 2015 $	**December 31, 2014** $
Mortgage loans, classified as loans and receivables	**242,453**	175,570
Mortgage loans, designated as FVTPL	**46,114**	54,818
	288,567	230,388

Mortgage and loan investments classified as loans and receivables are carried at outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

Within mortgage and loans investments, the total of uninsured mortgages in arrears is approximately $40.7 million. Four of these mortgages are non-performing and have principal balances totaling $39,315 as of September 30, 2015 [December 31, 2014 – six mortgages, totaling $36,263]. The Company has stopped accruing interest on three of these mortgages, and has provided an allowance for potential credit loss of $5,041 as at September 30, 2015 [December 31, 2014 – $4,041]. The Company acknowledges that there is a higher risk of credit losses on this portfolio than the other mortgage portfolios on its statement of financial position. The Company believes it has adequately provided for such losses in the allowance for potential credit loss disclosed above and considers there to be a small risk of credit loss on performing mortgages, such that credit losses have not been recorded on any of these mortgages.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

7. MORTGAGES UNDER ADMINISTRATION

As at September 30, 2015, the Company had mortgages under administration of $92,630,375 [December 31, 2014 – $85,889,561], including mortgages held on the Company's interim condensed consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at September 30, 2015, the Company administered 291,150 mortgages [December 31, 2014 – 274,674] for 96 institutional investors [December 31, 2014 – 93] with an average remaining term to maturity of 42 months [December 31, 2014 – 42 months].

Mortgages under administration are serviced as follows:

	September 30, 2015 $	**December 31, 2014** $
Institutional investors	**58,370,225**	53,625,460
Mortgages accumulated for sale or securitization and mortgage and loan investments	**1,349,108**	1,593,103
Deferred placement investors	**5,823,825**	5,197,507
Mortgages pledged under securitization	**24,145,690**	22,170,195
CMBS conduits	**2,941,527**	3,303,296
	92,630,375	85,889,561

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5. As at September 30, 2015, the Company has included in accounts receivable and sundry $21,486 [December 31, 2014 – $17,233] of insured non-performing mortgages, and $349 [December 31, 2014 – $229] of uninsured non-performing mortgages [net of provisions for credit losses]. The Company incurred actual credit losses, net of recoveries, of $180 during the three months ended September 30, 2015 [2014 – nil].

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the interim condensed consolidated statements of financial position. The aggregate of these accounts as at September 30, 2015 was $548,304 [December 31, 2014 – $537,524].

8. BANK INDEBTEDNESS

Bank indebtedness includes a revolving credit facility of $1,000,000 [December 31, 2014 – $1,000,000] maturing in May 2020, of which $622,833 [December 31, 2014 – $609,639] was drawn as at September 30, 2015 and against which the following have been pledged as collateral:

[a] a general security agreement over all assets, other than real property, of the Company; and

[b] a general assignment of all mortgages owned by the Company.

The credit facility bears a variable rate of interest based on prime and bankers' acceptance rates.

9. DEBT RELATED TO SECURITIZED AND PARTICIPATION MORTGAGES

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at September 30, 2015, debt related to securitized mortgages was $24,427,213 [December 31, 2014 – $22,555,678], net of unamortized discounts of $62,763 [December 31, 2014 – $56,482]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at September 30, 2015, debt related to participation mortgages was $20,755 [December 31, 2014 – $17,684].

Debt related to securitized and participation mortgages is reduced on a monthly basis when the principal payments received from the mortgages are applied. Debt discounts and premiums are amortized over the term of each debt on an effective yield basis.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

10. SHAREHOLDERS' EQUITY

[a] Authorized

Unlimited number of common shares
Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 1
Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 2

[b] Capital stock activities

	Common shares		Preferred shares	
	#	$	#	$
Balance, December 31, 2014 and September 30, 2015	**59,967,429**	**122,671**	**4,000,000**	**97,394**

[c] Earnings per share

	Three months ended September 30,		Nine months ended September 30,	
	2015	**2014**	**2015**	**2014**
Net income attributable to shareholders	**$29,308**	$35,331	**$68,347**	$86,609
Less dividends declared on preferred shares	**(1,163)**	(1,163)	**(3,488)**	(3,488)
Less earnings related to non-controlling interests	**(459)**	(640)	**(1,778)**	(2,079)
Net earnings attributable to common shareholders	**$27,686**	$33,528	**$63,081**	$81,042
Number of common shares outstanding	**59,967,429**	59,967,429	**59,967,429**	59,967,429
Basic earnings per common share	**$0.46**	$0.56	**$1.05**	$1.35

11. SENIOR UNSECURED NOTES

On April 9, 2015, the Company issued $175 million of new senior unsecured notes for a five-year term maturing on April 9, 2020. The notes bear interest at 4.01% payable in equal semi-annual payments commencing October 9, 2015. The net proceeds of the issuance [$174.3 million, net of financing fees] has been invested in FNFLP. Effectively, the Company used the proceeds from the issuance to fund the maturity of the $175 million 5.07% debentures on May 7, 2015.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value measurement

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments recorded at fair value in the interim condensed consolidated statements of financial position:

Level 1 – quoted market price observed in active markets for identical instruments;
Level 2 – quoted market price observed in active markets for similar instruments or other valuation techniques for which all significant inputs are based on observable market data; and
Level 3 – valuation techniques in which one or more significant inputs are unobservable.

Valuation methods and assumptions

The Company uses valuation techniques to estimate fair values, including reference to third party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

[a] FVTPL mortgages in mortgages under securitization and certain mortgage and loan investments

The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices. Discount rates used are determined by comparison to similar term loans made to borrowers with similar credit. This methodology will reflect changes in interest rates which have occurred since the mortgages were originated. Impaired mortgages are recorded at net realizable value. Refer to note 3 “Mortgages pledged under securitization” for the key assumptions used and sensitivity analysis.

[b] Deferred placement fees receivable

The fair value of deferred placement fees receivable is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the placed mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data. Refer to note 4 "Deferred placement fees receivable" for the key assumptions used and sensitivity analysis.

[c] Securities owned and sold short

The fair values of securities owned and sold short used by the Company to hedge its interest rate exposure are determined by quoted prices.

[d] Servicing liabilities

The fair value of the servicing liability is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cost related to the servicing of explicit mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

[e] Other financial assets and financial liabilities

The fair value of mortgage and loan investments classified as loans and receivables, mortgages accumulated for sale or securitization, cash held as collateral for securitization, restricted cash and bank indebtedness corresponds to the respective outstanding amounts due to their short-term maturity profiles.

Carrying value and fair value of selected financial instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of $24,329,330 [December 31, 2014 – $22,337,378] and a fair value of $24,782,706 [December 31, 2014 – $22,734,523], debt related to securitized and participation mortgages, which has a carrying value of $24,447,968 [December 31, 2014 – $22,573,362], and a fair value of $24,682,452 [December 31, 2014 – $22,802,804] and senior unsecured notes, which has a carrying value of $174,386 [December 31, 2014 – nil], and a fair value of $177,286 [December 31, 2014 – nil]. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3].

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2015

The following tables represent the Company's financial instruments measured at fair value on a recurring basis:

	September 30, 2015			
	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets				
Mortgages accumulated for sale	**—**	**37,017**	**—**	**37,017**
FVTPL mortgages	**—**	**—**	**3,252,570**	**3,252,570**
Deferred placement fees receivable	**—**	**—**	**37,332**	**37,332**
Mortgage and loan investments	**—**	**—**	**46,114**	**46,114**
Total financial assets	**—**	**37,017**	**3,336,016**	**3,373,033**
Financial liabilities				
Securities sold under repurchase agreements and sold short	**1,065,175**	**—**	**—**	**1,065,175**
Interest rate swaps	**—**	**35,139**	**—**	**35,139**
Total financial liabilities	**1,065,175**	**35,139**	**—**	**1,100,314**

	December 31, 2014			
	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets				
Mortgages accumulated for sale	—	15,206	—	15,206
FVTPL mortgages	—	—	3,983,793	3,983,793
Deferred placement fees receivable	—	—	34,644	34,644
Mortgage and loan investments	—	—	54,818	54,818
Interest rate swaps	—	1,432	—	1,432
Total financial assets	—	16,638	4,073,255	4,089,893
Financial liabilities				
Securities sold under repurchase agreements and sold short	1,330,699	—	—	1,330,699
Interest rate swaps	—	9,580	—	9,580
Debenture loan payable	—	176,418	—	176,418
Total financial liabilities	1,330,699	185,998	—	1,516,697

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used including those that are not fully supported by observable market prices or rates [Level 3]. The amount of the change in fair value recognized by the Company in net income for the three months ended September 30, 2015 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was a loss of $5,491 [2014 – gain of $1,316]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the interim condensed consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

Transfers between levels in the fair value hierarchy are deemed to have occurred at the beginning of the period in which the transfer is made. Transfers between levels can occur as a result of additional or new information regarding valuation inputs and changes in their observability. During the quarter, the Company did not have any transfers between levels.

The following table presents changes in the fair values including realized losses of $11,489 [2014 – loss of $8,194] of the Company's financial assets and financial liabilities for the quarters ended September 30, 2015 and 2014, all of which have been classified as FVTPL:

	Three months ended September 30,		**Nine months ended September 30,**	
	2015	**2014**	**2015**	**2014**
	$	$	$	$
FVTPL mortgages	**(11,294)**	172	**(18,852)**	7,957
Deferred placement fees receivable	**241**	(50)	**708**	81
Securities owned and sold short	**(7,993)**	(702)	**(34,342)**	(24,936)
Interest rate swaps	**(17)**	38	**13**	(30)
	(19,063)	(542)	**(52,473)**	(16,928)

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

Movement in Level 3 financial instruments measured at fair value

The following tables show the movement in Level 3 financial instruments in the fair value hierarchy for the three months ended September 30, 2015 and 2014. The Company classifies financial instruments to Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at July 1, 2015 $	**Investments** $	**Unrealized gains (losses) recorded in income** $	**Payments and amortization** $	**Fair value as at September 30, 2015** $
Financial assets					
FVTPL mortgages	**3,358,820**	**401,768**	**(5,732)**	**(502,286)**	**3,252,570**
Deferred placement fees receivable	**36,692**	**2,564**	**241**	**(2,165)**	**37,332**
Mortgage and loan investments	**48,621**	**7,449**	**—**	**(9,956)**	**46,114**
Total financial assets	**3,444,133**	**411,781**	**(5,491)**	**(514,407)**	**3,336,016**

	Fair value as at July 1, 2014 $	**Investments** $	**Unrealized gains (losses) recorded in income** $	**Payments and amortization** $	**Fair value as at September 30, 2014** $
Financial assets					
FVTPL mortgages	4,140,639	592,163	1,366	(680,361)	4,053,807
Deferred placement fees receivable	33,636	2,214	(50)	(2,138)	33,662
Mortgage and loan investments	59,156	—	—	(2,490)	56,666
Total financial assets	4,233,431	594,377	1,316	(684,989)	4,144,135

13. CAPITAL MANAGEMENT

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's equity, long-term debt and retained earnings. The Company has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the unsecured notes to four times FNFLP's equity. As at September 30, 2015, the ratio was 1.83:1 [December 31, 2014 – 1.85:1]. The Company was in compliance with the bank covenant throughout the period.

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

14. EARNINGS BY BUSINESS SEGMENT

The Company operates principally in two business segments, Residential and Commercial. These segments are organized by mortgage type and contain revenue and expenses related to origination, underwriting, securitization and servicing activities. Identifiable assets are those used in the operations of the segments.

	Three months ended September 30, 2015			Nine months ended September 30, 2015		
	Residential	**Commercial**	**Total**	**Residential**	**Commercial**	**Total**
	$	$	$	$	$	$
REVENUE						
Interest revenue – securitized mortgages	**120,511**	**36,000**	**156,511**	**354,622**	**106,813**	**461,435**
Interest expense – securitized mortgages	**(94,944)**	**(29,047)**	**(123,991)**	**(281,272)**	**(86,468)**	**(367,740)**
Net interest – securitized mortgages	**25,567**	**6,953**	**32,520**	**73,350**	**20,345**	**93,695**
Placement and servicing	**80,164**	**15,071**	**95,235**	**176,519**	**38,450**	**214,969**
Mortgage investment income	**8,571**	**5,387**	**13,958**	**26,348**	**15,028**	**41,376**
Realized and unrealized gains (losses) on financial instruments	**(14,968)**	**(4,095)**	**(19,063)**	**(47,782)**	**(4,691)**	**(52,473)**
	99,334	**23,316**	**122,650**	**228,435**	**69,132**	**297,567**
EXPENSES						
Amortization	**1,593**	**646**	**2,239**	**4,702**	**1,939**	**6,641**
Interest	**7,654**	**1,377**	**9,031**	**24,607**	**3,150**	**27,757**
Other operating	**61,353**	**10,374**	**71,727**	**143,344**	**27,533**	**170,877**
	70,600	**12,397**	**82,997**	**172,653**	**32,622**	**205,275**
Income before income taxes	**28,734**	**10,919**	**39,653**	**55,782**	**36,510**	**92,292**
Identifiable assets	22,277,138	5,317,445	27,594,583	22,277,138	5,317,445	27,594,583
Goodwill	—	—	29,776	—	—	29,776
Total assets	22,277,138	5,317,445	27,624,359	22,277,138	5,317,445	27,624,359
Capital expenditures	**199**	**85**	**284**	**2,281**	**977**	**3,258**

First National Financial Corporation

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

[Unaudited – in thousands of Canadian dollars, except per share amounts or unless otherwise noted]

September 30, 2015

	Three months ended September 30, 2014			Nine months ended September 30, 2014		
	Residential $	Commercial $	Total $	Residential $	Commercial $	Total $
REVENUE						
Interest revenue – securitized mortgages	107,510	35,296	142,806	301,448	101,194	402,642
Interest expense – securitized mortgages	(85,653)	(28,365)	(114,018)	(234,237)	(83,175)	(317,412)
Net interest – securitized mortgages	21,857	6,931	28,788	67,211	18,019	85,230
Placement and servicing	61,807	11,070	72,877	145,763	32,127	177,890
Mortgage investment income	9,764	5,648	15,412	25,792	15,457	41,249
Realized and unrealized gains (losses) on financial instruments	614	(1,157)	(543)	(10,310)	(6,618)	(16,928)
	94,042	22,492	116,534	228,456	58,985	287,441
EXPENSES						
Amortization	1,302	657	1,959	3,903	1,972	5,875
Interest	9,704	567	10,271	24,348	1,525	25,873
Other operating	47,861	8,822	56,683	114,387	24,207	138,594
	58,867	10,046	68,913	142,638	27,704	170,342
Income before income taxes	35,175	12,446	47,621	85,818	31,281	117,099
Identifiable assets	20,158,135	4,889,450	25,047,585	20,158,135	4,889,450	25,047,585
Goodwill	—	—	29,776	—	—	29,776
Total assets	20,158,135	4,889,450	25,077,361	20,158,135	4,889,450	25,077,361
Capital expenditures	1,583	678	2,261	4,020	1,723	5,743

15. RELATED PARTY AND OTHER TRANSACTIONS

The Company has referred several commercial mezzanine mortgage opportunities to various businesses controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. The mortgages, which are administered by the Company, have a balance of $33,661 as at September 30, 2015 [December 31, 2014 – $24,765]. Three of the mortgages are secured by real estate in which the Company is also a mortgage lender. For one of the mortgages, the Company's interests are ranked subordinately of the interests held by the controlled business.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid by the Company during the three-month period ended September 30, 2015 was $176 [2014 – $518], net of third party investor reimbursement. The insurance company has also engaged the Company to service a portfolio of mortgages at market commercial servicing rates. As at September 30, 2015, the portfolio had a balance of $7.1 million [December 31, 2014 – $8.8 million].

16. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative unaudited interim condensed consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2015 unaudited interim condensed consolidated financial statements.

First National Financial Corporation

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