FIRST NATIONAL

FINANCIAL CORPORATION

Report to Shareholders

Period Ended June 30, 2019

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Fellow Shareholders:

First National delivered strong performance in the second quarter of 2019. By successfully executing its business model, the Company took advantage of a solid economy, a low interest rate environment and market seasonality. Among the highlights:

- Mortgages Under Administration increased 6% to $109.6 billion year over year
- Revenue increased 15% to $335.2 million from $290.9 million a year ago
- Net income was $44.2 million ($0.72 per share) compared to $46.3 million ($0.76 per common share) a year ago
- Dividends declared amounted to $28.5 million, compared to $27.7 million a year ago, reflecting an increase in December 2018 that brought the annualized rate to $1.90 per share (paid monthly) from $1.85 per share. The common share payout ratio was 66% compared to 61% a year ago

New mortgage originations of $6.4 billion surpassed our expectations. After a slow start to the year, we're very pleased with the results of the second quarter.

Outlook

Management remains optimistic for the remainder of the year. Single-family mortgage commitments continue to outpace those at the same time in 2018, although not by the same degree as evidenced at the end of the first quarter of 2019. Similarly, the commercial segment continues to meet its growth initiatives and increase its presence across the country. While it is unlikely the growth rate of 50% in new commercial mortgage originations recorded in the second quarter will be repeated, the Company continues to forecast double digit rates of growth. Despite these favorable indications, the Company will continue to be faced with tight securitization margins as mortgage rates tightened toward quarter end and the effect of pre 2018 fair value accounting conventions will continue to have a negative impact on income for most of 2019.

The Company will continue to generate income and cash flow from its $31 billion portfolio of mortgages pledged under securitization and $76 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.

Yours 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 ("MD&A") of financial condition and results of operations is prepared as of July 30, 2019. This discussion should be read in conjunction with the unaudited condensed consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the three months (the "period') ended June 30, 2019. The unaudited condensed 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 almost $110 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.

Second Quarter 2019 Results Summary

Management is very pleased with the results of the second quarter of 2019. After a slow start to the year, single family origination increased 13% in the second quarter of 2019. The commercial segment was very strong, such that total origination was higher by 50% in the quarter compared to 2018. The higher volume had a favorable impact on earnings as Pre-FMV earnings increased by 22% in the quarter.

- MUA grew to $109.6 billion at June 30, 2019 from $103.6 billion at June 30, 2018, an increase of 6%; the growth from March 31, 2019, when MUA was $107.0 billion, was 10% on an annualized basis;
- Total new single-family mortgage origination was $3.9 billion in the second quarter of 2019 compared to $3.4 billion in the 2018 comparative quarter, an increase of 13%. The Company attributes this to a strong economy, lower mortgage rates and First National's market share in the mortgage broker channel. The commercial segment had a record quarter with origination of $2.6 billion, 50% more than the $1.7 billion originated in the second quarter of 2018. Overall new origination increased by 26% in the quarter compared to the second quarter of 2018;
- The Company took advantage of opportunities in the quarter to renew $1.5 billion of single-family mortgages. In 2018 second quarter, the Company renewed $1.9 billion of single-family mortgages. For the commercial segment, renewals increased to $664 million from $299 million;
- Revenue for second quarter of 2019 increased by 15% to $335.2 million from $290.9 million in the second quarter of 2018. The increase is related to a change in the funding mix in the quarter from securitization to placement through institutional investors. The volume of origination for institutions increased by 62% which resulted in an increase of $29 million in placement fee revenue. In addition, the comparatively higher interest rate environment which began in mid-2017 had an impact. Because of higher interest rates in recent years, mortgages added to the portfolio of securitized mortgages in those years have higher interest rates than the average rates of the mortgages maturing in the securitized portfolio. Interest revenue on securitized mortgages increased by $29 million between the quarters;
- Income before income taxes decreased to $60.3 million in the second quarter of 2019 from $63.0 million in the second quarter 2018. A significant reason for the decrease was changing capital markets conditions. In aggregate, the impact from financial instruments decreased this measure by $17.2 million comparing the second quarter of 2019 to the 2018 quarter; and
- The Company's earnings before income taxes, depreciation and amortization and gains and losses on financial instruments ("Pre-FMV EBITDA") for the second quarter of 2019 increased by 22% to $68.5 million from $56.0 million in the 2018 quarter. The increase is the result of wider mortgage spreads. With the sudden drop of interest rates recorded at the beginning of 2019, mortgage spreads started the year at levels not seen since 2016. Combined with higher volumes originated in the 2019 second quarter, the Company's placement transactions increased in value. Net interest margin from the securitized mortgage portfolio was lower by $0.8 million than in the second quarter of 2018, but increased by $3.6 million from the amount earned in the first quarter of 2019 as the impact of the accounting convention used for economic hedges prior to 2018 decreased.

Selected Quarterly Information

Quarterly Results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net Income for the period	Pre-FMV EBITDA for the period (1)	Net Income per Common Share	Total Assets
2019					
Second Quarter	$335,241	$44,164	$68,522	$0.72	$37,229,876
First Quarter	$286,311	$23,478	$40,225	$0.38	$36,193,793
2018					
Fourth Quarter	$312,039	$32,220	$55,780	$0.53	$36,038,527
Third Quarter	$321,835	$51,958	$62,989	$0.85	$35,597,827
Second Quarter	$290,935	$46,347	$56,048	$0.76	$35,794,066
First Quarter	$256,701	$35,902	$50,368	$0.59	$33,846,283
2017					
Fourth Quarter	$270,015	$45,948	$61,093	$0.75	$32,776,278
Third Quarter	$284,315	$58,809	$51,826	$0.96	$31,548,130

(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 (except those on mortgage investments) 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. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as mortgage rates. Because mortgage rates and MUA have both increased, revenue has also increased. Net income is partially dependent on conditions in bond markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the Company's core business. By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

Generally, in the years after the credit crisis in 2008, the Company grew its origination volumes which provided larger servicing and securitization portfolios. To the extent the Company employed securitization strategies, net interest margins were locked in for five- and ten-year terms. These margins were wide in 2008 as financial institutions maintained mortgage rates despite a significant drop in the cost of funds. Since 2008, such margins have steadily declined with competitive pressures and new securitizations are at much tighter spreads. For the Company this has meant that as high spread securitization transactions have matured and been replaced with new securitizations, profitability has decreased. This trend is evident in the Pre-FMV EBITDA figures above. In the third quarter 2017, Pre-FMV EBITDA was lower than expected as placement fees were negatively affected by a rising interest rate environment. The Company earned $14.4 million as a gain on holding short bonds in the second quarter 2017. Consistent with the Company's reporting practice, this amount was deducted from earnings to determine Pre-FMV EBITDA. However, this gain reduced the value of the hedged mortgages and when these were placed in the third quarter 2017, earnings were negatively affected. In the first quarter of 2019, Pre-FMV EBITDA was lower than the first quarter of 2018 due primarily to securitization spreads which have tightened significantly over the past several years. This trend reversed in the second quarter of 2019 as the Company was able to take advantage of wider mortgage spreads to increase profitability.

Outstanding Securities of the Corporation

At June 30, 2019 and July 30, 2019, the Corporation had 59,967,429 common shares; 2,887,147 Class A preference shares, Series 1; 1,112,853 Class A preference shares, Series 2; and 175,000 April 2020 senior unsecured notes outstanding.

Selected Annual Financial Information and Reconciliation to Pre-FMV EBITDA(1)

($000s, except per share amounts)

	2018	2017	2016
For the Year ended December 31, Income Statement Highlights			
Revenue	1,181,510	1,078,768	1,049,818
Interest expense – securitized mortgages	(646,069)	(511,939)	(495,681)
Brokerage fees	(75,354)	(83,260)	(103,719)
Salaries, interest and other operating expenses	(227,739)	(193,032)	(169,129)
Deduct: realized and unrealized gains on financial instruments	(3,162)	(56,259)	(27,750)
Deduct: unrealized losses regarding mortgage investments	(4,000)	—	—
Pre-FMV EBITDA(1)	225,186	234,278	253,539
Amortization of intangible and capital assets	(4,931)	(5,135)	(7,160)
Add: realized and unrealized gains on financial instruments excluding those on mortgage investments	7,162	56,259	27,750
Provision for income taxes	(60,990)	(75,750)	(72,300)
Net income	166,427	209,652	201,829
Common share dividends declared	171,407	184,400	98,946
Per Share Highlights			
Net income per common share	2.73	3.42	3.28
Dividends per common share	2.86	3.08	1.65
At Year End Balance Sheet Highlights Total assets	36,038,527	32,776,278	30,394,465
Total long-term financial liabilities	174,829	174,693	174,556

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

Key Performance Drivers

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

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

Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, longer-term value from servicing rights, renewals and the growth of the customer base for marketing initiatives. As at June 30, 2019, MUA totalled $109.6 billion, up from $103.6 billion at June 30, 2018, an increase of 6%. The growth of MUA in the second quarter of 2019 on an annualized basis was 10%.

Growth in Origination of Mortgages

Direct origination by the Company

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. Increased origination satisfies demand from its institutional customers and produces volume for the Company's own securitization programs. In the second quarter of 2019, the Company's single-family origination increased across most of the country. The Company believes this is the result of a strong economy coupled with lower mortgage rates and First National's market share in the mortgage broker distribution channel. The growth was experienced across all sales office with the exception of the Vancouver office: Toronto (25%), Vancouver (-2%), Calgary (6%) and Montreal (8%). In aggregate, the Company's single-family origination grew in the second quarter of 2019 by 13%. The commercial segment had record volume in the second quarter of 2019, growing from $1.7 billion in 2018 quarter to $2.6 billion in the 2019 second quarter. Together, overall new origination for the second quarter of 2019 increased 26% year over year.

Third Party Mortgage Underwriting and Fulfillment Processing Services

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

Relaunch of Excalibur Mortgage Products

In April 2018, the Company relaunched its alternative single family ("Excalibur") mortgage products. Alternative lending describes single family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. Alternative borrowers are generally considered "A" quality borrowers in terms of their credit histories, but do not qualify for a prime mortgage because of non-conformities, such as the degree of income disclosure and verification required. The Excalibur program also includes a product for borrowers with recently remediated credit. These mortgages generally have higher interest rates than prime mortgages. Although the Company's original alternative program was discontinued in 2008 as a result of the credit crisis, First National's relationships with mortgage brokers and underwriting systems allowed it to seamlessly relaunch the product in the spring of 2018. To start, the product has been originated for placement with institutional investors with the Company earning a one-time placement fee and servicing income over the term of the mortgages. In April 2019, the Company finalized an agreement with a bank sponsored securitization conduit to fund a portion of the Excalibur origination. The Excalibur relaunch has been rolled out gradually, beginning in Ontario. Currently the program is open to include all Ontario brokers with a potential expansion to Western Canada later in 2019.

Raising Capital for Operations

Bank Credit Facility

The Company has a revolving line of credit with a syndicate of banks of $1.25 billion. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In the second quarter of 2019, the Company extended the term of the facility by one year such that the maturity is now March 2024. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than the senior unsecured notes, which are fully drawn during their term; (3) the five-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Preferred Share Issuance

Commencing on April 1, 2016, the Company reset the dividend rate on the 2,887,147 Class A Series 1 preference shares issued in 2011 which did not elect to convert to Class A Series 2 preference shares. The Series 1 shares provide an annual dividend rate of 2.79%. Also, effective April 1, 2016, 1,112,853 Class A Series 2 were issued on the conversion from Series 1 shares. These bear a floating rate dividend calculated quarterly based on the 90-day T-Bill rate. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Director approval and are redeemable at the discretion of the Company such that after the five-year term ending on March 31, 2021, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While the investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (or vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital and classifies the shares as equity on its balance sheet. Management believes this capital has provided the Company with the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

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 served as an issuer and administrator 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 provides the Company with direct and independent access to reliable and low-cost funding.

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 - 2013	1.79%
2014	1.57%
2015	1.87%
2016	1.76%
2017	1.36%
2018	1.36%
2019 first quarter	1.67%
2019 second quarter	1.40%

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 2013, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels; however, in 2015, mortgage spreads quickly widened as a slowdown in economic growth and the Bank of Canada rate cut reduced bond yields dramatically. This trend continued into 2016, as optimism about the economy was mixed such that spreads remained at levels in excess of 1.8%. In 2017 and 2018, economic information was favorable and competition was strong such that spreads were the tightest seen in the past decade. With renewed worries about global economics, interest rates on government debt decreased suddenly in the first quarter of 2019. Mortgage rates stayed relatively higher as lenders delayed reducing profit margins in an unsettled economy. With competitive pressure through the second quarter of 2019, spreads tightened further, close to 2018 averages. In the second quarter of 2019, the Company originated and renewed for securitization purposes approximately $1.9 billion of single-family mortgages and $0.5 billion of multi-unit residential mortgages. In the second quarter of 2019, the Company securitized through NHA-MBS approximately $1.6 billion of single-family mortgages and $0.3 billion of multi-unit residential mortgages.

In August 2013, CMHC announced that it would be limiting the amount of guarantees it would provide 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. 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 maximum amount allocated under the process has exceeded First National's requirements in every quarter since inception. The process was amended in July 2016 to combine both NHA-MBS pools for sale to the market and to CHT under one allocation. The available guarantees to be allocated were increased to accommodate issuance to CHT and continue to exceed the Company's current needs.

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. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations. Beginning in July 2016, CHT effectively increased the price of the timely payment guarantees which CMB participants are required to purchase with the issuance of each CMB transaction. Although nominally CMB fees decreased, these rules require guarantee fees to be levied on the creation of NHA MBS pools being sold to the CMB. Prior to this rule change, the NHA MBS pools to be sold into the CMB were exempt from such fees. In aggregate, guarantee fees increased between 25% and 50% for CMB participants. This increase translates to approximately five basis points of cost over the term of the securitization. Since 2016, CMHC has also modified the tiered NHA MBS guarantee fee pricing structure, increasing the issuance threshold for increased fees from $7.5 billion to $9.0 billion. The tiered limit of $9.0 billion remains unchanged for 2019. In the second quarter of 2019, the Company, through its subsidiary First National Asset Management Inc. ("FNAM"), also took advantage of funding provided by the CMB, issuing two NHA MBS pools totalling $16 million and securitizing those pools in the CMB program.

Key Performance Indicators

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

- Earnings before income taxes, depreciation, and losses and gains on financial instruments with the exception of any losses related to mortgage investments ("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. 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		**Six months ended**	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
For the Period		**($ 000's)**		
Revenue	335,241	290,935	621,552	547,636
Income before income taxes	60,264	63,017	92,342	112,289
Pre-FMV EBITDA (1)	68,522	56,048	108,747	106,416
At Period end				
Total assets	37,229,876	35,794,066	37,229,876	35,794,066
Mortgages under administration	109,588,468	103,574,915	109,588,468	103,574,915

Note:

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

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

Determination of Common Share Dividend Payout Ratio

	Quarter ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
For the Period		**($000s)**		
Net income attributable to common shareholders	43,400	45,621	66,115	80,818
Total dividends paid or declared on common shares	28,485	27,735	56,969	55,470
Total common share dividend payout ratio	66%	61%	86%	69%
After-tax Pre-FMV dividend payout ratio (2)	58%	70%	74%	74%

Note:

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

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

For the quarter ended June 30, 2019, the common share payout ratio was 66% compared to 61% in the 2018 second quarter. In both 2019 and 2018 quarters, the Company recorded significant gains and losses on account of the changes in fair value of financial instruments. The gains and losses are recorded in the period in which the prices on Government of Canada bond yields change; however, the offsetting economic impact is largely to be reflected in mortgage spreads in the future from the mortgages pledged for securitization. Accordingly, management considers this a timing issue related to income recognition. If the gains and losses on financial instruments in the two periods are excluded, the dividend payout ratio for the second quarter of 2019 would have been 58% compared to 70% in 2018.

The Company also paid $0.8 million of dividends on its preferred shares in the second quarter of 2019 compared to $0.7 million in 2018 second quarter.

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 June 30, 2019, new origination volume increased from $5.1 billion to $6.4 billion, or about 26%, compared to the 2018 second quarter.

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 $8.6 billion of new originations and renewals in the second quarter of 2019, $2.4 billion was originated for its own securitization programs.

Placement Fees and Gain on Deferred Placement Fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "placement fees". The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a "deferred placement fee". A deferred placement fee arises when mortgages with spreads in excess of a base spread are placed. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a "deferred placement fee receivable" that is amortized as the fees are received by the Company. Of the Company's $8.6 billion of new originations and renewals in the second quarter of 2019, $5.9 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 are included in "Mortgage servicing income" in the consolidated statement of income.

Results of Operations

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

	Quarter ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
	($ millions)			
Mortgage Originations by Segment				
New single-family residential	3,885	3,423	5,720	5,593
New multi-unit and commercial	2,562	1,710	3,764	2,911
Sub-total	6,447	5,133	9,484	8,504
Single-family residential renewals	1,470	1,909	2,386	2,932
Multi-unit and commercial renewals	664	299	1,050	451
Total origination and renewals	8,581	7,341	12,920	11,887
Mortgage Originations by Funding Source				
Institutional investors – new residential	2,392	1,197	3,402	1,923
Institutional investors – renew residential	996	816	1,318	1,177
Institutional investors – multi/commercial	2,543	1,659	3,667	2,579
NHA-MBS/ CMB/ABCP securitization	2,403	3,429	4,062	5,766
Internal Company resources/CMBS	247	240	471	442
Total	8,581	7,341	12,920	11,887
Mortgages under Administration				
Single-family residential	80,272	78,025	80,272	78,025
Multi-unit residential and commercial	29,316	25,550	29,316	25,550
Total	109,588	103,575	109,588	103,575

Total new mortgage origination volumes increased in the second quarter of 2019 compared to 2018 by 26%. Single-family volumes increased by 13% and commercial segment volumes increased by 50% year over year. Management believes the increase in the single-family segment is due to a strong economy coupled with low mortgage rates and the Company's position in the mortgage broker distribution channel. With lower risk-free interest rates, mortgage rates offered by the Company have decreased since December 31, 2018. Accordingly, despite new stress tests implemented as part of revised B-20 guidelines effective in 2019, lower mortgage rates make it comparatively easier for borrowers to qualify for similar mortgage amounts between the quarters. The Company believes that its strong market share in the mortgage broker channel has also led to increased origination. While B.C. volumes were down 2% from 2018, the remainder of the Company's regional offices experienced growth, particularly in Ontario and the Maritimes which increased by 25% over comparative volumes in 2018. When combined with renewals, total production increased from $7.3 billion in 2018 to $8.6 billion in 2019, or by 17%. One part of the strength in eastern Canada for new single-family origination is partially the result of the relaunch of its Excalibur program which has added increased origination volume compared to that in the second quarter of 2018. The Company's expertise in mortgage underwriting drove commercial segment origination (including renewals) higher by 61% in the second quarter of 2019. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volume of $2.4 billion in the second quarter of 2019.

Net Interest - Securitized Mortgages

Comparing the quarter ended June 30, 2019 to the quarter ended June 30, 2018, "net interest – securitized mortgages" decreased by about 3% to $34.6 million from $35.5 million. The decrease was due to the impact of accounting for financial instruments and tighter weighted-average mortgage spreads on the portfolio. Prior to adopting hedge accounting in 2018, the Company recorded gains and losses on financial instruments in its current earnings and earned tighter or wider securitization spreads in future periods. In both 2017 and 2016 the Company recorded very large gains as interest rates began to climb. The offset to these gains is generally more expensive debt raised on the securitized mortgages. As the securitization transactions related to these debts performs, a lower net securitization margin is recorded. The Company estimates that the impact of this accounting treatment has decreased net interest – securitized mortgages in the second quarter of 2019 by about $2.1 million year over year. Second, as described earlier in this MD&A, 2019 securitization spreads have widened with the decrease in risk-free interest rates. As the Company has securitized these mortgages, the increased margins have had a favorable impact on the overall net margin earned.

Placement Fees

Placement fee revenue increased by 95% to $60.4 million from $31.0 million in 2018. The increase was the result of a changing funding mix between the quarters. With 26% higher new origination, the Company placed about $5.9 billion of volume with institutional investors compared to $3.7 billion in the 2018 quarter. The increase of 60% was partially at the expense of securitization volume but drove most of the increase in placement fees. This increase was also the outcome of the single-family renewal division. Although volumes of renewals were lower than in the 2018 quarter, the value of renewals increased with the wider spreads that were prevalent for the first 6 months of the 2019 year. The Company benefited by placing a large portion of these with institutional investors for placement fees economically linked to the value of the underlying mortgages. Per unit placement fees for both new and renewed origination were higher in the quarter as a result of the interest rate movements. As described previously, the Company does not apply any hedge accounting for the interest rate risk program related to its single-family mortgage commitment pipeline. Accordingly, any gains or losses related to the financial instruments used for this program are recorded in the Company's current period net income. To the extent that any of these mortgage commitments become funded mortgages, the mortgages may be more or less valuable given the change in the interest rate environment. For 2019, bond yields dropped significantly creating large losses on financial instruments. The related mortgage commitments that became funded mortgages generally had higher mortgage rates than newly originated mortgages. The Company was able to immediately crystalize the value of such mortgages through placement transactions.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue increased 21% to $2.9 million from $2.4 million. The gains related to multi-unit residential mortgages originated and sold to institutional NHA-MBS issuers. Volumes for these transactions increased by 20% from 2018 and spreads on these transactions were similar year over year such that the Company realized consistent per unit gains.

Mortgage Servicing Income

Mortgage servicing income increased 5% to $39.0 million from $37.1 million. This increase was largely due to the benefits associated with higher MUA.

Mortgage Investment Income

Mortgage investment income decreased 2% to $21.8 million from $22.2 million. The decrease was due primarily to lower amount of commercial segment mortgage and loan investments held in the period which decreased by 24% year over year. This was offset by higher interest earned on mortgages held for securitization. Although mortgage rates are similarly between the periods, the Company carried higher average balances of these mortgages in the 2019 quarter. The Company earns interest on the mortgages during the warehouse period prior to securitization.

Realized and Unrealized Gains (Losses) on Financial Instruments

This financial statement line item typically consists of three components: (1) gains and losses related to the Company's economic hedging activities of single-family commitments, (2) gains and losses related to holding a portfolio of mortgage and loan investments at fair value, and (3) gains and losses on interest rate swaps used to mitigate interest rate risk associated with its CMB activity. With the adoption of IFRS 9 in 2018, a significant portion of the Company's interest rate management program qualifies as hedging for accounting purposes. The Company has elected to document hedging relationships for virtually all of the multi-residential commitments and mortgages it originates for its own securitization programs. It has also done the same for the funded single-family mortgages and the swaps used in its ABCP programs. This decision has reduced the volatility of gains and losses on financial instruments otherwise recorded in the Company's regular earnings as gains and losses on hedged items are generally deferred and amortized into income over the term of the related mortgages. The Company has not documented a hedging relationship for its interest mitigation program used to economically hedge commitments on single-family mortgages. The Company believes given the optional nature of these commitments it is difficult to establish a valid hedging relationship. For financial reporting purposes, this means that there will still be gains and losses on financial instruments, but these should be limited to those on the short bonds used to mitigate such risk. The Company has recorded mortgage and loan investments at fair value on its balance sheet. Accordingly, there are fair value gains or losses associated with these mortgages. The following table summarizes these gains and losses by category in the periods indicated:

	Quarter ended		Six months ended	
Summary of realized and unrealized gains (losses) on financial instruments	**June 30, 2019**	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
		($000s)		
Gains (losses) on short bonds used for the economic hedging program	(6,425)	8,614	(17,707)	9,390
Losses on mortgages held at fair value	(1,200)	(1,000)	(2,600)	(2,000)
Gains (losses) on interest rate swaps	(876)	(340)	3,215	(907)
Net gains (losses) on financial instruments	(8,501)	7,274	(17,092)	6,483

In 2018, economic data was generally positive and interest rates began the year climbing slowly higher. However, in the fourth quarter some poor economic data moved rates lower. Together with the adoption of hedge accounting by the Company in 2018, which removes some of the volatility from its earnings, First National had gains on financial instruments of about $8.6 million in the second quarter of 2018. In 2019, economic concerns had a significant impact on bond yields as bond prices rose in both the first two quarters. Overall, the Company experienced losses of $52.3 million on its total short bond book in the six months ended June 30, 2019; however about $34.6 million of this pertained to mortgages which the Company was able to apply hedge accounting. This left losses on account of financial instruments of $17.7 million. These losses largely reflect the decrease in the value of short bonds used to mitigate interest rate risk related to the Company's single-family mortgage commitments which the Company does not attempt to document a hedge relationship.

Brokerage Fees Expense

Brokerage fees expense increased 131% to $29.3 million from $12.7 million. This increase is explained by higher origination volumes of prime single-family mortgages for institutional investors which increased by 100% year over year. Broker fees on a per unit basis were slightly higher in the second quarter of 2019 compared to 2018; however, in the 2018 quarter the Company capitalized a greater portion of higher rate broker fees related to insured mortgage origination. Because the Company securitized a lower volume of mortgages in the 2019 quarter, higher rate broker fees were expensed. Portfolio insurance costs were also higher than in 2018 as the Company purchased new insurance policies to insure conventional mortgages originated for securitization and placement.

Salaries and Benefits Expense

Salaries and benefits expense increased 17% to $29.6 million from $25.3 million. Salaries were higher as overall headcount increased by 11% (936 employees as at June 30, 2018 and 1,040 at June 30, 2019). The increase was also the result of $2.8 million of higher compensation earned by commercial sales staff pursuant to increased origination in the 2019 second quarter. Management salaries were paid to the two senior executives (Co-founders) who together control about 74% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO") in 2006.

Interest Expense

Interest expense increased 11% to $18.8 million from $17.0 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the investor or funding with a securitization vehicle. The Company used the senior unsecured notes together with a $1.25 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense increased from the prior year due to higher short-term interest rates pursuant to Bank of Canada announcements that increased short-term borrowing rates by 0.75% from January 1, 2018 to the current quarter - an increase of 23%. The Company also carried higher amounts of mortgages accumulated for securitization in the second quarter of 2019 compared to 2018 which increased the related interest costs.

Other Operating Expenses

Other operating expenses decreased by 30% to $12.2 million from $17.5 million. The primary change in other operating expenses was lower hedge expenses which were $4.4 million lower than in the 2018 quarter. The expense decreased as bond yields moved downward in 2019. With 30-day interest rates remaining relatively static, it became cheaper to borrow the short bonds which the Company uses to hedge interest rate exposure. A smaller hedge book because of lower securitization activity also had an impact on this expense. The remaining decrease in other operating expenses of $0.9 million reflects information technology expenses incurred compared to the 2018 quarter.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes decreased by 4% to $60.3 million from $63.0 million. This decrease was affected by changing capital markets. In the second quarter of 2019, the Company recorded $8.5 million of losses on financial instruments (including $1.2 million of losses related to mortgage and loan investments). In the 2018 comparative quarter, the Company recorded $7.3 million of gains on financial instruments (which includes the impact of $1.0 million of losses related to mortgage and loan investments). The change in these values, excluding the losses on mortgage investments, accounted for a $15.6 million decrease in comparative income before income taxes. Pre-FMV EBITDA, which eliminates the impact of such gains and losses on financial instruments, increased by 22% to $68.5 million from $56.0 million. As described previously in this MD&A, not only did the Company increase new origination volumes by 26% but increased the amount of mortgages placed with institutional investors. By placing mortgages with investors as opposed to using securitization, the Company effectively accelerates the recognition of the value inherent in the mortgages to the current accounting period. With wider mortgage spreads prevalent for much of the 2019 quarter, the per unit value of the placements also were more favourable than in the 2018 quarter. Together the value of higher placement fee revenue net of the cost of the related broker fees, increased by $12.9 million year over year which describes the largest component of the increase in Pre-FMV EBITDA.

Provision for Income Taxes

The provision for taxes decreased by 4% to $16.1 million from $16.7 million. The provision decreased proportionately with net income before income taxes. The overall effective tax rate was consistent between the two quarters.

Other Comprehensive Income

Beginning January 1, 2018, the Company adopted IFRS 9. As a part of this transition the Company began accounting for some of its interest rate risk mitigation strategies as hedges for reporting purposes. For the commercial segment, the Company hedges the interest rate risk associated with insured multi-residential mortgages. This hedging begins on commitment and ends when the Company either securitizes the mortgages (primarily through CMB funding) or places the mortgage with an institutional investor. As the Company determined that these hedges were effective, the Company recorded $5.5 million of pre-tax net losses on such hedges in the second quarter of 2019 that would have been recorded as losses on financial instruments under the previous IFRS standard. In the quarter, the Company amortized these losses and a portion of opening accumulated OCI into regular earnings. In the second quarter, $6.1 million of pre-tax OCI was amortized into the Company's Net Income. The remaining OCI amount will be amortized into Net Income in future periods.

Operating Segment Review

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

	Operating Business Segments			
	Residential		**Commercial**	
	($000s except percent amounts)			
For the quarter ended	**June 30, 2019**	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
Originations and renewals	5,355,254	5,331,841	3,225,601	2,008,815
Percentage change	*0%*		*61%*	
Revenue	253,498	224,955	81,743	65,980
Percentage change	*13%*		*24%*	
Income before income taxes	41,744	47,400	18,520	15,617
Percentage change	*(12%)*		*19%*	
As at	**June 30, 2019**	**December 31, 2018**	**June 30, 2019**	**December 31, 2018**
Identifiable assets	28,539,107	27,717,831	8,660,993	8,289,520
Mortgages under administration	80,272,208	79,165,363	29,316,259	26,985,711

Residential Segment

Overall residential origination volumes including renewals were largely the same between the 2019 and 2018 second quarters while residential revenues increased by 13%. Revenues in both quarters were affected by gains and losses on fair value associated with changing interest rates. If revenues are normalized for these gains and losses, revenue would have increased by 20%. Revenue growth exceeded the growth in origination as the Company placed a higher portion of origination as opposed to securitization. Placement transactions accelerate the recognition in revenue of the value inherent in a mortgage. Together with a wider spread environment which increased the value of placement fees on a per unit basis, placement fee revenue increased by 95% year over year. Net income before tax was also affected by fair value related amounts. Without the impact of these revenues, net income before tax increased from $39.1 million in 2018 to $49.0 million in 2019 or by 25%. This was the result of higher placement fees as described above. The costs of originating mortgages on a per unit basis was similar year over year such that the additional placement flowed through to increase net income. Identifiable assets increased from December 31, 2018, as the Company increased its investment in mortgages pledged under securitization by about $325 million and mortgages accumulated for securitization by about $400 million. Hedging related assets were higher by about $125 million.

Commercial Segment

Second quarter 2019 commercial revenues increased by about 24% compared to 2018. This increase was the result of higher origination which saw higher interest on securitized mortgages, placement fees and mortgage investment income. Interest revenue on securitized mortgages increased 22% year over year as the average mortgage rate in the securitized portfolio increased with the higher interest rate environment and the portfolio grew. Income before income taxes was only slightly affected by fair value considerations. This measure increased by 11% year over year. The increase is due to the higher revenue offset by higher compensation payable to the Company's commercial origination employees. Identifiable assets increased from those at December 31, 2018, as the Company increased its investment in mortgages pledged for securitization by $500 million and mortgage and loan investments by $80 million. These increases were offset by a decrease in mortgages accumulated for securitization of $215 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 should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets faltered 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 notes and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) the origination costs associated with securitization, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of ten financial institutions for a total credit of $1.25 billion. This facility was extended in May 2019 for a five-year term maturing in May 2024. At June 30, 2019, the Company entered into repurchase transactions with financial institutions to borrow $1.4 billion related to $1.4 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At June 30, 2019, outstanding bank indebtedness was $988.3 million (December 31, 2018 - $918.3 million). Together with the unsecured notes of $175 million (December 31, 2018 – $175 million), this "combined debt" was used to fund $871.4 million (December 31, 2018 - $902.0 million) of mortgages accumulated for sale or securitization. At June 30, 2019, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $41.4 million (December 31, 2018 – $41.6 million) and (2) mortgage and loan investments of $307.6 million (December 31, 2018 - $188.7 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 decreased between December 31, 2018 and June 30, 2019, and now stands at $291.7 million (December 31, 2018 – $191.1 million). This represents a debt-to-equity ratio of approximately 0.55:1. This ratio increased from 0.36:1 at December 31, 2018. In general, the increase is due to the Company investing in net new mortgages of $118.9 million within mortgage and loan investments in the first six months of 2019. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

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

The Company also invests in short-term mortgages, usually for 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 an efficient source of funding primarily for short-term insured mortgages. 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 does impact the Company. Almost two years after the announcement, legislation was passed and detailed transition information was published. The legislation was reconfirmed in February 2016 with some delayed application dates. Generally, the regulations make mortgage default insurance invalid for any single-family mortgages with maturity dates beyond December 31, 2021 in a non-CMHC sponsored securitization vehicle. Accordingly, existing single-family mortgages in ABCP conduits can be funded by ABCP until their maturity, not to exceed 5 years and new insured single-family mortgages can be sold in as long as the maturity date of the mortgage is prior to January 1, 2022. As this date approaches, the Company must find other funding sources for the insured mortgages it has historically funded with ABCP. The Company is considering various alternatives including whole loan sales and selling short-term NHA-MBS pools to ABCP conduits. The Company may also adjust its renewal offering to provide incentives to borrowers to select five-year terms as opposed to shorter 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 June 30, 2019, the investment in cash collateral was $72.3 million (December 31, 2018 - $75.9 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 March 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

Commencing January 1, 2018, the Company has recorded mortgages accumulated for sale and mortgage and loan investments, as financial assets measured at "fair value through profit or loss" such that changes in market value are recorded in the consolidated statement of income. The mortgages accumulated for sale are held for very short periods and any change in value due to changing interest rates is the obligation of the ultimate institutional investor. Accordingly, the Company believes there will be little, if any, effect on its income related to the change in fair value of these mortgages. The majority of mortgages in mortgage and loan investments are uninsured commercial segment bridge loans. These are primarily floating rate loans that have mortgages terms of eighteen months or less. As the mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. The Company estimates fair value based upon: benchmark interest rates, credit spreads for similar products, creditworthiness and status of the borrower, valuation of the underlying real property, payment history, and other conditions specific to the rationale for the loan. Any favourable or unfavourable amounts will be recorded in the statement of income each quarter.

The Company believes its hedging policies are suitably designed such that the interest rate risk of holding mortgages prior to securitization is mitigated. Prior to 2018, the Company did not attempt to adopt hedge accounting; however, with the introduction of IFRS 9 on January 1, 2018, the Company began designating hedging relationships such that the results of any effective hedging will not affect the Company's statement of income. See previous discussion in this MD&A under "Realized and Unrealized Gains (Losses) on Financial Instruments". As at June 30, 2019, the Company had about $1.3 billion of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund, and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages to be sold to the Company's other securitization vehicles. As at June 30, 2019, the Company had entered into $0.5 billion of notional value forward bond sales for this segment. The Company is also party to four interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at June 30, 2019, the aggregate notional value of these swaps, maturing between June 2021 and September 2026, was $52.9 million. During the second quarter of 2019, the value of these swaps decreased by $0.9 million.

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 by adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from 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 June 2011 and continuing through 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 June 30, 2019, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were over $2.2 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. The business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the quarter ended June 30, 2019, the Company purchased new computer equipment, software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $6.0 million annually.

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year leases of premises for its offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully-serviced basis and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

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, 2018. 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 assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages. Currently there are no deferred placement fees related to single-family mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The method of determining the assumptions underlying the estimates used for the quarter ended June 30, 2019 continue to be consistent with those used for the year ended December 31, 2018 and the quarter ended March 31, 2019.

Effective January 1, 2018, the Company elected to treat certain of its financial assets and liabilities, including mortgages accumulated for sale, mortgage and loan investments and bonds sold short, at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. If the bonds sold short are designated as an effective hedge, a portion of the change in the short bonds fair value may be recorded in Other Comprehensive Income or deferred against hedge assets. This accounting should reduce the volatility in current earnings as changes in the value on short bonds should be better matched to the change in value of the hedged items (mortgages). The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of the assets listed above are subject to Company estimates. The most significant would be implicit in the valuation of mortgage and loan investments. These are generally non-homogeneous mortgages and other loans where it is difficult to find independent valuation comparatives. The Company uses information in its underwriting files, regional real estate information and other internal measures to determine the fair value of these assets.

As a mortgage lender, the Company invests in uninsured mortgages. When it funds these mortgages through securitization debt, it continues to be liable for any credit losses. The key inputs in the measurement of any ECL include Probability of Default, Loss Given Default and forecast of future economic conditions which involves significant judgment. Upon application of IFRS 9 with respect to impairment, there has been no impact on the Company's earnings. Because of the high proportion of government insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends, ECL has been determined to be insignificant.

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 June 30, 2019 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 including third party servicing customers, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination including the impact of trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance, CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, unfavorable litigation, and environmental liability. In addition, there are risks associated with the structure of the Company including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions. The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. 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 in the ''Risk and Uncertainties Affecting the Business'' section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the ''Risk and Uncertainties Affecting the Business'' section, 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 July 30, 2019, 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

The seasonally strong second quarter exceeded management's expectations as single-family origination increased by 13% from the comparative quarter in 2018 and commercial segment origination increased by 50%. Management remains optimistic for the remainder of the year. Single-family mortgage commitments continue to outpace those at the same time in 2018, although not by the same degree as evidenced at the end of the first quarter of 2019. Similarly, the commercial segment continues to meet its growth initiatives and increase its presence across the country. While it is unlikely the growth rate of 50% recorded in the second quarter will be repeated, the Company continues to forecast double digit rates of growth. Despite these favorable indications, the Company will continue to be faced with tight securitization margins as mortgage rates have tightened toward quarter end and the effect of pre 2018 fair value accounting conventions will continue to have a negative impact on its income for most of 2019.

The Company is confident that its strong relationships with mortgage brokers and diverse funding sources will continue to set First National apart from its competition. The Company will continue to generate income and cash flow from its $31 billion portfolio of mortgages pledged under securitization and $76 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.

Interim condensed consolidated financial statements

First National Financial Corporation

[Unaudited]

Second quarter 2019

First National Financial Corporation

Interim condensed consolidated statements of financial position

[Unaudited – in thousands of Canadian dollars]

As at

	June 30, 2019	December 31, 2018
	$	$
Assets		
Restricted cash *[note 3]*	**740,638**	577,096
Cash held as collateral for securitization *[note 3]*	**72,337**	75,913
Accounts receivable and sundry	**145,627**	150,668
Mortgages accumulated for sale or securitization *[note 5]*	**2,258,867**	2,204,886
Mortgages pledged under securitization *[note 3]*	**31,307,882**	30,567,036
Deferred placement fees receivable *[note 4]*	**41,388**	41,584
Mortgage and loan investments *[note 6]*	**307,637**	188,666
Income taxes recoverable	**869**	3,982
Securities purchased under resale agreements	**2,303,188**	2,188,149
Other assets *[note 7]*	**51,443**	39,147
Total assets	**37,229,876**	36,037,127
Liabilities and equity		
Liabilities		
Bank indebtedness *[note 9]*	**988,328**	918,347
Obligations related to securities and mortgages sold under repurchase agreements	**1,355,226**	1,262,395
Accounts payable and accrued liabilities	**136,149**	106,095
Securities sold short	**2,297,801**	2,183,411
Debt related to securitized and participation mortgages *[note 10]*	**31,673,420**	30,781,007
Senior unsecured notes	**174,898**	174,829
Deferred tax liabilities	**72,700**	78,800
Total liabilities	**36,698,522**	35,504,884
Equity attributable to shareholders		
Common shares *[note 11]*	**122,671**	122,671
Preferred shares *[note 11]*	**97,394**	97,394
Retained earnings	**324,440**	315,294
Accumulated other comprehensive income	**(13,151)**	(3,116)
Total equity	**531,354**	532,243
Total liabilities and equity	**37,229,876**	36,037,127

See accompanying notes

On behalf of the Board:

John Brough

Robert Mitchell

First National Financial Corporation

Interim condensed consolidated statements of income

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
	$	$	$	$
Revenue				
Interest revenue – securitized mortgages	**219,673**	190,941	**433,619**	374,411
Interest expense – securitized mortgages	**(185,036)**	(155,462)	**(367,970)**	(300,598)
Net interest – securitized mortgages *[note 3]*	**34,637**	35,479	**65,649**	73,813
Placement fees	**60,441**	30,952	**87,695**	50,701
Gains on deferred placement fees *[note 4]*	**2,862**	2,384	**5,241**	5,852
Mortgage investment income	**21,780**	22,245	**41,992**	42,185
Mortgage servicing income	**38,986**	37,139	**70,097**	68,004
Realized and unrealized (losses) gains on financial instruments *[note 12]*	**(8,501)**	7,274	**(17,092)**	6,483
	150,205	135,473	**253,582**	247,038
Expenses				
Brokerage fees	**29,299**	12,747	**41,639**	21,223
Salaries and benefits	**29,644**	25,281	**56,900**	49,158
Interest	**18,784**	16,976	**37,009**	31,170
Other operating	**12,214**	17,452	**25,692**	33,198
	89,941	72,456	**161,240**	134,749
Income before income taxes	**60,264**	63,017	**92,342**	112,289
Income tax expense	**16,100**	16,670	**24,700**	30,040
Net income for the period	**44,164**	46,347	**67,642**	82,249
Earnings per share				
Basic *[note 11]*	**0.72**	0.76	**1.10**	1.35

See accompanying notes

First National Financial Corporation

Interim condensed consolidated statements of comprehensive income

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
	$	$	$	$
Net income for the period	**44,164**	46,347	**67,642**	82,249
Other comprehensive income items that may be subsequently reclassified to income				
Net gains from change in fair value of cash flow hedges	**(5,553)**	5,223	**(25,520)**	10,432
Reclassification of net losses (gains) to income	**6,093**	(2,788)	**11,885**	(5,256)
	540	2,435	**(13,635)**	5,176
Income tax recovery (expense)	**(200)**	(650)	**3,600**	(1,380)
Total other comprehensive income	**340**	1,785	**(10,035)**	3,796
Total comprehensive income for the period	**44,504**	48,132	**57,607**	86,045

First National Financial Corporation

Interim condensed consolidated statements of changes in equity

[Unaudited – in thousands of Canadian dollars]

	Common shares $	Preferred shares $	Retained earnings $	Accumulated other comprehensive income $	Total equity $
Balance as at January 1, 2019	**122,671**	**97,394**	**315,294**	**(3,116)**	**532,243**
Net income	**—**	**—**	**67,642**	**—**	**67,642**
Total other comprehensive income, net of tax	**—**	**—**	**—**	**(10,035)**	**(10,035)**
Dividends paid or declared	**—**	**—**	**(58,496)**	**—**	**(58,496)**
Balance as at June 30, 2019	**122,671**	**97,394**	**324,440**	**(13,151)**	**531,354**

	Common shares $	Preferred shares $	Retained earnings $	Accumulated other comprehensive income $	Total equity $
Balance as at January 1, 2018	122,671	97,394	323,202	—	543,267
Net income	—	—	82,249	—	82,249
Total other comprehensive income, net of tax	—	—	—	3,796	3,796
Dividends paid or declared	—	—	(56,904)	—	(56,904)
Balance as at June 30, 2018	122,671	97,394	348,547	3,796	572,408

First National Financial Corporation

Interim condensed consolidated statements of cash flows

[Unaudited – in thousands of Canadian dollars]

	Three months ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
	$	$	$	$
Operating activities				
Net income for the period	**44,164**	46,347	**67,642**	82,249
Add (deduct) items				
Decrease (increase) in deferred income taxes	**(800)**	4,750	**(2,500)**	5,520
Non-cash portion of gains on deferred placement fees	**(2,817)**	(2,220)	**(5,095)**	(5,557)
Increase in restricted cash	**(169,235)**	(229,132)	**(163,542)**	(218,234)
Net investment in mortgages pledged under securitization	**(339,071)**	(885,805)	**(702,612)**	(1,687,525)
Net increase in debt related to securitized mortgages	**510,771**	1,088,468	**892,413**	1,855,027
Securities purchased under resale agreements and owned, net	**(264,181)**	(178,247)	**(115,039)**	(464,373)
Securities sold under repurchase agreements and sold short, net	**270,434**	168,397	**86,191**	480,832
Amortization of deferred placement fees receivable	**2,653**	2,702	**5,291**	5,379
Amortization of property, plant and equipment	**1,855**	1,305	**3,710**	2,610
Unrealized losses (gains) on financial instruments	**(2,763)**	(1,072)	**13,948**	(13,738)
	51,010	15,493	**80,407**	42,190
Net change in non-cash working capital balances related to operations	**(220,625)**	(701,588)	**(61,592)**	(679,166)
Cash (used in) provided by operating activities	**(169,615)**	(686,095)	**18,815**	(636,976)
Investing activities				
Additions to property, plant and equipment	**(1,189)**	(1,208)	**(5,146)**	(2,039)
Repayment (investment) of cash held as collateral for securitization	**(3,048)**	(11,731)	**3,576**	(15,536)
Investment in mortgage and loan investments	**(314,279)**	(225,213)	**(454,718)**	(363,432)
Repayment of mortgage and loan investments	**283,326**	284,204	**333,147**	408,642
Cash (used in) provided by investing activities	**(35,190)**	46,052	**(123,141)**	27,635
Financing activities				
Dividends paid	**(29,247)**	(28,440)	**(58,486)**	(56,876)
Obligations related to securities and mortgages sold under repurchase agreements	**257,859**	418,530	**92,831**	259,944
Decrease in debt related to participation mortgages	**—**	(8)	**—**	(17)
Cash provided by financing activities	**228,612**	390,082	**34,345**	203,051
Net decrease (increase) in bank indebtedness, during the period	**23,807**	(249,961)	**(69,981)**	(406,290)
Bank indebtedness, beginning of period	**(1,012,135)**	(800,157)	**(918,347)**	(643,828)
Bank indebtedness, end of period	**(988,328)**	(1,050,118)	**(988,328)**	(1,050,118)
Supplemental cash flow information				
Interest received	**259,835**	229,228	**512,706**	447,487
Interest paid	**195,809**	132,011	**385,691**	279,068
Income taxes paid	**14,956**	16,523	**24,086**	40,043

Notes to interim condensed consolidated financial statements

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

June 30, 2019

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 $109 billion in mortgages under administration as at June 30, 2019, FNFLP is 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, FN.PR.A and FN.PR.B, 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. Except as indicated below, 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, 2018.

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 July 30, 2019.

Changes in accounting policies

IFRS 16 – *Leases*

On January 1, 2019, the Company adopted *IFRS 16 – Leases* [IFRS 16]. The Company has elected to apply IFRS 16 on a modified retrospective approach, with no restatement of comparative period results.

The Company has applied the cost method to measure the right-of-use asset. The right-of-use asset is subsequently amortized using the straight-line method. If any impairment is identified, the unamortized balance related to the impaired asset is charged fully to income. The lease liability is calculated using the present value of future lease payment, discounted at the Company’s incremental borrowing rate. The lease liability is subsequently measured at amortized cost.

The Company’s major leases are for premises at its Toronto head office and four regional offices. The Company has elected not to recognize right-of-use assets and a lease liability for its various office equipment leases which are insignificant for application of the new standard. As a result of adopting the new standard, the Company recorded a right-of-use asset of $10,859 and a lease liability of $10,859 on January 1, 2019.

Notes to interim condensed consolidated financial statements

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

June 30, 2019

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 ABCP, NHA-MBS, and CMB programs. 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 June 30, 2019, the cash held as collateral for securitization was $72,337 [December 31, 2018 – $75,913].

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

	June 30, 2019		December 31, 2018	
	Carrying amount of securitized mortgages	**Carrying amount of associated liabilities**	**Carrying amount of securitized mortgages**	**Carrying amount of associated liabilities**
	$	$	$	$
Securitized mortgages	**31,071,732**	**31,720,115**	30,385,005	30,876,519
Capitalized hedge changes	**66,068**	**56,591**	12,578	18,356
Capitalized origination costs	**170,082**	**—**	169,453	—
Debt discounts	**—**	**(103,286)**	—	(113,868)
	31,307,882	**31,673,420**	30,567,036	30,781,007
Add				
Principal portion of payments held in restricted cash	**684,611**	**—**	521,690	—
	31,992,493	**31,673,420**	31,088,726	30,781,007

Notes to interim condensed consolidated financial statements

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

June 30, 2019

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.

Mortgages pledged under securitization have been classified as amortized cost and are carried at par plus adjustment for unamortized origination costs.

The changes in capitalized origination costs for the three months ended June 30, 2019 are as follows:

	2019 $	2018 $
Opening balance, March 31	**167,452**	145,560
Add: new origination costs capitalized in the period	**21,906**	31,277
Less: amortization in the period	**(19,276)**	(18,084)
Ending balance, June 30	**170,082**	158,753

The following table summarizes the mortgages pledged under securitization that are past due:

	June 30, 2019 $	December 31, 2018 $
Arrears days		
31 to 60	**7,497**	25,763
61 to 90	**10,356**	4,814
Greater than 90	**14,270**	16,380
	32,123	46,957

All the mortgages listed above are insured, except for four mortgages which are uninsured and have a principal balance of $1,157 as at June 30, 2019 [December 31, 2018 – $605]. The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totaling $1,355,146 [December 31, 2018 – $1,251,236], before consideration of the value of underlying collateral. Virtually all such mortgages are conventional prime single-family mortgages, with an 80% or less loan to value ratio at origination, and verified borrower income. Accordingly, the expected credit loss related to these mortgages is insignificant, and the Company has not provided any allowance for expected credit loss for the quarter ended June 30, 2019.

[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.

Deferred placement fees receivable is classified as amortized cost, and has been calculated initially based on the present value of the anticipated future stream of placement fees. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment 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, if any, between actual experience and assumptions will be recorded in future statements of income but is expected to be minimal.

During the three months ended June 30, 2019, $740,134 [2018 – $575,160] of mortgages were placed with institutional investors which created gains on deferred placement fees of $2,862 [2018 – $2,384]. Cash receipts on deferred placement fees receivable for the three months ended June 30, 2019 were $3,149 [2018 – $3,201].

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 amortized cost and are recorded at par plus adjustment for unamortized origination costs. Mortgages funded for placement with institutional investors are designated as FVTPL and are recorded at fair value. The fair values of mortgages classified as FVTPL approximate their carrying values as the time period between origination and sale is short. The following table summarizes the components of mortgages according to their classification:

	June 30, 2019	**December 31, 2018**
	$	$
Mortgages accumulated for securitization	**2,203,285**	2,170,416
Mortgages accumulated for sale	**55,582**	34,470
	2,258,867	2,204,886

The Company's exposure to credit loss is limited to $511,836 [December 31, 2018 – $321,341] of principal balances of uninsured mortgages within mortgages accumulated for sale or securitization, before consideration of the value of underlying collateral. Virtually all are conventional prime single-family mortgages similar to the mortgages described in note 3. Accordingly the expected credit loss related to these mortgages is insignificant.

[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 are classified as FVTPL and are recorded on a fair value basis. Any changes in fair value are immediately recognized in income. The Company recorded unrealized losses on account of fair value of $1,200 [2018 - $1,000] for the quarter ended June 30, 2019.

The portfolio contains $18,851 [December 31, 2018 – $13,133] of insured mortgages and $312,990 [December 31, 2018 – $175,533] of uninsured mortgage and loan investments as at June 30, 2019. Of the uninsured mortgages, approximately $35,560 [December 31, 2018 – $39,941] have principal balance in arrears. Three of these mortgages are non-performing and the Company has stopped interest on accrual. These mortgages had a total original principal balance of $39,348 and are recorded at fair value of $20,012 as at June 30, 2019 [December 31, 2018 – three mortgages, original principal balance of $44,001, and fair value of $25,262].

7. Other assets

The components of other assets are as follows as at June 30:

	2019 $	2018 $
Property, plant and equipment, net	**12,605**	9,371
Right-of-use assets	**9,062**	—
Goodwill	**29,776**	29,776
	51,443	39,147

The right-of-use assets pertain to five building leases for the Company's office space across the country. The leases have terms of three to five years.

The related lease liability is grouped with accounts payable and accrued liabilities on the interim condensed consolidated statements of financial position, and has a balance of $9,164 as at June 30, 2019.

The recoverable amount of the company's goodwill is calculated by reference to the Company's market capitalization, mortgages under administration, origination volume, and profitability. These factors indicate that the Corporation's recoverable amount exceeds the carrying value of its net assets and accordingly, goodwill is not impaired.

Notes to interim condensed consolidated financial statements

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

June 30, 2019

8. Mortgages under administration

As at June 30, 2019, the Company managed mortgages under administration of $109,588,468 [December 31, 2018 – $106,151,363], 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 June 30, 2019, the Company administered 309,672 mortgages [December 31, 2018 – 306,221] for 109 institutional investors [December 31, 2018 – 111] with an average remaining term to maturity of 39 months [December 31, 2018 – 40 months].

Mortgages under administration are serviced as follows:

	June 30, 2019	December 31, 2018
	$	$
Institutional investors	**61,869,214**	59,768,374
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,569,893**	2,387,285
Deferred placement investors	**12,700,462**	12,441,436
Mortgages pledged under securitization	**31,071,732**	30,385,005
CMBS conduits	**1,377,166**	1,169,263
	109,588,468	106,151,363

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.

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 June 30, 2019 was $727,302 [December 31, 2018 – $630,166].

Notes to interim condensed consolidated financial statements

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

June 30, 2019

9. Bank indebtedness

Bank indebtedness includes a revolving credit facility of $1,250,000 [December 31, 2018 – $1,250,000] maturing in March 2024. At June 30, 2019, $988,328 [December 31, 2018 – $918,347] was drawn 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.

10. 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 June 30, 2019, debt related to securitized mortgages was $31,673,420 [December 31, 2018 – $30,781,007], net of unamortized discounts of $103,286 [December 31, 2018 – $113,868]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

11. 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, 2018 and June 30, 2019	**59,967,429**	**122,671**	**4,000,000**	**97,394**

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

June 30, 2019

[c] Earnings per share

	Three months ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
	$	$	$	$
Net income attributable to shareholders	**44,164**	46,347	**67,642**	82,249
Less: dividends declared on preferred shares	**(764)**	(729)	**(1,527)**	(1,434)
Net earnings attributable to common shareholders	**43,400**	45,618	**66,115**	80,815
Number of common shares outstanding	**59,967,429**	59,967,429	**59,967,429**	59,967,429
Basic earnings per common share	**0.72**	0.76	**1.10**	1.35

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] Mortgage and loan investments

Mortgages and loan investments are measured at FVTPL. The fair value of these mortgages is based on non-observable inputs, and is measured at management's best estimated of the net realizable value.

[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.

[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 on a secondary market.

[d] Servicing liability

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 mortgages accumulated for sale or securitization, cash held as collateral for securitization, restricted cash and bank indebtedness correspond to the respective outstanding amounts due to their short-term maturity profiles.

[f] Fair value of financial instruments not carried at fair value

The fair value of these financial instruments are determined by discounting projected cash flows using market industry pricing practices, including the rate of unscheduled prepayment. 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. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3], and are calculated for disclosure purposes only.

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 $31,307,882 [December 31, 2018 – $30,567,036] and a fair value of $32,309,730 [December 31, 2018 – $31,071,851], debt related to securitized and participation mortgages, which has a carrying value of $31,673,420 [December 31, 2018 – $30,781,007] and a fair value of $31,848,440 [December 31, 2018 – $30,574,471], and senior unsecured notes, which have a carrying value of $174,898 [December 31, 2018 – $174,829] and a fair value of $176,880 [December 31, 2018 – $175,856]. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3].

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

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

	June 30, 2019			
	Level 1	**Level 2**	**Level 3**	**Total**
	$	$	$	$
Financial assets				
Mortgages accumulated for sale	**––**	**55,582**	**––**	**55,582**
Mortgage and loan investments	**––**	**––**	**307,637**	**307,637**
Interest rate swaps	**––**	**41,325**	**––**	**41,325**
Total financial assets	**––**	**96,907**	**307,637**	**404,544**
Financial liabilities				
Securities sold short	**––**	**2,297,801**	**––**	**2,297,801**
Interest rate swaps	**––**	**1,569**	**––**	**1,569**
Total financial liabilities	**––**	**2,299,370**	**––**	**2,299,370**

	December 31, 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
	$	$	$	$
Financial assets				
Mortgages accumulated for sale	—	34,470	—	34,470
Mortgage and loan investments	—	—	188,666	188,666
Interest rate swaps	—	51,410	—	51,410
Total financial assets	—	85,880	188,666	274,546
Financial liabilities				
Securities sold short	—	2,183,411	—	2,183,411
Interest rate swaps	—	4,784	—	4,784
Total financial liabilities	—	2,188,195	—	2,188,195

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 June 30, 2019 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 $1,200 [2018 – $1,000]. 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.

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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, there were no transfers between levels.

The following table presents changes in the fair values including realized gains of $19,266 [2018 – gains of $12,781] of the Company's financial assets and financial liabilities for the three months ended June 30, 2019 and 2018, all of which have been classified as FVTPL:

	Three months ended June 30		**Six months ended June 30**	
	2019	**2018**	**2019**	**2018**
	$	$	$	$
FVTPL mortgages	**(1,200)**	(1,000)	**(2,600)**	(2,000)
Securities sold short	**(6,426)**	8,614	**(17,708)**	9,390
Interest rate swaps	**(875)**	(340)	**3,216**	(907)
	(8,501)	7,274	**(17,092)**	6,483

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 June 30, 2019 and 2018. The Company classifies financial instruments as Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at March 31, 2019	**Investments**	**Unrealized losses recorded in income**	**Payment and amortization**	**Fair value as at June 30, 2019**
	$	$	$	$	$
Financial assets					
Mortgage and loan investments	**277,884**	**314,279**	**(1,200)**	**(283,326)**	**307,637**

	Fair value as at March 31, 2018	**Investments**	**Unrealized losses recorded in income**	**Payment and amortization**	**Fair value as at June 30, 2018**
	$	$	$	$	$
Financial assets					
Mortgage and loan investments	392,494	107,162	(1,000)	(166,153)	332,503

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

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13. Capital management

The Company's objective is to maintain a 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 common share capital and retained earnings. FNFLP 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 June 30, 2019, the ratio was 2.03:1 [December 31, 2018 – 1.90:1]. The Company was in compliance with the bank covenant throughout the period.

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 June 30, 2019			Six months ended June 30, 2019		
	Residential	**Commercial**	**Total**	**Residential**	**Commercial**	**Total**
	$	$	$	$	$	$
Revenue						
Interest revenue – securitized mortgages	**164,881**	**54,792**	**219,673**	**328,417**	**105,202**	**433,619**
Interest expense – securitized mortgages	**(139,978)**	**(45,058)**	**(185,036)**	**(280,609)**	**(87,361)**	**(367,970)**
Net interest – securitized mortgages	**24,903**	**9,734**	**34,637**	**47,808**	**17,841**	**65,649**
Placement and servicing	**81,943**	**20,346**	**102,289**	**127,428**	**35,605**	**163,033**
Mortgage investment income	**13,975**	**7,805**	**21,780**	**28,215**	**13,777**	**41,992**
Realized and unrealized gains (losses) on financial instruments	**(7,301)**	**(1,200)**	**(8,501)**	**(14,469)**	**(2,623)**	**(17,092)**
	113,520	**36,685**	**150,205**	**188,982**	**64,600**	**253,582**
Expenses						
Amortization	**1,642**	**213**	**1,855**	**3,257**	**453**	**3,710**
Interest	**13,866**	**4,918**	**18,784**	**27,231**	**9,778**	**37,009**
Other operating	**56,268**	**13,034**	**69,302**	**96,539**	**23,982**	**120,521**
	71,776	**18,165**	**89,941**	**127,027**	**34,213**	**161,240**
Income before income taxes	**41,744**	**18,520**	**60,264**	**61,955**	**30,387**	**92,342**

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Identifiable assets	**28,539,107**	**8,660,993**	**37,200,100**	**28,539,107**	**8,660,993**	**37,200,100**
Goodwill	**—**	**—**	**29,776**	**—**	**—**	**29,776**
Total assets	**28,539,107**	**8,660,993**	**37,229,876**	**28,539,107**	**8,660,993**	**37,229,876**
Capital expenditures	**833**	**356**	**1,189**	**3,603**	**1,543**	**5,146**

	Three months ended June 30, 2018			**Six months ended June 30, 2018**		
	Residential	**Commercial**	**Total**	**Residential**	**Commercial**	**Total**
	$	$	$	$	$	$
Revenue						
Interest revenue – securitized mortgages	146,086	44,855	190,941	286,860	87,551	374,411
Interest expense – securitized mortgages	(118,342)	(37,120)	(155,462)	(228,058)	(72,540)	(300,598)
Net interest – securitized mortgages	27,744	7,735	35,479	58,802	15,011	73,813
Placement and servicing	55,125	15,350	70,475	94,962	29,595	124,557
Mortgage investment income	15,472	6,773	22,245	27,685	14,500	42,185
Realized and unrealized gains on financial instruments	8,272	(998)	7,274	8,494	(2011)	6,483
	106,613	28,860	135,473	189,943	57,095	247,038
Expenses						
Amortization	1,100	205	1,305	2,201	409	2,610
Interest	13,240	3,736	16,976	23,046	8,124	31,170
Other operating	44,873	9,302	54,175	81,742	19,227	100,969
	59,213	13,243	72,456	106,989	27,760	134,749
Income before income taxes	47,400	15,617	63,017	82,954	29,335	112,289
Identifiable assets	28,512,260	7,252,030	35,764,290	28,512,260	7,252,030	35,764,290
Goodwill	—	—	29,776	—	—	29,776
Total assets	28,512,260	7,252,030	35,794,066	28,512,260	7,252,030	35,794,066
Capital expenditures	845	363	1,208	1,427	612	2,039

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15. Related party and other transactions

The Company has servicing contracts in connection with commercial mezzanine mortgages originated by the Company and subsequently sold to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the quarter, the Company originated $18,820 of new mortgages for the related parties. The related parties also funded several progress draws totaling $2,521 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of $138,926 as at June 30, 2019 [December 31, 2018 – $121,556]. As at June 30, 2019, three of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

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 months ended June 30, 2019 was $826 [2018 – $2,339], net of third-party investor reimbursement. The insurance company had also engaged the Company to service a portfolio of mortgages at market servicing rates. The portfolio had a balance of $1,625 as at December 31, 2018, but was fully paid down during the first quarter of 2019.

16. Comparative unaudited interim condensed consolidated financial statements

Certain comparative figures have been reclassified to conform to the current period's presentation.

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