Romspen Investment Corporation
Investment Manager Review
January 15, 2013

EXECUTIVE SUMMARY

- On January 15, 2013 Martin Bélanger met with the following Romspen professionals from 9:00 a.m. to 12:00 p.m. at their Toronto office:
  - Ron Lloyd, Managing Partner
  - Mark Hilson, Managing General Partner
- The Western Retirement Plans invests in the Romspen Mortgage Investment Fund (RMIF), an unincorporated closed-end investment trust, managed by Romspen Investment Corporation. The investment is made through a blocker corporation.
- The strategy is not rated by Russell Investments.
- Romspen manages 15% of the Diversified Bond Fund.
- Romspen managed $41.5 million for the Western Retirement Plans at the end of 2012. Investment management fees are 1% of assets under management.
- The Western Operating & Endowment Fund has a 5.0% target allocation to RMIF. As of December 31, 2012 Western had invested $26.7 million with Romspen, which represents a 4.8% allocation.
- Romspen was hired in July 2012 for the Retirement Plans and in November 2011 for the Operating & Endowment Fund.
- There haven't been any changes to Romspen's organizational structure since they were hired by Western in November 2011.
- Romspen has recently started a real estate fund, at the request of some of its high net worth investors.
- The Fund had $1,010 million in assets as of December 31, 2012. The firm has added approximately 400 new accounts in 2012.
- Romspen has added three senior employees in 2012: Blair Martin, Senior Vice President, Underwriting; Pierre Leonard, Vice President, Origination; Tom Conwell, U.S. Mortgages. There was one notable departure in 2012: Rob Shiller, Vice President, Origination. Management feels that they need to hire another lawyer, an underwriting analyst and an origination professional for Western Canada. The firm had 33 employees in total at the end of 2012.
- The performance of the RMIF has met expectations. The Fund has produced strong absolute returns (gross return of 4.16% since inception) and has significantly outperformed its benchmark (which is 60% DEX Short-Term Bond Index, 40% DEX Mid-Term Bond Index + 0.50%). The Fund has also outperformed the DEX Bond Universe Index, a secondary benchmark, since inception.
- The Fund's investment process hasn't changed since Romspen was hired by Western. However, the Fund has recently started to invest in U.S. mortgages, which is in line with the Fund's Offering Memorandum. Although the existing Offering Memorandum allows investing in U.S. mortgages, the firm is planning to revise this document to clarify its position relative to U.S. mortgages and to set a 20% limit.
- The portfolio is exposed mainly to residential developments, commercial buildings and land held for development. Exposure to the condo market is relatively small, as it represented only 5.8% of the portfolio at the end of 2012, and only 1.8% was in the city of the Toronto. Approximately 83% of the portfolio was exposed to the provinces of Ontario, Alberta and British Columbia. Approximately 15% of the mortgages were on properties located in the city of Toronto.

- At the end of 2012, Romspen had $39.2 million of accrued but unpaid interest payments. Also, 15% of the loans in the portfolio are not accruing interest. The Fund currently has a $12 million loss reserve.
- Over the years the Fund has had realized losses of $8.1 million. In 2012 a $1.1 million loss was realized with respect to a loan to an entertainment complex in Niagara Falls.
- Romspen doesn't have any compliance issues. The Fund is in compliance with the terms of the Offering Memorandum. Romspen is currently working with the Ontario Securities Commission with respect to the accredited status of its investors. Neither the Fund nor Romspen are currently facing major litigation, although the firm did recently reach a settlement regarding a property in Collingwood. Romspen employees have to comply with a code of conduct and the only conflict of interest to disclose relates to a property located in Calgary that the Romspen real estate fund is about to purchase.

RECOMMENDATION

Romspen has met Western's return expectations since they were hired in November 2011. The Fund has generated strong absolute returns. The portfolio's exposure to the Toronto condominium market is small at 1.8% (as of December 31, 2012). The organization has been stable, but it has been growing at a steady pace. Although there are no major areas of concerns, there are a few items that need to be monitored concerning the growth of the firm. These include the increase in assets under management, the number of mortgages in the portfolio, the U.S. expansion and the launch of a real estate fund. Given the strong performance and the disciplined process that the firm has used to manage its growth, I wouldn't recommend making changes to Western's relationship with Romspen.

ORGANIZATION

There haven't been any changes to Romspen's organizational structure since they were hired by Western in November 2011. The firm has four shareholders:

- Mark Hilson (31%)
- Wesley Roitman (31%)
- Sheldon Esbin (28%)
- Blake Cassidy (10%)

Ron Lloyd is also a partner at the firm and, although he does not have equity ownership, he receives a share of the firm's profits. There are currently internal discussions at Romspen to transfer some of Sheldon Esbin's ownership, either to Ron Lloyd or more broadly to other team members. It is a positive development to spread the firm's ownership. Romspen's five partners hold approximately $40 million of the assets in the Fund.

Romspen's activities have evolved since its founding. The Mortgage Fund started investing in Ontario only and then moved to Western Canada. Mortgage size has increased from about $2 million to about $30 - $50 million; they also moved from dealing with mortgage brokers to dealing directly with law firms and banks. Further, they started with small investors and now have a significant component of the Fund with sophisticated investors. The next natural extension of the Fund is to move into the U.S. to source mortgages and they have started to do so this past year. Because of a liquidity crunch stemming from the financial crisis, there are more opportunities in the U.S. This can potentially lead to a separate U.S.

only fund. When the Offering Memorandum is re-written in the coming weeks, they will specifically set a 20% limit on U.S. mortgages.

The firm also started testing the equity real estate market, at the request of some of its high net worth investors. Romspen recently purchased a 50% ownership in one Canadian property. The investment was funded by 20 high net worth investors. They partnered with a firm called Abacus, which owns the remaining 50%. Romspen is investigating purchasing two additional properties. They also purchased one property in the U.S. where they partnered with a REIT called Titan Star. According to Romspen's management, the new real estate venture only takes a small portion of senior management time, but we'll need to monitor this.

As of December 31, 2012, Romspen had $1.010 billion in assets under management, compared to $763 million a year earlier, for a 32% increase.

Romspen gained 400 new accounts in 2012. They didn't lose any clients for reasons other than deaths, divorces and de-selection. De-selection refers to clients who were asked to leave because they didn't meet the definition of accredited investors. The firm has currently over 3000 accounts. Given that some high net worth individuals have two accounts (one registered and one non-registered), they estimate that they have approximately 2500 individual clients. Three senior professionals and one administrative staff service these clients.

Currently the breakdown between retail and institutional investors is about 75% retail and 25% institutional investors. Romspen doesn't expect this ratio to change over time.

PERSONNEL

There have been some personnel changes in recent month. Three senior individuals were recently hired:

- Blair Martin, Senior Vice President, Underwriting
- Pierre Leonard, Vice President, Origination
- Tom Conwell, U.S. Mortgages

There has also been one departure - Rob Shiller, Vice President, Origination, left to join Downing Street Financial, a commercial real estate financing firm.

Compensation for senior professionals is mostly fixed salary and bonuses are minimal. A typical breakdown between fixed and variable compensation for a senior professional in underwriting and origination is 90% fixed and 10% variable. This compensation structure prevents mortgage origination and underwriting specialists from generating large volumes of mortgages at the expense of quality. In addition, none of the three professionals in the client servicing and business development area, who report to Ron Lloyd, receive any variable compensation at all. Ron Lloyd, as a partner of Romspen, receives a share of the firm's profits. The only professional with significant variable compensation is Richard Weldon, Vice President, Development and Restructuring. His compensation structure is approximately 50% fixed and 50% variable. Given that he's responsible for the workouts of troubled mortgage investments, his compensation is aligned with the interests of the firm.

The firm currently has 33 employees in total, broken down in the following areas:

- Mortgage Administration: 6
- Client Servicing: 3

- Finance and Accounting: 5
- Legal: 2
- Origination: 4
- Workouts: 3
- Underwriting: 6
- Senior partners: 4

Management feels that they need to hire another lawyer, an underwriting analyst and an origination professional for Western Canada.

ROMSPEN MORTGAGE INVESTMENT FUND

Performance Analysis

	Periods Ended December 31, 2012	
	2012 Q4	**Since Inception (July 2012)**
Romspen Mortgage Investment Fund	2.06%	4.16%
Benchmark[1]	1.10%	1.60%
Value Added	0.96%	2.56%

The portfolio's gross return was 2.06% for the last quarter of 2012 (1.81% net of fees), which was above the Fund's benchmark by 0.96%. Since inception, the portfolio has returned 4.16% (3.66% net of fees), outperforming the benchmark return by 2.56%. A secondary benchmark for the Fund is the DEX Universe Bond Index, as commercial mortgages were added to offset the low expected returns for the main Canadian Bond Index. The DEX Bond Universe Index returned 1.54% during the last two quarters of 2012.

Investment Process

The Fund's investment process hasn't changed since Romspen was hired by Western. The process starts with a review of deals that have been identified through Romspen's extensive network. Typically 50% of the deals initially reviewed lead to a letter of intent. At that stage, Romspen requests a deposit from potential borrowers and they conduct due diligence, including an environmental assessment. If they're satisfied, they issue a commitment letter and request a larger deposit. They then complete the legal work. If a potential borrower turns down the mortgage after a commitment letter has been executed, they lose their entire deposit.

The Fund's investment guidelines haven't substantially changed:

- Conventional first mortgages
- Short-term mortgages
- Loan to value smaller than 65%
- Solid underwriting – visit each property, know each borrower
- Limit of 10% to any single borrower or mortgage
- Diversified portfolio – by size, borrower, geography & property type

[1] 60% DEX Short-Term Bond Index, 40% DEX Mid-Term Bond Index + 0.50%

- Adjunct collateral & personal guarantees. 95% of the loans in the portfolio have personal guarantees. Some loans don't involve personal guarantees because of unusual circumstances such as the borrower is a corporation or a limited partnership, making it difficult to provide personal guarantees. To remedy the situation, Romspen may lower the loan-to-value ratio or request other collateral.
- Fund is not leveraged
- Well developed exit strategy

The Fund has relaxed its requirement to have Canadian mortgages only. Romspen has identified many opportunities to invest in the U.S. due to the financial crisis and Basel III. Given that the U.S. real estate market has bottomed up, the timing is right to invest and management views this as a logical extension of their business. Although the Offering Memorandum technically allowed U.S. mortgages, Romspen has decided to re-write its Offering Memorandum to clarify its position regarding U.S. mortgages.

The Fund has also relaxed its restriction to limit the number of mortgages at 100. The Fund went above that number to take advantage of opportunities in the market and as of December 31, 2012 it had 136 mortgages.

Adding U.S. mortgages exposes Romspen to currency fluctuations and this is a risk that Romspen would prefer to avoid. To remedy the situation, they will attempt to structure deals in such a way that the client is responsible for currency losses. As of December 31, 2012, Romspen had $106 million of mortgages in U.S. dollars. The Fund's currency exposure is as follows:

- For 68% of the mortgages, the client is responsible for the currency losses
- For 14% of the mortgages, Romspen uses forward contracts to hedge the risk
- For 18% of the mortgages, the portfolio is unhedged

In 2012, there was a currency gain of approximately $200,000, which represents about 0.02%.

Portfolio Summary

As of December 31, 2012, the portfolio had 136 mortgages. The table below shows the distribution of the properties by building type.

Portfolio Breakdown by Building Type
As of December 31, 2012

Building Type	Principal ($ Thousands)	Weight
Residential Development	191,766	19.0%
Commercial Building	152,282	15.1%
Land for Development	141,112	14.0%
Golf Course	86,119	8.5%
Hotel	85,212	8.4%
Industrial Buildings	65,792	6.5%
Office Building	47,822	4.7%
Condominium	36,793	3.6%
Shopping Centre	36,163	3.6%
Commercial Development	25,504	2.5%
Other	141,764	14.0%

At the end of 2012, the largest portfolio exposures were to residential developments, commercial buildings and land for development. Total exposure to the condo market was 5.8% at the end of 2012; that includes the 3.6% noted above next to condominium and a portion of the mortgages backed by land held for development, which will be used for condo projects. The total portfolio exposure to the condo market in the Greater Toronto Area was 3.6% and for Toronto only was 1.8%.

The following table shows the portfolio distribution by province or state. The largest exposures are in Ontario, Alberta and British Columbia. At the end of 2012, 11.8% of the mortgages were in the U.S.

Portfolio Breakdown By Province/State
As of December 31, 2012

Provincial / State	Principal ($ Thousands)	Weight
Ontario	471,872	46.7%
Alberta	207,114	20.5%
British Columbia	157,602	15.6%
North Carolina	28,478	2.8%
Illinois	22,332	2.2%
Nova Scotia	20,883	2.1%
Florida	20,256	2.0%
Québec	18,047	1.8%
Colorado	13,684	1.4%
New York	13,395	1.3%
New Brunswick	9,110	0.9%
New Jersey	4,492	0.4%
Saskatchewan	4,400	0.4%
California	3,954	0.4%
South Carolina	3,717	0.4%
Arizona	3,369	0.3%
Washington	2,637	0.3%
Manitoba	2,108	0.2%
Indiana	1,195	0.1%
Ohio	1,176	0.1%
New Hampshire	508	0.1%

The following table shows the portfolio distribution by city for the ten largest holdings. The largest exposures are in Toronto, Calgary and Edmonton.

Portfolio Breakdown
Top 10 Largest Holdings by City
As of December 31, 2012

City	Principal ($ Thousands)	Weight
Toronto (ON)	151,170	15.0%
Calgary (AB)	60,999	6.0%
Edmonton (AB)	51,264	5.1%
Peterborough (ON)	49,873	4.9%
Langford (BC)	43,229	4.3%
Oakville (ON)	39,155	3.9%
Peachland (BC)	39,065	3.9%
Abbotsford (BC)	29,305	2.9%
Pembroke (ON)	28,924	2.9%
Matthews (NC)	28,478	2.8%

Risk Factors

Management believes that every property is affected by the following risk factors:

- Location
- The borrower
- The deal structure
- The value of the deal

In addition, each sector has specific risk factors:

a) Residential Developments

The main risks for residential developments include: 1) cost overruns; this can be overcome by backing experienced developers, ensuring developers have financial flexibility, hiring quantity surveyors to monitor the progression of the construction and advancing money when certain milestones are met. 2) The absorption of the development; Romspen needs to assess the competition and price points of residences, and perform sensitivity analyses. 3) Pricing is a major risk factor. Romspen must ensure that it is not overly optimistic and review pro forma financial statements to make sure developers can make money even if a price reduction is required. 4) Reviewing the floor plans is also important as this may significantly impact demand. 5) Topography of the land needs to be assessed as it may impact the cost of building and the number of houses that can be built.

b) Commercial Buildings

Leasing is the most important item to consider when reviewing commercial buildings. An assessment of how much space can be absorbed must be made, the credit quality of the tenant evaluated, the possibility of losing a tenant addressed, and the need for potential repairs addressed early (e.g. roofing).

c) Land for Development

Zoning is a key item to investigate when sourcing a mortgage backed by land for development. The lender must investigate whether or not the land is properly zoned and, if not, future zoning plans. The lender must also address how long it will take to absorb the land and ensure there is a solid exit plan as the land will not generate revenue until it is re-developed. The exit strategy must clearly define the timeline and the possibility of having other collateral.

d) Hotels

The key risk factor about a hotel is that it is an operating business. The quality of management must be clearly addressed. In addition, vacancy, occupancy, location, price paid per door and the reservation system must be assessed.

e) Golf courses

Golf courses are also operating businesses and, as such, good management is important. Management needs to be experienced. Location and whether or not the course is surrounded by homes and land are also important considerations. Finally, Romspen reduces risk by lending a maximum of $3 to $4 million to golf courses.

f) Industrial Buildings

Industrial buildings present environmental risks, such as asbestos, spillage, light ballast, etc. According to Romspen's experience, the best industrial buildings are built by U.S. multi-nationals.

g) Condominiums

The most important factor to assess with condominium projects is the developer's experience. Other items to address include floor design and layout, competition, fit and finish, demographics and project price points.

h) Retail Buildings

Credit quality of tenants is key when assessing retail buildings. Building surroundings as well as access and egress are also important elements.

Portfolio risk is generally managed in the following way:

- They try to avoid concentration by area and borrower
- They avoid overheated markets
- 95% of mortgages are first mortgages
- Romspen controls the deal
- They define an exit strategy at the beginning
- The loan-to-value ratio is a maximum of 65%
- It is "high-touch" lending, i.e. one of the four partners must see each deal
- The Fund has no leverage (other than to manage cash flows)

Overall, Romspen management seems to have a good understanding of the risk factors impacting its loans.

New Deals and Renewals
In 2012, the Fund had 120 mortgages renewed for a total of $130 million. The Fund also sourced 49 new mortgages for $357 million. Of these new mortgages, 12 were in the U.S., for a total of $91 million.

A significant portion of Romspen's business is renewals. Because overall interest rates have gone down, Romspen must adjust the rates it charges on its new loans. They could maintain higher interest rates and refuse to renew below a certain threshold, but they feel that their business would start to shrink as the borrowers they turn down would go to the competition. In addition, having a larger fund gives them access to higher quality properties.

Loans in Default
As of December 31, 2012, the Fund had $39.2 million of accrued but unpaid interest payments. These are recognized as revenues in the financial statement and Romspen is generally confident that these payments will be made. For mortgages where Romspen is unsure when they will get paid with respect to timing of the payment or collectability, they keep track of unpaid and unaccrued interest off balance sheet. Some of these unaccrued payments end up being recognized as income. Currently, 15% of the loans in the portfolio are not accruing interest. The Fund currently has a $12 million loss reserve. Over the years the Fund has had realized losses of $8.1 million. When the loan is in default they try to improve the property to get their money back.

Mortgage Writedowns and Losses
Over the years the Fund has had realized losses of $8.1 million. In 2010, realized losses were $6.1 million and the losses came mainly from three properties: 1) A gas station in Nova Scotia accounted for $1.9 million; 2) a hotel in North Bay accounted for $3.1 million and 3) a water park accounted for $800,000. Management indicated these loans would not be approved today with their current underwriting standards. In 2011, a $300,000 loss was recorded with a motel in Niagara Falls. In 2012, a $1.1 million loss was realized with an entertainment complex in Niagara Falls.

The mortgage to BioExx was also reviewed. The mortgage to BioExx was challenged by some members of Western Investment Committee as being too risky. The company is in discussion with several multi-nationals to be acquired. Although an interest reserve was set up, everything is fine with the loan: the building is worth more than the mortgage value and no value was attributed to the equipment, even though it is brand new. This deal was more complex than typical deals made by Romspen.

Environmental, Social and Governance Factors
ESG factors will be taken into consideration when they have an economic impact. For each deal there's a phase one environmental assessment. They are conscious of money laundering. If they're suspicious about anything with a borrower, they won't lend. As of December 31, 2012, there were no loans to firearm manufacturers.

Deal Pipeline
They prepare a weekly report that is discussed every month and that details the deal pipeline. Deals are classified as follows:

- Deals about to be funded
- Deals with a commitment letter
- Deals with a letter of intent signed
- Deals with a letter of intent not signed
- Deals under review

- Deals lost to competitors

Currently, there is approximately $1,112.8 million of deals under consideration and about $237 million about to be funded.

Romspen charges a fee to the borrower when a loan is sourced. Fees are higher for construction loans because money is drawn more than once and loans are tedious.

Overall, Romspen's deal pipeline is sufficient to allow the firm to generate new business.

Capacity

The Fund has about $1.0 billion in assets (as of December 31, 2012). Management expects the Fund to reach $1.3 billion in assets by the end of 2013. Currently, assets are split 75%/25% between retail and institutional investors. There are no plans to deviate substantially from that ratio. Management expects that they will close the Fund at some point, although no fixed asset target has been set yet.

COMPLIANCE

The Fund is in compliance with the terms and conditions of the Offering Memorandum. Although the existing Offering Memorandum doesn't preclude Romspen from investing in the U.S., management feels that it is prudent to re-write the document in order to clearly define the U.S. strategy. The new Offering Memorandum should be available within a few months. A supplement to the Offering Memorandum will be sent to all investors in the next two weeks.

Romspen is in compliance with all applicable laws. Neither the firm nor its employees are engaged in litigation. However, due to the nature of the mortgage business, it is expected that the Fund will be engaged in litigation from time to time. Management estimates that there are typically four or five loans involved in litigation at any given time. They expect to settle litigation with a Home Depot store located in Collingwood in the coming days.

Romspen has been an Exempt Market Dealer (EMD) since May 2011. In July 2012, the Ontario Securities Commission conducted a field review of all new EMDs in Ontario (80 EMDs). The OSC's objective was to make sure that all investors were accredited and that the investments were suitable for them. Romspen submitted a response on November 8 regarding investors who had been accredited since 2011 (when Romspen became an EMD). They also provided a final response to the OSC on January, 18 2013, detailing the status of all investors since they started investing with Romspen. The OSC has not replied yet.

Romspen employees have to comply with a code of conduct.

Conflicts of interest are reported in note 11 of the Financial Statements. Currently, there is a property in Calgary where the developer went bankrupt and Romspen new real estate fund intends to purchase the building. This building has been independently appraised by real estate valuators as well as an investment bank. In addition, some loans had to be syndicated with some of Romspen's partners because of the firm's previously small line of credit. Mark Hilson has about $10 million in mortgages. With the Fund's new $100 million line of credit, this will be less of an issue.

KPMG has been the Fund's auditor for about six years. There are no plans to rotate them and they are satisfied with their services. KPMG rotates its engagement partners from time to time.

The firm doesn't product a Section 5970 report.

The firm has an adequate business continuity plan and data is stored at an offsite location. Due to growth, the firm is currently reviewing the adequacy of its IT systems.