CENTURION
ASSET MANAGEMENT INC

2017 Annual Commentary

2017 – Portfolio Year in Review

In 2017, the REIT bought only one property:

- A 60% interest in a 208-unit rental apartment building in Regina, Saskatchewan. This property was financed by REOT and built by a development partner with whom Centurion has a number of properties currently in various stages of development.

On a weighted basis, this means that the REIT only added a total of 125 rental units in the year, which means that it was our quietest year. The market was extremely active however, and record volumes traded. We chose to stick to our investment discipline and not make purchases that we thought we would have to stretch too far on. While we are disappointed that we could not find more opportunities to buy apartments, this result was largely expected and consistent with the messaging that we have been highlighting to our investors–that the most attractive opportunities for Centurion currently exist on the debt side.

We have also messaged that the rental market in 2017 was extremely tight and that rents have been rising quickly in our core market of Ontario. While it is true that we could have bought properties and likely made our targeted returns based on what is happening with rents, we chose not to do so as it is inconsistent with our perception of risk and reward. We have always wanted to buy properties with a reasonable "going in" rate of return, and looked at rental upside as a way to drive total return. We have not wanted to buy poor "going in" returns, on the hope of improving them to get them to our target returns, as we perceive this as a much riskier strategy as you are relying on runaway rents and assuming that the politicians will remain passive to this. As the Ontario government showed with their re-introduction of rent controls in 2017, we cannot always assume that governments will not respond to political pressure to "do something" no matter how ill-advised that something could be.

We made significant progress with the portfolio. Rents on turnover in some of our communities rose greater than 20%. We now have the largest gap-to-market rents that we ever have had of around 12%. The gap-to-market is the amount of increase in rents that we would get, compared to the contract rates already in place, if all the rents were at the current market rent. In most years, the gap has been 3-4% of rents, meaning that our 12% gap is 3-4 times as large as it has ever been. This means that we forecast that we could get about another $8 million in rent based on today's market demand and rental rates, and we believe rental rates, due to extremely tight vacancy conditions, likely has room to rise. Stabilized properties are now 94.1% of the portfolio, with unstabilized units at 0% and repositioning at 5.9%.

Portfolio occupancy exceeded 99% at the end of 2017, which is the lowest we have ever seen it, which reflects strong demand, low market vacancy rates, an increased tendency for residents to "stay put", and also excellent execution by our operating teams. We were able to push operating margins further, increasing them to about 64.8% up from 63% in 2016. We anticipate that we will add another 2

25 Sheppard Ave W, Suite 710, Toronto, ON M2N 6S6
T (416) 733-5600 | F (416) 733-5613

percentage points in 2018 and are targeting 67% for the full year 2018, although the exceptionally cold weather may conspire against us.

All told, 2017 was our strongest year ever with returns almost triple last year's results in absolute dollar terms. The REIT, on a consolidated basis, earned $147.5 million, up from $52.1 million; REOT earned $45.3 million, up from $25.8 million; and CFIT earned $1.1 million in its first (partial) year. In percentage terms, the REIT increased its earning by 183%, and the REOT increased its earnings by 76%. REIT consolidated assets ended the year at $1.3 billion, REOT assets ended the year at $374.7 million, and CFIT assets ended the year at $30.5 million.

The REIT and REOT made their first deployments into the US with a combined Canadian/US group into class A development properties in the central business districts of Detroit and Minneapolis. We are looking at further opportunities with this group and others.

A Look Forward to 2018

We continue to believe that there will be limited opportunities to buy properties. Our main focus is on debt investment and development opportunities where we find the risk/reward to be in our favour relative to buying apartments at today's prices. January was already our most active month, with nearly $60 million of debt investments funding. The pipeline is exceptionally strong and this is where we are seeing our growth. We continue to scale our debt origination teams with new additions to meet what we see as more demand than we have the staff to currently service.

We think that strong rental demand and rising rents will give the REIT an opportunity to increase both Net Operating Income and our margins, as we have consistently been able to do over time. Further, this strong rental growth may increase the potential for more development deals.

We believe that the financial markets will be volatile in 2018 and we have already seen a taste of that in the last few weeks. If anything surprised us about 2017, it was how much higher equity markets went with valuations well into nosebleed territory and volatility at historic lows.

I have increasing concerns about Canada's direction as I have been very vocal about. Trump, love him or hate him, is doing a lot to put our economy at a competitive disadvantage. While Canada has increased taxes on small businesses to confiscatory rates, and increased minimum wages and regulations, the US has cut taxes to levels lower than Canada and simplified them, while also decreasing regulations. The US is becoming a powerhouse in onshore energy production, while Canada cannot seem to get a pipeline built and is looking to cripple our energy industries and economy with further carbon taxation, while our competitors are going the other way. Further, NAFTA negotiations look to be a failure for Canada. While NAFTA failure or a significant worsening of the terms of trade for Canada is bad enough, the confiscatory taxes the government has imposed and that Canadian exporters will be on the wrong side of the border if trade barriers go up, mean that we may see a significant hollowing out of corporate Canada and a "brain drain" and capital drain towards the US. The Prime Minister's statements that he has no intention of competing with the US on taxes or otherwise, reflects both his naivete on economic matters and an utter contempt for businesses that create jobs and pay taxes in Canada.

While Trump's moves may extend the economic expansion in the US to be the longest, uninterrupted period of growth in history, Canada's fortunes seem to be turning for the worse. While this expansion

in the US may allow the Federal Reserve to increase interest rates at a modest pace, Canada has limited scope to do so. As the economy here slows, and with little scope for additional fiscal spending given the large deficits, the country is already running; there will be little choice when the next slowdown comes that rates will have to be cut substantially to cushion the decline.

We believe that we have positioned our funds conservatively for this environment as overall leverage is low at 36% in the REIT, 6% in REOT, and 0% in CFIT. Liquidity positions are very good. Further, we will be boosting capital reserves to get a little ahead of the demand that we are seeing and to scale reserves with this the sizes of the funds today. We believe the scope for returns in 2018 is excellent with room for significant rent growth in our core markets in the REIT and a number of development completions in the REOT driving returns there as well. CFIT continues to grow and diversify its portfolio and we are looking at a number of very interesting potential opportunities.

Greg Romundt