

Financial Statements of

SIERRA MORTGAGE FUND LTD.

And Independent Practitioners' Review Engagement Report thereon

Year ended September 30, 2020
(Unaudited)



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INDEPENDENT PRACTITIONERS' REVIEW ENGAGEMENT REPORT

To the Shareholders of Sierra Mortgage Fund Ltd.

We have reviewed the accompanying financial statements of Sierra Mortgage Fund Ltd., which comprise the statement of financial position as at September 30, 2020, the statement of comprehensive income and changes in shareholders' equity and statement of cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioners' Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements based on our review. We conducted our review in accordance with International Financial Reporting Standards for review engagements, which require us to comply with relevant ethical requirements.

A review of financial statements in accordance with International Financial Reporting Standards for review engagements is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less in extent than, and vary in nature from, those performed in an audit conducted in accordance with Canadian generally accepted auditing standards. Accordingly, we do not express an audit opinion on these financial statements.



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Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects, the financial position of Sierra Mortgage Fund Ltd. as at September 30, 2020, and its results of operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants

Vernon, Canada

January 13, 2021

SIERRA MORTGAGE FUND LTD.

Statement of Financial Position

September 30, 2020, with comparative information for 2019
(Unaudited)

	2020	2019
Assets		
Current assets:		
Cash and cash equivalents (note 4)	\$ 3,988,188	\$ 3,620,006
Mortgages receivable (note 5)	6,335,408	6,765,755
	<u>\$ 10,323,596</u>	<u>\$ 10,385,761</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 28,498	\$ 34,379
Distributions payable to shareholders	121,825	144,165
Deferred revenue	15,693	21,347
Redeemable preferred shares (note 6)	10,157,480	10,185,770
	<u>10,323,496</u>	<u>10,385,661</u>
Shareholders' equity:		
Common shares (note 7)	100	100
Related party transactions (note 8)		
Contingency (note 9)		
	<u>\$ 10,323,596</u>	<u>\$ 10,385,761</u>

See accompanying notes to financial statements.

On behalf of the Board:



Director



Director

SIERRA MORTGAGE FUND LTD.

Statement of Comprehensive Income and Changes in Shareholders' Equity

Year ended September 30, 2020, with comparative information for 2019

(Unaudited)

	2020	2019
Revenue:		
Interest income	\$ 726,076	\$ 827,204
Fee income	85,931	84,860
	812,007	912,064
Mortgage impairment expense (note 5)	100,910	89,553
	711,097	822,511
Expenses:		
Management fees (note 8)	144,248	171,257
Professional fees	15,627	20,536
Office and general (note 8)	7,672	11,003
Brokerage fees	7,352	9,805
Interest and bank charges	599	646
	175,498	213,247
Earnings before distributions to shareholders	535,599	609,264
Distributions to shareholders	(535,599)	(609,264)
Profit, being comprehensive income for the year, and shareholders' equity end of year	\$ -	\$ -

See accompanying notes to financial statements.

SIERRA MORTGAGE FUND LTD.

Statement of Cash Flows

Year ended September 30, 2020, with comparative information for 2019
(Unaudited)

	2020	2019
Cash provided by (used in):		
Operating activities:		
Interest and fees received	\$ 705,443	\$ 812,155
Cash paid to suppliers	(183,565)	(221,720)
Distributions to shareholders	(344,081)	(374,087)
	<u>177,797</u>	<u>216,348</u>
Financing activities:		
Redemption of preferred shares	(238,060)	(101,010)
Issuance of preferred shares	-	446,370
	<u>(238,060)</u>	<u>345,360</u>
Investing activities:		
Issuance of new mortgages receivable	(4,863,670)	(4,940,600)
Repayment of mortgages receivable	5,292,115	5,747,258
	<u>428,445</u>	<u>806,658</u>
Increase in cash and cash equivalents	368,182	1,368,366
Cash and cash equivalents, beginning of year	3,620,006	2,251,640
Cash and cash equivalents, end of year	<u>\$ 3,988,188</u>	<u>\$ 3,620,006</u>
Non-cash investing and financing activities:		
Shares issued in lieu of cash dividends (note 6)	\$ 209,770	\$ 240,250

See accompanying notes to financial statements.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements

Year ended September 30, 2020
(Unaudited)

1. Reporting entity:

Sierra Mortgage Fund Ltd. (the "Corporation") was incorporated under the laws of British Columbia on January 10, 1995. The objective of the Corporation is to originate and manage long-term income generation through a portfolio of interests in mortgages underwritten on real property.

The investment objective of the Company is to acquire and maintain a diverse portfolio of investments that generate income which allows the Company to pay quarterly dividends to shareholders.

As long as the Corporation continues to qualify as a mortgage investment corporation ("MIC") under Section 130.1 of the Income Tax Act (Canada), taxable income may be reduced by distributions paid during the year, or within 90 days of the fiscal year-end. As a result, the Corporation can distribute its net earnings from operations to shareholders without the payment of corporate income tax.

The Corporation is domiciled in Canada at 3300 - 34th Avenue, Vernon, British Columbia and its registered office is 3rd Floor, 1665 Ellis Street, Kelowna, British Columbia.

2. Basis of preparation:

(a) Statement of compliance:

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements were authorized for issue by the Board of Directors on DATE.

(b) Basis of measurement:

The financial statements have been prepared on the historical cost basis, except foreclosed properties held for sale that are measured at fair value at each reporting date.

(c) Functional and presentation currency:

These financial statements are presented in Canadian dollars, which is the functional currency of the Corporation.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

2. Basis of preparation (continued):

(d) Use of estimates and judgment:

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The most significant estimates that the Corporation is required to make relate to the impairment of the mortgages receivable (note 5). These estimates may include assumptions regarding local real estate market conditions, interest rates and the availability of credit, cost and terms of financing, the impact of present or future legislation or regulation, prior encumbrances and other factors affecting the investments and underlying security of the investments.

(e) Measurement of fair values:

The Corporation's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities.

When measuring the fair value of an asset or liability, the Corporation uses market observable data where possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);
- Level 3 Inputs for the asset or liability that are not based on observable market data (that is unobservable inputs).

Management reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or appraisals are used to measure fair values, management will assess the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

The information about the assumptions made in measuring fair value is included in the following note:

Note 3 (d) - Foreclosed properties held for sale

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, unless otherwise indicated.

(a) Financial instruments:

(i) Financial assets:

The Corporation initially recognizes loans and receivables on the date that they are originated. The Corporation's financial assets are comprised of mortgages receivable and cash and cash equivalents, both of which are classified as loans and receivables. Such financial assets are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial assets are measured at amortized cost using the effective interest method.

The Corporation derecognizes a financial asset when the contractual rights of the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial assets that is created or retained by the Corporation is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Corporation has a legal right to offset the amounts and intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

(ii) Financial liabilities:

The Corporation initially recognizes financial liabilities on the date that they are originated. The Corporation derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Corporation has the following financial liabilities which it has classified as other financial liabilities: accounts payable and accrued liabilities, distributions payable to shareholders and redeemable preferred shares. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

3. Significant accounting policies (continued):

(b) Cash and cash equivalents:

Cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition, including cash and deposits with banks and cheques and other items in transit.

(c) Mortgages receivable:

Mortgages receivable are recognized initially at fair value. Subsequent to initial recognition, the mortgages are measured at amortized cost using the effective interest method, less any impairment losses.

The mortgages are assessed at each reporting date to determine whether there is objective evidence of impairment.

Mortgage credit quality is assessed at a specific and collective level for reasonable assurance of timely collection of the full amount of principal and interest. Impairment is assessed on a specific mortgage basis taking into account past experience, credit quality, payments in arrears, general economic conditions and real estate market conditions. When a mortgage is identified as impaired, the carrying amount becomes the lower of the recorded investment and the estimated realizable amount. Estimated realizable amounts are measured by discounting the expected future cash flows at the effective interest rate inherent in the mortgage. When the amount and timing of such cash flows cannot be estimated with reasonable reliability, estimated realizable amounts are based on the fair value of the security underlying the mortgages, net of expected costs of realization.

All individually significant mortgages not found to be specifically impaired are then collectively assessed for impairment that has occurred, but not yet been identified.

Mortgages that are not individually significant are collectively assessed for impairment by grouping together mortgages with similar risk characteristics. In assessing the collective impairment, the Corporation uses analysis of past performance and the level of the allowance already in place, adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to be greater or less than suggested by past performance.

Losses are recognized in the statement of comprehensive income and reflected in an allowance account against the mortgages receivable. Interest on the impaired asset continues to be recognized through the unwinding of the discount if it is considered collectable, and adjusted to the allowance account if not considered collectable. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

3. Significant accounting policies (continued):

(d) Foreclosed properties held for sale:

When the Corporation obtains legal title of the underlying security of an impaired mortgage investment, the carrying value of the mortgages receivable, which comprises of principal, costs incurred, accrued interest and the related provision for mortgage investment loss, if any, is reclassified from mortgage investments to foreclosed properties held for sale ("FPHFS"). At each reporting date, FPHFS are measured at fair value, with changes in fair value recorded in profit or loss in the period they arise. The Corporation uses management's best estimate to determine fair value of the properties, which may involve frequent inspections, engaging realtors to assess market conditions based on previous property transactions, or retaining professional appraisers to provide independent valuations.

Contractual interest on the mortgages receivable is discontinued from the date of transfer from mortgage investments to FPHFS. Net income or loss generated from FPHFS, if any, is recorded as net operating (gain) loss from FPHFS, while fair value adjustments on FPHFS are recorded separately.

At year end there were nil FPHFS (2019 - nil).

(e) Revenue recognition:

Interest income is recorded on the accrual basis using the effective interest method. When calculating the effective interest rate, the Corporation estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

Deferred revenue includes lender fees received from borrowers that are amortized over the contractual terms of the mortgage to fee income using the effective interest method. Discharge fees are recognized as mortgages are discharged.

(f) Income taxes:

It is the intention of the Corporation to qualify as a MIC for Canadian income tax purposes. As such, the Corporation is able to deduct, in computing its income for a taxation year, dividends paid to its shareholders during the year or within 90 days of the end of the year. The Corporation intends to maintain its status as a MIC and pay dividends to its shareholders in the year and in future years to ensure that it will not be subject to income taxes. Accordingly, for financial statement reporting purposes, the tax deductibility of the Corporation's distribution of dividends result in the Corporation being effectively exempt from taxation and no provision for current or deferred taxes has been recorded.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

3. Significant accounting policies (continued):

(g) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity.

Preferred shares are classified as a liability due to redemption options of the shareholders. Dividends are recognized as distributions to shareholders in profit or loss as accrued.

(h) Dividends:

Subject to the discretion of the Board of Directors, dividends on shares are calculated and paid quarterly. Interest income from mortgages in arrears by three months or more is not included in the calculation until the mortgage is no longer in arrears, or if sufficient equity on the secured property exists and the loan is still considered collectible.

4. Cash and cash equivalents:

Cash and cash equivalents includes cash held in trust and the related trust liability. The Corporation is required to hold monies received for certain types of transactions in a trust account, separate from the Corporation's general cash accounts.

These funds were received by the Corporation during the year as an interest reserve to be drawn upon against the related mortgage and for purchases of shares. As at September 30, 2020, the Corporation had funds in trust totaling \$nil (2019 - \$30,545).

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

5. Mortgages receivable:

The mortgages receivable are first and second mortgages and consist of short-term financing for residential construction projects and term loans for completed or substantially completed owner-occupied and income-producing properties in British Columbia. The mortgages bear interest at rates from 7.7% to 11.95% (2019 - 7.7% to 12.0%) per annum.

At year end, there are 30 (2019 - 34) mortgage investments. Of these, 21 mortgages totaling \$5,090,962 - 73% (2019 - 22, \$4,708,497, 65%) are first mortgages. The remaining 9 mortgages totaling \$1,866,743 - 27% (2019 - 12, \$2,576,732, 35%) are non-first mortgages, which may include second mortgages, or a combination of first, second and third mortgages if more than one property is secured.

At September 30, 2020, one mortgage was in arrears (2019 - two). This mortgage was subsequently paid out on October 5, 2020. At September 30, 2020, one (2019 - one) of the mortgages has been assessed as impaired. A provision for mortgage impairment has been deemed necessary.

A mortgage is considered in arrears when a payment has not been received by the contractual due date. A mortgage is considered impaired if the recoverable amount is less than its carrying amount. Mortgages are not considered impaired if they are either (i) less than 90 days past due, unless there is information to the contrary; or (ii) fully secured and collection effects are reasonably expected to result in repayment.

	2020	2019
Performing mortgages	\$ 5,385,324	\$ 5,661,790
Mortgages in arrears	659,854	811,833
Impaired mortgages	912,526	811,615
	6,957,704	7,285,238
Accrued interest	39,319	41,222
	6,997,023	7,326,460
Allowance for credit losses:		
Specific	(661,615)	(560,705)
Collective	-	-
	\$ 6,335,408	\$ 6,765,755

The specific allowance for credit losses relates to the impaired mortgage balance and allows for accrued and unpaid interest on the mortgage receivable.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

5. Mortgages receivable (continued):

The Corporation provides for specific losses based on a regular review of individual mortgages. In assessing the existence of impairment in value of mortgage investments, management compares the current fair market valuation data against data at the date of the initial appraised amount, monitors changes in market interest rates whereby increasing rates will affect the discount rate used in fair valuing properties and monitors monthly cash flows receivable to ensure repayment terms are being met. In addition, mortgages receivable are issued on short-terms thereby limiting the period of exposure to the negative impact of market conditions on their recoverability.

Payments received on mortgages that have been classified as impaired are recorded first to recover collection costs, principal and any previous write-offs or allowances, and then as interest income.

A mortgage will be classified back to performing status when it is determined that there is reasonable assurance of full and timely repayment of interest and principal in accordance with the terms and conditions of the mortgage, and that none of the criteria for classification of the mortgage as impaired continue to apply.

	2020	2019
Allowance for credit losses:		
Beginning of period	\$ 560,705	\$ 471,152
Current provisions	100,910	89,553
Prior year provisions recognized in profit and loss	-	-
	<hr/> \$ 661,615	<hr/> \$ 560,705

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

5. Mortgages receivable (continued):

Diversification:

The mortgages receivable at year end consisted of 35% (2019 - 51%) residential mortgages and 65% (2019 - 49%) residential construction mortgages.

At year end, there were no borrowers that represented greater than 10% of outstanding mortgage investments. (2018 - \$nil).

	2019		2018	
	Amount	#	Amount	#
South Okanagan	\$ 1,405,607	6	\$ 1,839,588	6
North Okanagan	4,449,946	21	3,627,373	23
Shuswap	1,102,151	3	1,478,277	3
Other	-	-	340,000	2
	6,957,704	30	7,285,238	34
Accrued interest	39,319		41,222	
Allowances for credit losses	(661,615)		(560,705)	
	\$ 6,335,408		\$ 6,765,755	

The maturity of loans at the reporting date was as follows:

	2020	2019
Within 6 months	\$ 6,080,168	\$ 4,330,374
6 to 12 months	256,058	2,334,834
12 to 18 months	621,478	620,030
	6,957,704	7,285,238
Accrued interest	39,319	41,222
Allowances for credit losses	(661,615)	(560,705)
	\$ 6,335,408	\$ 6,765,755

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

6. Redeemable preferred shares:

The Corporation is authorized to issue up to 9,000,000 Class A and 900,000 Class B redeemable preferred shares. The shares are non-voting, participating, redeemable, retractable, and without par value. The shares are retractable at the option of the holder and therefore have characteristics that are similar to debt. The redemption price is defined in the Corporation articles by formula and may not amount to the price paid for each share by the holder if certain circumstances prevail at the time of redemption. The Directors of the Corporation have discretion in suspending redemption of the preferred shares. In the event that the Directors choose to establish a period of suspension, preferred shares may still be redeemed every six months and the total amount of preferred shares to be redeemed at either redemption date is not to exceed 5% of outstanding shareholders' equity, as set out in the financial statements of the Corporation for the most recently completed fiscal year, distributed on a pro-rata basis amongst those redeeming shareholders who have provided the required notice. The option to suspend or delay redemption has not been considered an unconditional right to avoid redemption as the suspension cannot be carried forward indefinitely.

As of February 15, 2019, the Corporation can no longer issue shares to raise additional capital due to the changes in regulations made by the BC Securities Commission with the exception of reinvested dividends. As such, the Securities Solicitor for Sierra was engaged to identify share trade options between existing shareholders for the biannual share redemption requests.

There are 4 (2019 - 10) share redemptions requests totaling \$363,810 for December 31, 2020 (2019 - \$466,580), of which \$343,360 has already been traded to other shareholders, leaving 1,945 shares left to redeem for December 31, 2020.

There are 2 (2019 - 9) share redemptions requests totaling \$80,000 for June 30, 2021 (2019 - \$424,480), of which all has already been traded to other shareholders.

	Class A Shares	
	#	Amount
October 1, 2018	\$ 960,016	\$ 9,600,160
Issued for cash	44,637	446,370
Issued for dividends	24,025	240,250
Redeemed	(10,101)	(101,010)
October 1, 2019	1,018,577	10,185,770
Issued for dividends	20,977	209,770
Redeemed	(23,806)	(238,060)
September 30, 2020	\$ 1,015,748	\$ 10,157,480

The Corporation has not issued any Class B preferred shares.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

6. Redeemable preferred shares (continued):

At year end, related parties including directors and common shareholders of the Corporation; directors, common shareholders and key employees of Lakeland Asset Management Inc. ("Lakeland", the Corporation's parent); and close family members and related corporations held 220,776 Class A shares, or 22% (2019 - 218,435 shares, or 21%).

7. Common shares:

	2020	2019
Authorized:		
10,000 Voting redeemable, participating common shares without par value		
Issued:		
100 Common shares	\$ 100	\$ 100

8. Related party transactions:

During the year, \$144,248 (2019 - \$171,257) in management fees were paid to Lakeland. The Management Agreement states that the Manager be paid an annual fee not to exceed 2% of the outstanding balance of the mortgage portfolio, calculated monthly.

460284 B.C. Ltd. is the parent company of Lakeland and provides office supplies, telephone, and office space to the Corporation. During the year the Corporation paid \$7,672 (2019 - \$9,488) for these services.

The Corporation has no employees. Directors were remunerated \$3,850 (2019 - \$4,300) for services provided to the Corporation.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

9. Contingency:

A \$200,000 claim from March 19, 2003 exists against the Corporation. The claim is by a party who alleges that security for amounts advanced by the Corporation in a syndicated loan arrangement was improperly placed. The Corporation filed an appearance immediately and is currently in correspondence with the lawyer involved with the claim to have it expunged.

Management believes that the settlement of this issue will not have a material adverse impact on the Corporation's financial position; however, the outcome of this matter is presently unknown.

10. Financial Risks:

Overview:

The Board of Directors approves and monitors the risk management processes. The Corporation has exposure to the following risks from its use of financial instruments:

The COVID-19 outbreak was declared a pandemic by the World Health Organization in March 2020. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Corporation is not known at this time. These impacts could include impairment of assets and decreases in revenue. While future conditions are uncertain, the Corporation has realized a decrease to revenues over the prior year. Considering the impacts noted, as of the financial statement reporting date, there is increased exposure to the risks below.

(a) Credit risk:

The Corporation's exposure to credit risk is on its cash and cash equivalents and mortgages receivable.

Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Credit risk for accrued interest and mortgage investments is the risk that the mortgagor will fail to discharge the obligation, causing the Corporation to incur a financial loss. Credit risk is reduced by ensuring that the collateral value of the security adequately protects the advances, that there is a viable exit strategy for each investment, that the mortgages are made to qualified borrowers and by limiting amounts advanced in relation to the value of the property secured. The mortgage portfolio is also diversified by location, property type and size of loan on any one property, which further manages credit risk.

The credit quality of performing mortgages is directly related to their nature, interest rate and term as described in note 5. The maximum amount of credit risk is equal to the carrying value of the underlying assets.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

10. Financial Risks: (continued):

(b) Liquidity risk:

Liquidity risk is the risk that the Corporation will encounter difficulty in receiving funds due to delayed mortgage payments to meet commitments associated with financial instruments. Management controls liquidity risk through cash flow projections used to forecast funding requirements for mortgage investments and anticipated retraction of redeemable preferred shares. As described in note 6, the Corporation also has the ability to manage liquidity risk through control of redeemable preferred share retractions and the payment of dividends on the redeemable preferred shares. In addition, certain shareholders request their distribution by way of reinvestment of shares in lieu of cash dividends. All other financial liabilities are due within 12 months of the balance sheet date.

	Carrying value	Contractual cash flows	Due between 1 and 365 days	Due greater than 365 days
Accounts payable and accrued liabilities	\$ 28,498	\$ 28,498	\$ 28,498	\$ -
Distributions to shareholders	121,825	121,825	121,825	-
Redeemable preferred shares	10,157,480	10,157,480	443,810	9,713,670
	<u>\$ 10,307,803</u>	<u>\$ 10,307,803</u>	<u>\$ 594,133</u>	<u>\$ 9,713,670</u>

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

10. Financial Risks: (continued):

(c) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises of three types of risk: currency risk, interest rate risk and other price risk. The Corporation is not subject to currency and other price risks. Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fluctuations in general market interest rates have a limited impact on the interest rates of new mortgage investments due to the nature of the lending. The availability of funds for the Corporation's type of lending, as described in note 5, is the primary influence on the interest rates. The interest rates achieved on mortgage investments directly influence the rate of return available to redeemable preferred shareholders. The Corporation is not exposed to interest rate risk on existing loans as the interest income generated from the mortgages receivable is fixed.

The Corporation does not account for any fixed rate financial assets and liabilities at fair value through profit or loss; therefore a change in interest rates at the reporting date would not affect equity and profit or loss.

The carrying amounts of cash and cash equivalents, mortgages receivable, accounts payable and accrued liabilities, and distributions payable in cash to preferred shareholders approximate their fair values due to the relatively short periods to maturity of these items or because they are receivable or payable on demand.

Due to the uncertainty of the timing of redemption and retraction, the fair value of the redeemable preferred shares, including distributions payable in preferred shares, are not readily determinable.

SIERRA MORTGAGE FUND LTD.

Notes to Financial Statements (continued)

Year ended September 30, 2020
(Unaudited)

10. Financial Risks: (continued):

(d) Industry risk:

Effective February 15, 2019, the British Columbia Securities Commission has revoked BC Instrument 32-517 Exemption from Dealer Registration Requirement for Trades in Securities of Mortgage Investment Entities. As a result, firms or individuals who currently are in the business of trading in securities of "mortgage investment entities" were required to be registered under NI 31-103 as an exempt market dealer or dealing representative on or before February 15, 2019.

The Corporation did not register under NI 31-103 as an exempt market dealer, and as such has ceased issuing shares for capital. However, the Corporation is still able to facilitate share exchanges between its shareholders to preserve current capital. Accordingly, this does not prevent the Corporation from continuing with its mortgage lending operations with the capital on-hand at the effective date, only its ability to raise additional capital.

11. Capital disclosures:

The Corporation considers its capital to comprise its common shares and redeemable preferred shares, which are classified as a financial liability on the balance sheet. In managing its capital, the Corporation's primary objective is to ensure its continued ability to provide a consistent return for its shareholders through investments in mortgages bearing an acceptable interest rate and level of risk. In order to achieve this objective, the Corporation seeks to balance risks and returns at an acceptable level by providing mortgage financing at an interest rate commensurate with the level of risk. In making decisions to adjust its capital structure to achieve these objectives, the Corporation considers both its short-term and its long-term strategic objectives.

The Corporation is subject to externally imposed financial covenants of the Income Tax Act in order to qualify as a MIC. The Corporation was in compliance with these covenants throughout the year. There have been changes to the overall capital management strategy as the Company is no longer an exempt market dealer, it cannot issue its own shares for capital as has been done in the past. The Company manages capital by facilitating share exchanges to replace redemption requests where possible.