

Capital Direct I Income Trust

Minimally Impacted by the Pandemic / Lowers Risk Profile

Target Yield (p.a.):
7.0% - 7.5%
Rating*: 2-
Risk*: 3

Sector / Industry: Mortgage Investment Entities

[Click here for more research on the company and to share your views](#)

Highlights

- Despite the pandemic, Capital Direct expanded its mortgage receivable by 21% YTD to \$243M, across 1,697 properties, by the end of Q3-2020. The company maintains its spot among the 15 largest mortgage investment entities in Canada.
 - Due to lower lending rates, and slightly higher losses (0.28% of portfolio in 2020-9M vs 0.24% in 2019), annualized dividends declined in 2020 (9M) to 6.9%, from 7.4% in 2019 (full year). We expect yields to increase to 7.2% in 2021.
 - **The company remains focused on first/second mortgages on single family residential properties.** Loan-to-Value (“LTV”) remains low at just 55%. At the end of Q3, B.C. accounted for 52%, and ON accounted for 39%.
- Considering the rollout of vaccines, we expect an economic recovery in H2-2021. **As we expect interest rates to remain low for most of the year, we believe Capital Direct offers an attractive high-yield opportunity.**

Sid Rajeev, B.Tech, CFA, MBA
Head of Research

Offering Summary	
Issuer	Capital Direct I Income Trust
Securities Offered	Classes A, C, and F Trust Units
Unit Price	\$10
Minimum Subscription	\$5,000
Hurdle Rate	N/A
Distribution to Investors	80% of net income on a quarterly basis
Redemption	Class A - a fee of 5% of NAV in year 1, decreasing by 1% every year; no fee after year 5 / Class C & Class F - a fee of 2% within 6 months and no fee after that
Management Fee	2.0% p.a. of NAV on Classes A and C units / 1.0% p.a. of NAV on Class F units
Auditor	Johnsen Archer LLP

Financial Summary	2016	2017	2018	2019	2020 (9M)
Mortgage Investments (net)	\$147,121,047	\$165,613,676	\$182,156,694	\$200,483,054	\$242,815,792
Debt as a % of Mortgage Outstanding	30%	23%	20%	12%	19%
Revenues	\$11,043,006	\$15,340,499	\$18,612,285	\$21,100,094	\$16,363,972
Net Income	\$7,339,429	\$10,279,629	\$13,315,679	\$15,372,537	\$12,176,530
Net Asset Value	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00
Investors' Returns (% of Invested Capital)	7.59%	7.86%	7.66%	7.62%	6.87%

*See last page for important disclosures, rating and risk definitions. All figures in C\$ unless otherwise specified.

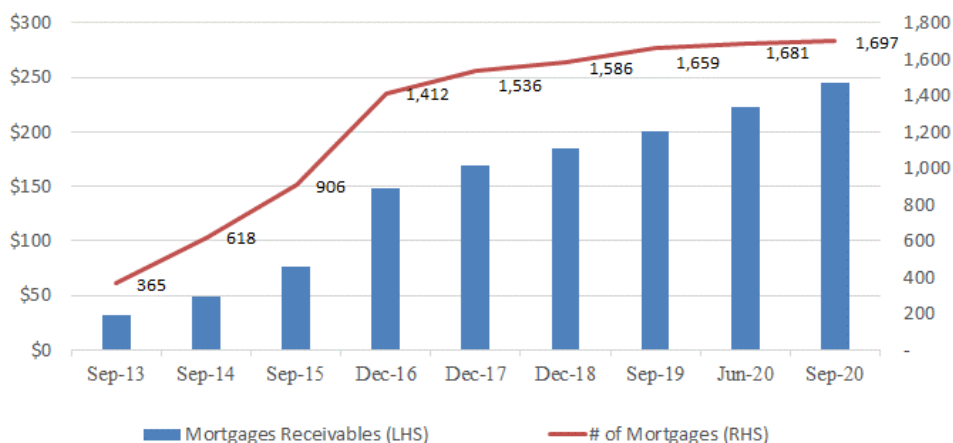
Portfolio Update

As of September 30, 2020, gross mortgage receivables were up 21% YTD to \$243M – implying that originations were minimally impacted by the pandemic

Debt to capital of 19% the end of Q3, inline with past three-year average; MICs of comparable size have a debt to capital between 15% and 30%

Exposure to first mortgages increased to 47%; well above historical levels; implying a reduction in risk profile

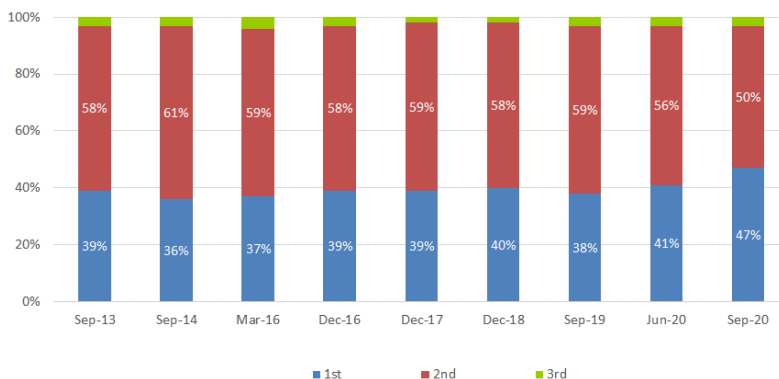
Mortgage Receivables gross in \$M & No. of Mortgages



Balance Sheet	2015	2016	2017	2018	2019	Q3-2020
Assets						
Cash	\$194,106	\$1,982,407	\$4,004,562	\$8,052,977	\$14,405,424	\$3,300,998
Accounts Receivable	\$1,736,095	\$5,226,932	\$3,223,329	\$2,524,347	\$3,943,906	\$2,539,401
Prepaid Expense						
Due from Related Party					\$2,060,600	
Assets held for sale			\$88,282		\$834,499	\$834,499
Mortgage Investments (net)	\$88,672,929	\$147,121,047	\$165,613,676	\$182,156,694	\$200,483,054	\$242,815,792
Total Assets	\$90,603,130	\$154,330,386	\$172,929,849	\$192,734,018	\$221,727,483	\$249,490,690
Liabilities						
Loan Payable	\$35,619,549	\$44,018,502	\$38,915,187	\$35,524,445	\$24,355,427	\$47,222,028
Accounts Payable & Accrued Liabilit	\$1,601,517	\$3,606,666	\$5,242,910	\$7,927,563	\$13,726,639	\$2,914,945
Total Liabilities	\$37,221,066	\$47,625,168	\$44,158,097	\$43,452,008	\$38,082,066	\$50,136,973
Net Asset	\$53,382,064	\$106,705,218	\$128,771,752	\$149,282,010	\$183,645,417	\$199,353,717
SE + Liabilities	\$90,603,130	\$154,330,386	\$172,929,849	\$192,734,018	\$221,727,483	\$249,490,690

Debt to Capital	40%	29%	23%	19%	12%	19%
Debt as a % of Mortgage Outstanding	40%	30%	23%	20%	12%	19%
Interest Coverage Ratio	4.5	7.3	7.8	9.3	10.9	18.0

Mortgages by Priority



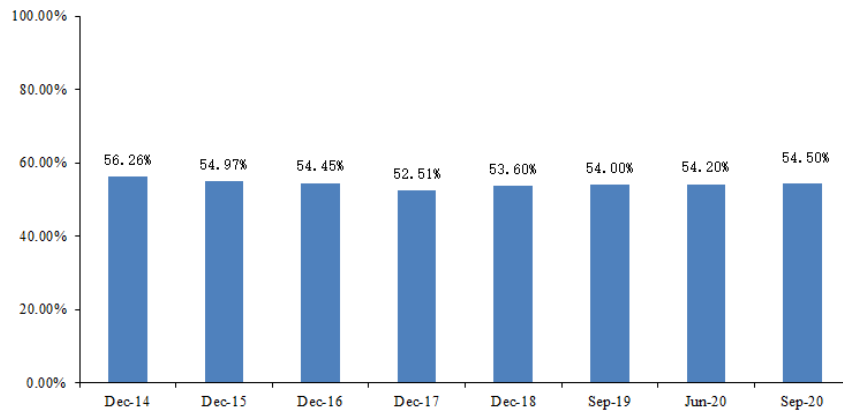
Source: Company / FRC

LTV increased slightly to 54.5%

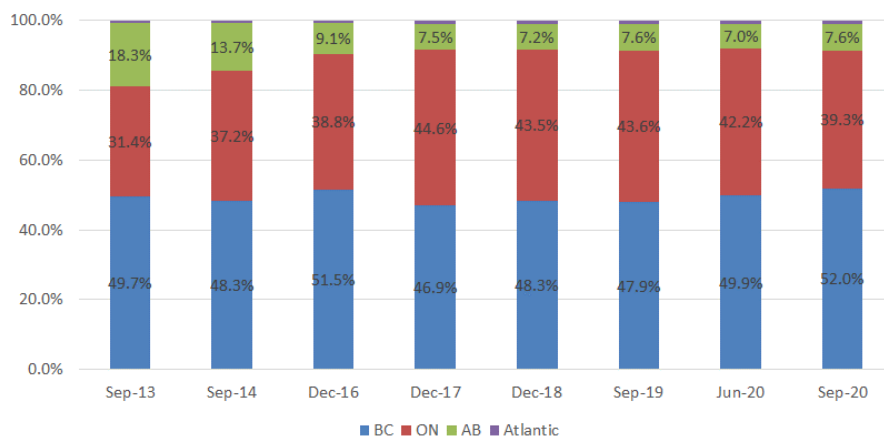
Exposure to B.C. increased in 2020; B.C. and ON accounted for over 90% of the portfolio at the end of Q3-2020

Average mortgage size rising

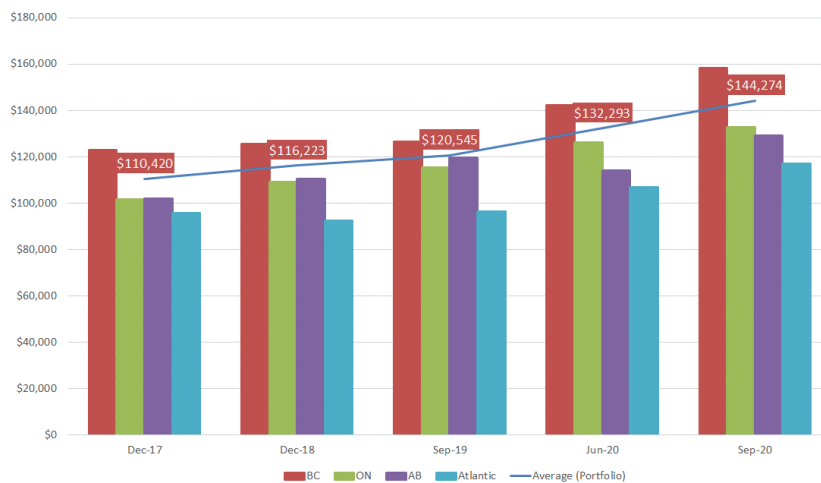
Loan to Value (LTV)



Mortgages by Region

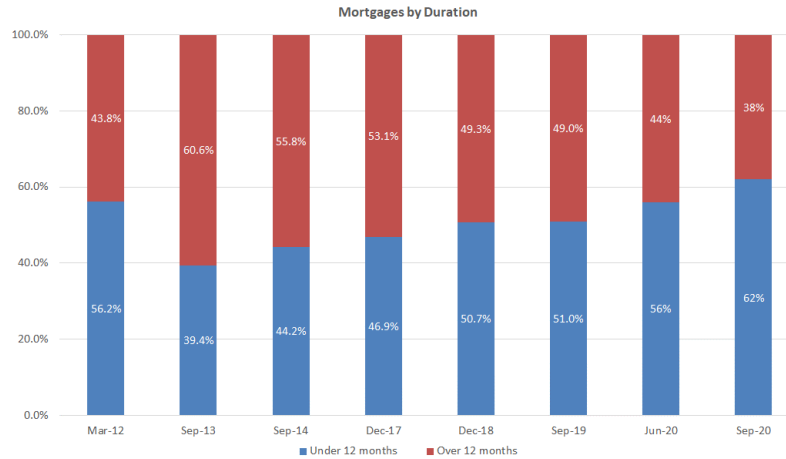


Average Mortgage Size



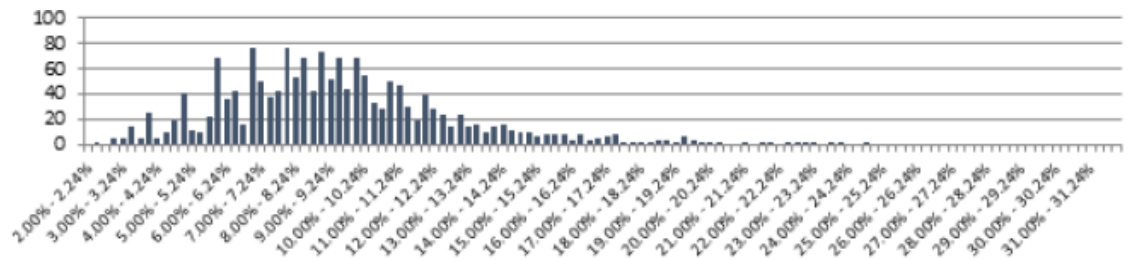
Source: Company / FRC

Duration decreased in 2020 as the percentage of mortgages under 12M increased



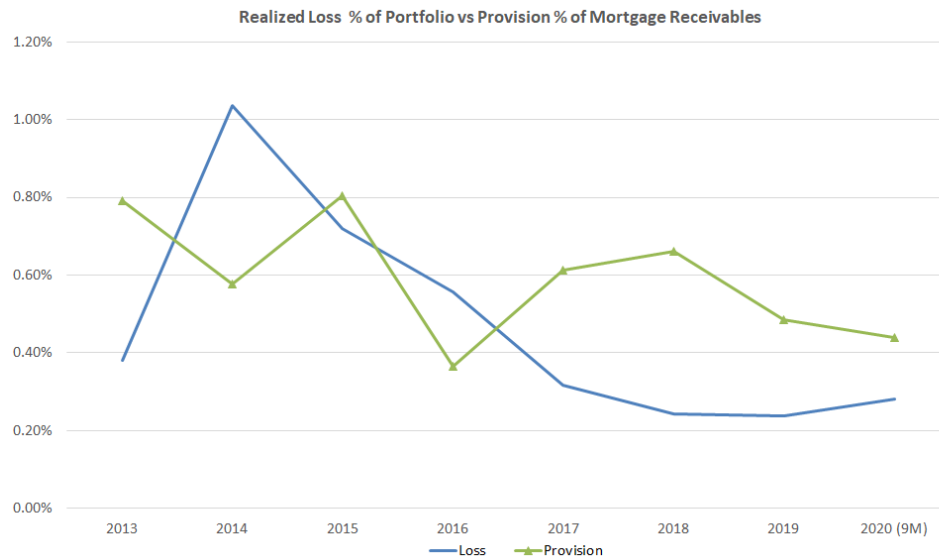
Source: Company / FRC

The weighted average lending rate at the end of Q3 was undisclosed, but our review of the financial statements indicated that rates declined slightly YoY; note that lending rates of MIEs are typically more stable as the market is less competitive relative to conventional lenders



Source: Company

Realized loss of 0.28% of mortgages in 2020 (9M) vs 0.24% in 2019 (full year)



Source: Company / FRC

Loan loss provision lowered from 0.48% at the end of 2019, to 0.44% at the end of 2020 – we believe this is on the lower-end of comparables

	2016	2017	2018	2019	2020 (9M)
Actual Losses	\$654,748	\$494,257	\$424,021	\$452,974	\$624,422
Actual Losses (% of mortgage receivable)	0.56%	0.32%	0.24%	0.24%	0.28%
Distributions	\$6,075,876	\$9,251,666	\$10,652,543	\$12,687,277	\$9,869,730
Reinvested	\$3,739,538	\$5,554,651	\$6,430,896	\$7,575,654	\$6,332,591
Reinvested (as a % of Distributions)	62%	60%	60%	60%	64%
Redemptions	\$3,210,287	\$7,408,860	\$7,157,098	\$19,721,850	\$14,694,209
Redemption (% of invested capital)	4%	6%	5%	12%	8%
Loan loss reported	\$477,919	\$971,133	\$613,053	\$221,274	\$717,752
Loan loss provision (year/quarter ended)	\$536,762	\$1,013,638	\$1,202,670	\$970,970	\$1,064,300
Provision % of Receivable	0.36%	0.61%	0.66%	0.48%	0.44%

Source: Company / FRC

Overall, we believe the **risk profile of the company’s portfolio has declined**; the positive impact from an increase in first mortgages and lower duration was partially offset by an increase in mortgage size.

Lowers risk profile

Parameter	Risk Profile
Total Portfolio Size	↑
Average Mortgage	↑
Diversification	-
Duration	↓
Priority	↑
Property Type	-
LTV	-
Default	-

- red (green) indicates an increase (decrease) in risk level

Source: FRC

Financials

Revenue up 5% YoY, and net income up 6% in 2020 (9M); Distribution to investors up 7%

Income Statement	2019 (9M)	2020 (9M)	YoY
Revenues			
Interest Income	\$13,466,476	\$14,310,262	6%
Other Income	\$2,119,730	\$2,053,710	-3%
Total Revenue	\$15,586,206	\$16,363,972	5%
Expenses			
G&A	\$389,773	\$443,447	14%
Interest on Loan Payable	\$1,272,742	\$716,462	-44%
Management Fees	\$1,947,699	\$2,309,558	19%
Loan Loss Provision	\$237,545	\$717,752	202%
Total Operating Expenses	\$4,106,143	\$4,509,844	10%
Net Income	\$11,480,064	\$11,854,128	3%
Net Asset Value			
	\$10.00	\$10.00	0%
Units Outstanding	18,061,876	19,935,372	10%
Distributions			
Investors	\$9,184,070	\$9,869,731	7%
Management	\$2,296,012	\$1,984,397	-14%
Investors' Share	80.0%	83.3%	

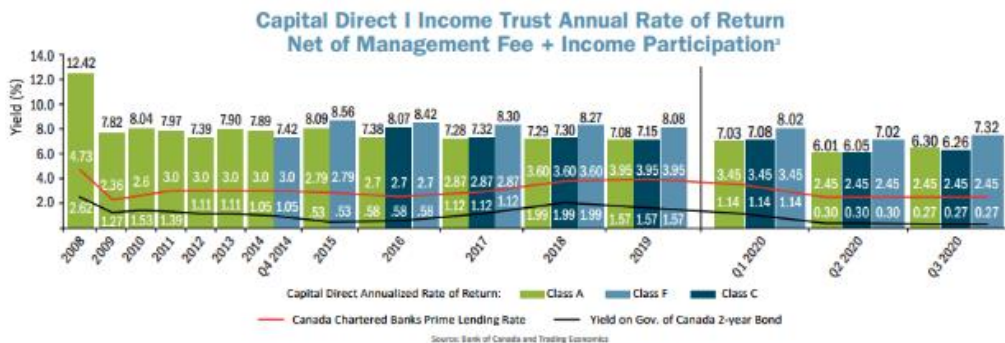
Due to lower lending rates, and higher provision for loan losses, dividends as a percentage of invested capital declined in 2020 (9M)

% of Mortgage Receivable	2018	2019	2019 (9M)*	2020 (9M)*
Interest Income	9.68%	10.11%	9.45%	8.61%
Other Income	1.02%	0.92%	1.49%	1.24%
Interest Income + Others	10.70%	11.03%	10.94%	9.84%
Less:				
Management Fee	-1.25%	-1.39%	-1.37%	-1.39%
G&A Expenses	-0.52%	-0.46%	-0.45%	-0.46%
Loan Loss Provision	-0.35%	-0.12%	-0.17%	-0.43%
Interest	-0.92%	-0.83%	-0.89%	-0.43%
Net	7.66%	8.23%	8.06%	7.13%
Investors' Returns (% of Invested Capital)	7.66%	7.62%	7.42%	6.87%

Note that the above figures may be slightly different from the figures reported by Capital Direct due to the difference in the method of calculation. We used the average of the opening balance, and year-end balance of the mortgages outstanding, and invested capital, to arrive at the above figures.

Source: Company / FRC

Dividend yield declined from 7.4% in 2019, to 6.9% in 2020 (9M)



Source: Company

Units Outstanding and Ownership

19.94M units outstanding at the end of Q3, up 9% YTD

Units Outstanding	31-Dec-19	% of Total	30-Sep-20	% of Total
Class A	7,577,136	41.3%	7,683,458	38.5%
Class C	3,730,982	20.3%	4,114,171	20.6%
Class F	7,056,424	38.4%	8,137,743	40.8%
Total	18,364,542	100.0%	19,935,372	100.0%

Source: Company

- Class A (since inception) - offered to investors directly
- Class F (introduced in 2014) - offered to funds managed by portfolio managers, and other fee-based investment advisors.
- Class C (introduced in 2016) - offered to investors who purchase units through Dealers (IIROC and Exempt Market Dealers).

Management's share ownership at the end of April 2020 was 0.62% of the total outstanding, up from 0.42% at the end of September 2019.

Management increased ownership

	Dec-17	% of Total	Dec-18	% of Total	Sep-19	% of Total	Apr-20	% of Total
Richard F.M. Nichols	10,006	0.08%	10,006	0.07%	11,962	0.07%	12,390	0.06%
Derek R. Tripp	15,386	0.12%	15,386	0.10%	18,393	0.10%	19,052	0.10%
Tim Wittig	18,002	0.14%	18,002	0.12%	25,721	0.14%	28,155	0.14%
David Rally	11,032	0.09%	5,689	0.04%	19,160	0.11%	61,708	0.32%
Total	54,426	0.42%	49,083	0.33%	75,236	0.42%	121,305	0.62%

Market Update

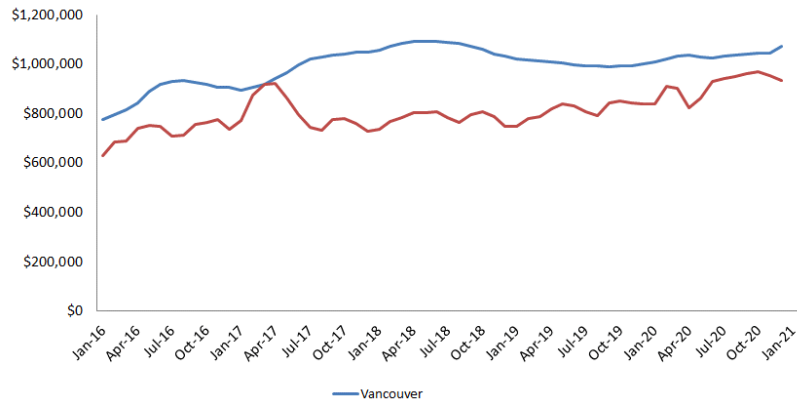
Sales of residential units in Toronto and Vancouver have rebounded sharply, with double digit YoY growth rates every month since July 2020. Prices were up 11% YoY in Toronto, and 7% in Vancouver in December 2020. The sales to active ratios in both cities are also up YoY. The following charts show average home prices in Vancouver and Toronto.

Strong rebound in real estate sales

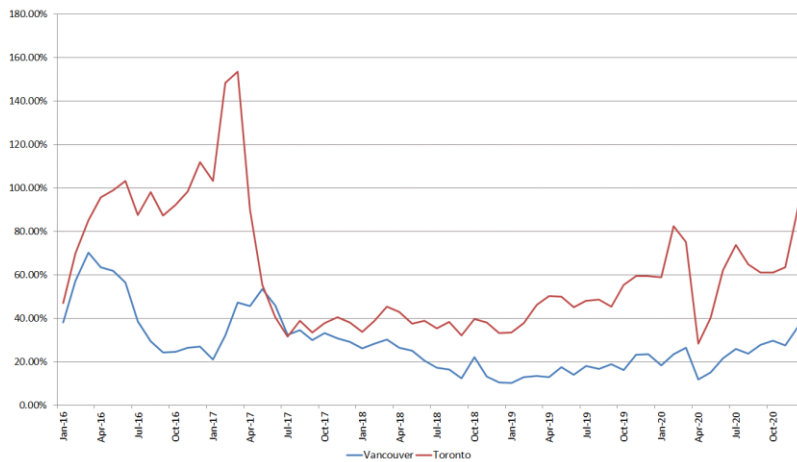
Metro Vancouver	Sep-19	Sep-20	YoY	Oct-19	Oct-20	YoY	Nov-19	Nov-20	YoY	Dec-19	Dec-20	YoY
Residential Sales	2,333	3,634	56%	1,966	3,687	88%	2,498	3,064	23%	2,016	3,093	53%
New Listings	4,866	6,402	32%	4,074	5,571	37%	2,987	4,068	36%	1,588	2,409	52%
Active Listings	12,439	13,096	5%	12,236	12,416	1%	10,770	11,118	3%	8,603	8,538	-1%
Sales to Listings	18.76%	27.75%		16.07%	29.70%		23.19%	27.56%		23.43%	36.23%	
MLS Home Price Index	\$990,600	\$1,041,300	5%	\$992,900	\$1,045,100	5%	\$993,700	\$1,044,000	5.06%	\$1,001,000	\$1,074,000	7%

Toronto	Sep-19	Sep-20	YoY	Oct-19	Oct-20	YoY	Nov-19	Nov-20	YoY	Dec-19	Dec-20	YoY
Residential Sales	7,825	11,083	42%	8,491	10,563	24%	7,090	8,766	24%	4,399	7,180	63%
New Listings	15,611	20,420	31%	13,050	17,802	36%	8,650	11,545	33%	3,531	5,865	66%
Active Listings	17,254	18,167	5%	15,375	17,313	13%	11,958	13,798	15%	7,406	7,892	7%
Sales to Listings	45.35%	61.01%		55.23%	61.01%		59.29%	63.53%		59.40%	90.98%	
MLS Home Price Index	\$843,115	\$960,772	14%	\$852,142	\$968,318	14%	\$843,637	\$955,615	13%	\$837,788	\$932,222	11%

Home Index Price



Sales to Active



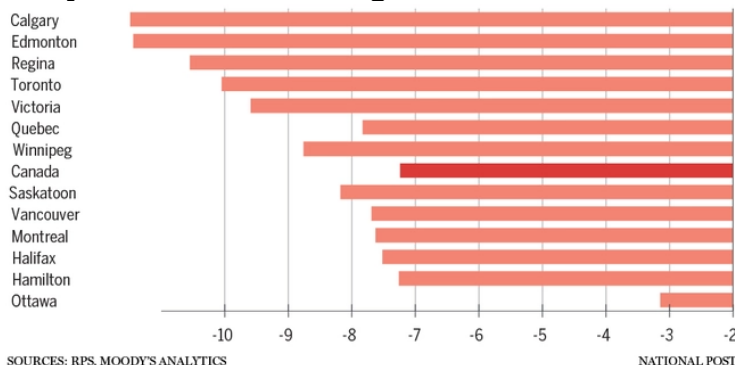
Source: TREB and REBGV

Considering the rollout of vaccines, we expect an economic recovery in H2-2021. Lack of new immigrants and international students had a significant impact on the country's rental market. However, we expect a surge in both new immigrants and students once travel restrictions are relaxed and conditions normalize. **The Federal Government recently increased its immigration targets for the next three years to make up for last year's decline due to the pandemic.**

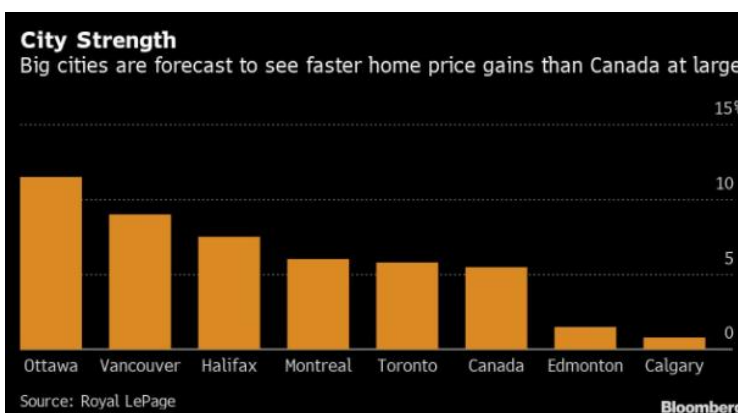
Moody's estimates housing prices across the country will decline 7% in 2021, while Royal LePage expects prices to appreciate 5.5%. **We believe the low interest rate environment will support residential sales and prices.**

Mixed forecasts for real estate prices in 2021; we have a positive outlook

Moody's and RPS Housing Price Forecast for 2021



SOURCES: RPS, MOODY'S ANALYTICS
Source: National Post, RPS Real Property & Moody's



Source: Royal LePage

Bloomberg

As work-from-home culture is prompting people to move out of downtown areas, we expect stronger demand and price growth in suburban areas. We also expect the demand for office space to decline, which will prompt landlords to reposition/convert their office space to residential units, bringing more supply to the market. The low duration of MICs (as mortgages are short-term) is a major advantage, as it will allow them to adapt to changing demand and trends.

Rating

Based on our estimate of \$275M in gross mortgage receivables at the end of 2021, we are estimating a yield of 7.2% for the year.

Expecting a 7.2% yield in 2021

Financial Summary	2018	2019	2020E	2021E
Mortgage Investments (net)	\$182,156,694	\$200,483,054	\$248,750,000	\$273,625,000
Debt as a % of Mortgage Outstanding	20%	12%	18%	16%
Revenues	\$18,612,285	\$21,100,094	\$22,110,704	\$25,453,555
Net Income	\$13,315,679	\$15,372,537	\$16,097,578	\$19,012,513
Net Asset Value	\$10.00	\$10.00	\$10.00	\$10.00
Investors' Returns (% of Invested Capital)	7.66%	7.62%	6.93%	7.18%

Source: Company/FRC

We are maintaining our overall rating at 2-, and risk rating at 3. With interest rates expected to remain low this year, we believe that the trust’s 7.2% expected yield, with a low portfolio average LTV of 55%, offers an attractive risk adjusted return.

FRC Rating	
Yield (2021)	7.0% - 7.5%
Rating	2-
Risk	3

Risks

Investors are exposed to the following risks:

- Loans are short term and need to be sourced and replaced quickly.
- Timely deployment of capital is crucial.
- A drop in housing prices will result in higher LTVs, and higher default risk, as the value of collateral decreases.
- Unit holders’ principal is not guaranteed, as the NAV per share could decrease from current levels (as a result of loan losses). Unit holders are also not guaranteed minimum distributions.
- No hurdle rate.
- The fund has the ability to use leverage, which would increase the exposure of the fund to negative events.

Fundamental Research Corp. Rating Scale:

- Rating – 1: Excellent Return to Risk Ratio
- Rating – 2: Very Good Return to Risk Ratio
- Rating – 3: Good Return to Risk Ratio
- Rating – 4: Average Return to Risk Ratio
- Rating – 5: Weak Return to Risk Ratio
- Rating – 6: Very Weak Return to Risk Ratio
- Rating – 7: Poor Return to Risk Ratio

A "+" indicates the rating is in the top third of the category, A "-" indicates the lower third and no "+" or "-" indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:

- 1 (Low Risk)
- 2 (Below Average Risk)
- 3 (Average Risk)
- 4 (Speculative)
- 5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	30%	Risk - 2	8%
Rating - 3	47%	Risk - 3	40%
Rating - 4	9%	Risk - 4	34%
Rating - 5	4%	Risk - 5	8%
Rating - 6	1%	Suspended	10%
Rating - 7	0%		
Suspended	10%		

Disclaimers and Disclosure

The opinions expressed in this report are the true opinions of the analyst about this company and industry. Any "forward looking statements" are our best estimates and opinions based upon information that was provided and that we believe to be correct, but we have not independently verified with respect to truth or correctness. There is no guarantee that our forecasts will materialize. Actual results will likely vary. The analyst and Fundamental Research Corp. "FRC" does not own any shares of the subject company, does not make a market or offer shares for sale of the subject company, and does not have any investment banking business with the subject company. Fees have been paid by the issuer to FRC to issue this report. The purpose of the fee is to subsidize the high costs of research and monitoring. FRC takes steps to ensure independence including setting fees in advance and utilizing analysts who must abide by CFA Institute Code of Ethics and Standards of Professional Conduct. Additionally, analysts may not trade in any security under coverage. Our full editorial control of all research, timing of release of the reports, and release of liability for negative reports are protected contractually. Distribution procedure: our reports are distributed first to our web-based subscribers on the date shown on this report then made available to delayed access users through various other channels for a limited time.

To subscribe for real-time access to research, visit <https://www.researchfrc.com/website/subscribe/> for subscription options. This report contains "forward looking" statements. Forward-looking statements regarding the Company and/or stock's performance inherently involve risks and uncertainties that could cause actual results to differ from such forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of the Company's products/services in the marketplace; acceptance in the marketplace of the Company's new product lines/services; competitive factors; new product/service introductions by others; technological changes; dependence on suppliers; systematic market risks and other risks discussed in the Company's periodic report filings, including interim reports, annual reports, and annual information forms filed with the various securities regulators. By making these forward looking statements, Fundamental Research Corp. and the analyst/author of this report undertakes no obligation to update these statements for revisions or changes after the date of this report. A report initiating coverage will most often be updated quarterly while a report issuing a rating may have no further or less frequent updates because the subject company is likely to be in earlier stages where nothing material may occur quarter to quarter.

Fundamental Research Corp DOES NOT MAKE ANY WARRANTIES, EXPRESSED OR IMPLIED, AS TO RESULTS TO BE OBTAINED FROM USING THIS INFORMATION AND MAKES NO EXPRESS OR IMPLIED WARRANTIES OR FITNESS FOR A PARTICULAR USE. ANYONE USING THIS REPORT ASSUMES FULL RESPONSIBILITY FOR WHATEVER RESULTS THEY OBTAIN FROM WHATEVER USE THE INFORMATION WAS PUT TO. ALWAYS TALK TO YOUR FINANCIAL ADVISOR BEFORE YOU INVEST. WHETHER A STOCK SHOULD BE INCLUDED IN A PORTFOLIO DEPENDS ON ONE'S RISK TOLERANCE, OBJECTIVES, SITUATION, RETURN ON OTHER ASSETS, ETC. ONLY YOUR INVESTMENT ADVISOR WHO KNOWS YOUR UNIQUE CIRCUMSTANCES CAN MAKE A PROPER RECOMMENDATION AS TO THE MERIT OF ANY PARTICULAR SECURITY FOR INCLUSION IN YOUR PORTFOLIO. This REPORT is solely for informative purposes and is not a solicitation or an offer to buy or sell any security. It is not intended as being a complete description of the company, industry, securities or developments referred to in the material. Any forecasts contained in this report were independently prepared unless otherwise stated, and HAVE NOT BEEN endorsed by the Management of the company which is the subject of this report. Additional information is available upon request. THIS REPORT IS COPYRIGHT. YOU MAY NOT REDISTRIBUTE THIS REPORT WITHOUT OUR PERMISSION. Please give proper credit, including citing Fundamental Research Corp and/or the analyst, when quoting information from this report.

The information contained in this report is intended to be viewed only in jurisdictions where it may be legally viewed and is not intended for use by any person or entity in any jurisdiction where such use would be contrary to local regulations or which would require any registration requirement within such jurisdiction