Mortgages: Fixed Term & Construction - Pooled Fund Financial Statements

DECEMBER 2018

British Columbia Investment Management Corporation

British Columbia Investment Management Corporation

Mortgages: Fixed Term & Construction - Pooled Investment Portfolios

Group of Funds

Fixed Term Mortgage Fund
Construction Mortgage Fund

Financial Statements
For the year ended December 31, 2018

British Columbia Investment Management Corporation
Pooled Investment Portfolios

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

British Columbia Investment Management Corporation (BCI) manages Pooled Investment Portfolios on behalf of governing fiduciaries such as pension fund trustees and other public sector clients. This report contains the financial statements for the following Pooled Investment Portfolios for the year ended December 31, 2018:

Fixed Term Mortgage Fund
Construction Mortgage Fund

The financial statements of the Pooled Investment Portfolios have been prepared by management of BCI and approved by the Chief Investment Officer/Chief Executive Officer. All of the financial statements have been prepared in accordance with International Financial Reporting Standards. The significant accounting policies used in the preparation of these statements are disclosed in note 3 to the financial statements. The statements include certain amounts that are based on management's judgement and best estimates.

BCI's Board has established an Audit Committee. The Committee's mandate includes making recommendations on the appointment of the external auditor for the Pooled Investment Portfolios, reviewing the external audit plan; reviewing BCI's Service Organization Controls Report for the Investment System of British Columbia Investment Management Corporation, and reviewing the annual audited financial statements of the Pooled Investment Portfolios. The Committee reviews the recommendations of the internal and external auditors with respect to internal controls and the responses of management to those recommendations, and also meets with management and the internal and external auditors to review annual audit plans.

BCI maintains systems of internal control and supporting processes to provide reasonable assurance that assets are safeguarded; that transactions are appropriately authorized and recorded; and that there are no material misstatements in the financial statements. BCI's internal control framework includes: a strong corporate governance structure; a code of conduct that includes conflict of interest guidelines; an organizational structure that provides for appropriate segregation of duties and accountability for performance; an enterprise-wide risk management framework that identifies, monitors and reports on key risks; and Board-approved Pooled Investment Portfolio Policies and client-approved investment mandates. BCI's system of internal control is supported by external auditors who review and evaluate internal controls and report directly to the Audit Committee.

BCI's external auditors, KPMG LLP, have full and unrestricted access to the Audit Committee and BCI management. KPMG LLP discusses with management and the Committee the results of their audit of the Pooled Investment Portfolios' financial statements and related findings with respect to such audits. Each of the Pooled Investment Portfolio financial statements is audited by KPMG LLP in accordance with Canadian generally accepted auditing standards. KPMG LLP has performed such tests and other procedures as they considered necessary to express an opinion on the Pooled Investment Portfolio financial statements.

[S] Gordon J. Fyfe	[S] Lawrence E. Davis
Gordon J. Fyfe	Lawrence E. Davis
Chief Executive Officer / Chief Investment Officer	Senior Vice President, Finance

Victoria, British Columbia
April 4, 2019

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INDEPENDENT AUDITORS' REPORT

To the Unitholders of the following funds managed by British Columbia Investment Management Corporation (the Manager):

Fixed Term Mortgage Fund
Construction Mortgage Fund
(collectively, the "Funds")

Opinion

We have audited the financial statements of the Funds, which comprise:

- the statements of financial position as at December 31, 2018
- the statements of comprehensive income/(loss) for the year then ended
- the statements of changes in net assets attributable to holders of redeemable units for the year then ended
- the statements of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies.

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Funds as at December 31, 2018, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audits in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Funds in accordance with the ethical requirements that are relevant to our audits of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Manager and Those Charged with Governance for the Financial Statements

The Manager is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as the Manager determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Manager is responsible for assessing the Funds' abilities to continue as going concerns, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Manager either intends to liquidate the Funds or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Funds' financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Funds' internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Manager.

- Conclude on the appropriateness of the Manager's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Funds' ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Funds to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audits.

KPMG LLP

Chartered Professional Accountants

Vancouver, Canada
April 4, 2019

FIXED TERM MORTGAGE FUND

Statement of Financial Position
(all amounts in thousands *except number of units*)

	Note	December 31, 2018	December 31, 2017
Assets			
Receivable from issuance of units		$ 44,000	$ -
Investments		1,790,853	1,612,403
		1,834,853	1,612,403
Liabilities			
Payable for redemption of units		-	9,000
BCI cost recoveries payable	4	2,110	1,546
Other accounts payable		11	11
		2,121	10,557
Net assets attributable to holders of redeemable units		**$ 1,832,732**	**$ 1,601,846**
Number of redeemable units outstanding	5	*423.997*	*385.024*
Net assets attributable to holders of redeemable units per unit		**$ 4,323**	**$ 4,160**

Statement of Comprehensive Loss
(all amounts in thousands)

	Note	Year Ended December 31, 2018	Year Ended December 31, 2017
Revenue:			
Interest income		$ 63,505	$ 64,052
Change in fair value of investments:			
Net realized loss		(263)	(67)
Net change in unrealized appreciation		7,906	(37,241)
Total revenue		71,148	26,744
Expenses:			
BCI cost recoveries	4	4,223	4,191
Administrative fees		34	62
Custodial fees		2	-
Legal fees		3	-
Total operating expenses		4,262	4,253
Increase in net assets attributable to holders of redeemable units from operations excluding distributions		66,886	22,491
Distributions to holders of redeemable units:			
From net investment income		(68,770)	(60,870)
Decrease in net assets attributable to holders of redeemable units		**$ (1,884)**	**$ (38,379)**

[S] Gordon J. Fyfe

Gordon J. Fyfe
Chief Executive Officer
Chief Investment Officer

See accompanying Notes to the Financial Statements.

FIXED TERM MORTGAGE FUND

Statement of Changes in Net Assets Attributable to Holders of Redeemable Units
(all amounts in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Balance, beginning of year	$ 1,601,846	$ 1,614,355
Decrease in net assets attributable to holders of redeemable units	(1,884)	(38,379)
Redeemable unit transactions:		
Proceeds from units issued	415,844	178,000
Reinvestment of distributions	68,770	60,870
Amounts paid for units redeemed	(251,844)	(213,000)
Net increase from redeemable unit transactions	232,770	25,870
Balance, end of year	**$ 1,832,732**	**$ 1,601,846**

Statement of Cash Flows
(all amounts in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Operating activities:		
Decrease in net assets attributable to holders of redeemable units	$ (1,884)	$ (38,379)
Adjustments for:		
Interest income	(63,505)	(64,052)
Net realized loss from investments	263	67
Net change in unrealized appreciation from investments	(7,906)	37,241
Non cash distributions	68,770	60,870
Proceeds from sale of investments	700,222	374,082
Amounts paid for purchase of investments	(871,029)	(393,111)
BCI cost recoveries	564	1,219
Other accounts payable	-	11
Interest received	63,505	64,052
	(111,000)	42,000
Financing activities:		
Proceeds from issue of redeemable units	371,844	178,000
Payments on redemption of redeemable units	(260,844)	(220,000)
	111,000	(42,000)
Net increase (decrease) in cash	-	-
Cash, beginning and end of year	$ **-**	$ **-**

See accompanying Notes to the Financial Statements.

FIXED TERM MORTGAGE FUND

Schedule of Investments
as at December 31
(all amounts in thousands)

	2018		2017	
	Fair Value	Cost	Fair Value	Cost
Mortgage Investments [1]	$ 1,789,691	$ 1,774,484	$ 1,602,361	$ 1,595,048
Money Market Investments:				
Units in BCI Pooled Investment Portfolio:				
Fund ST1	1,162	1,163	10,042	10,055
Total Investments	**$ 1,790,853**	**$ 1,775,647**	**$ 1,612,403**	**$ 1,605,103**

[1] The mortgage investments are held through a limited partnership.

See accompanying Notes to the Financial Statements.

FIXED TERM MORTGAGE FUND

Financial Risk Management Discussion
as at December 31

The investment objectives, eligible investments and general information on the financial risks related to the Fixed Term Mortgage Fund are described in note 6 of the financial statements. The information contained in this Financial Risk Management Discussion pertains specifically to the Fixed Term Mortgage Fund.

The Fund holds most of its investments through a limited partnership. The limited partnership holds the following investments and other net receivables:

(in 000s)	2018			2017		
		Total	% of Total		Total	% of Total
Fixed-Rate Mortgages	$	1,527,451	85.3 %	$	1,518,342	94.7 %
Floating-Rate Mortgages		173,155	9.7 %		73,022	4.6 %
Money Market Funds		84,504	4.7 %		5,786	0.4 %
Other Net Receivables		4,581	0.3 %		5,211	0.3 %
Total Net Assets of Limited Partnership	$	1,789,691	100.0 %	$	1,602,361	100.0 %

The Fund's activities expose it to a variety of financial risks. For purposes of describing the financial risks of the Fund, the composition of the investments held by the limited partnership have been considered.

Credit Risk

The majority of the Fund's holdings are in uninsured first mortgages where the possibility of a borrower defaulting on payment obligations exists. To reduce default risk, the Fund invests in uninsured mortgages with conservative loan to value ratios. No uninsured mortgages will be entered into, and no mortgage bonds or A/B Notes will be purchased, if they exceed a 75% loan-to-value ratio at inception and no insured mortgages will be entered into if they exceed a 95% loan-to-value ratio at inception. Also, all mortgages will include additional collateral and guarantees from borrowers. The fair value of the Fund's mortgage and money market investments represents the Fund's maximum exposure to credit risk.

Financial Risk Management Discussion (continued)
as at December 31

Credit Risk (continued)

Mortgages by Industry Sector

Investments in the Fund are diversified across industry sectors. Sectors to which the Fund had exposure as at December 31 are as follows:

INDUSTRY SECTOR (in 000s)	2018			2017		
		Total	% of Total		Total	% of Total
Retail	$	437,677	25.7 %	$	487,856	30.7 %
Office		689,814	40.6 %		581,677	36.6 %
Industrial		204,041	12.0 %		227,003	14.3 %
Residential		355,792	20.9 %		281,467	17.7 %
Other		13,282	0.8 %		13,361	0.8 %
Total Mortgages	$	1,700,606	100.0 %	$	1,591,364	100.0 %

INDUSTRY SECTOR (Number of Mortgages)	2018		2017	
	Total	% of Total	Total	% of Total
Retail	8	19.5 %	10	22.2 %
Office	19	46.3 %	20	44.4 %
Industrial	5	12.2 %	5	11.1 %
Residential	8	19.5 %	9	20.0 %
Other	1	2.5 %	1	2.2 %
Total Mortgages	41	100.0 %	45	100.0 %

Liquidity Risk

The Fund's liabilities are due within three months of the year-end of the Fund.

FIXED TERM MORTGAGE FUND

Financial Risk Management Discussion (continued)
as at December 31

Interest Rate Risk

The Fund invests in fixed term mortgages with maturities typically ranging from 1 to 5 years. The duration of the Fund is 3.1 years (2017 - 2.4 years). Lending rates for mortgages are determined based on the current yield of Government of Canada debt securities with a similar term to maturity plus a risk and liquidity premium.

As at December 31, the Fund invested in mortgages with the following terms to maturity:

MORTGAGES BY MATURITY DATE (in 000s)	2018			2017		
		Total	Avg Effective Yield %		Total	Avg Effective Yield %
Floating-Rate Mortgages:						
Within 1 year	$	173,155	n/a	$	73,022	n/a
Fixed-Rate Mortgages:						
Within 1 year		161,475	3.58 %		307,532	2.56 %
1 to 5 years		1,070,355	3.61 %		1,182,428	3.51 %
5 to 10 years		295,621	3.61 %		28,382	3.38 %
Total Mortgages	$	1,700,606	3.60 %	$	1,591,364	3.32 %

If prevailing interest rates increased or decreased by 1% (100 bps), with all other variables held constant, net assets would have decreased or increased by approximately $47,193,000 (2017 - $35,840,000), representing 2.6% of the Fund's net assets (2017 - 2.2%).

Currency Risk

The Fund is not exposed to significant currency risk as the Fund’s assets and liabilities are denominated in Canadian dollars.

Financial Risk Management Discussion (continued)
as at December 31

Other Price Risk

Management monitors the concentration of risk for mortgage securities based on counterparties and industries and geographic location. The Fund’s industry sector exposure is presented in the Credit Risk section.

The Fund is not exposed to significant other price risk since the Fund's assets and liabilities are fixed income instruments.

Investments by Geographic Region

All of the Fund’s motgage investments are exposed to the Canadian market.

FIXED TERM MORTGAGE FUND

Fair Value Measurement Discussion
as at December 31

As described in note 7 of the financial statements, a three-tier hierarchy is used as a framework for disclosing fair value based on inputs used to value the Fund's financial instruments.

The table below analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the Statement of Financial Position.

All fair value measurements noted in the tables below are recurring.

	December 31, 2018		
(in 000s)	Level 1 (Quoted Price in Active Market)	Level 2 (Significant Observable Inputs)	Total
Mortgage Investments	$ -	$ 1,700,606	$ 1,700,606
Money Market Funds	85,666	-	85,666
Net Investment-Related Receivable	-	4,581	4,581
Total Investments	$ 85,666	$ 1,705,187	$ 1,790,853

	December 31, 2017		
(in 000s)	Level 1 (Quoted Price in Active Market)	Level 2 (Significant Observable Inputs)	Total
Mortgage Investments	$ -	$ 1,591,364	$ 1,591,364
Money Market Funds	15,828	-	15,828
Net Investment-Related Receivable	-	5,211	5,211
Total Investments	$ 15,828	$ 1,596,575	$ 1,612,403

Fair Value Measurement Discussion (continued)
as at December 31

The carrying amount of the Fund's net assets attributable to the holders of redeemable units also approximates fair value as it is measured at redemption amount and is classified as Level 2 in the fair value hierarchy.

During 2018 and 2017, there were no significant transfers between Level 1 and Level 2.

FIXED TERM MORTGAGE FUND

Involvement with Structured Entities
as at December 31

A structured entity is an entity that has been designed so that voting or other similar rights are not the dominant factor in determining who controls the entity. The Fund holds interests in structured entities. These structured entities are comprised of investee funds organized as unit trusts. These investee funds have been constituted to manage assets on behalf of third party investors and are financed through the issue of units to these investors. Accordingly, the Fund's interests in these entities is reflected through the holdings of units issued by the investee funds. During 2018 and 2017, the Fund did not provide additional financial or other support to these structured entities, other than through its investment in units of these entities. Furthermore, these structured units are not subject to restrictions over operations or redemptions, other than certain investment related restrictions in accordance with maintaining their investment objectives. The tables below sets out the interests held by the Fund in these structured entities:

	December 31, 2018		
Entity	Number of Investee Funds	Total Net Assets of Investee Funds (in 000s)	Carrying amount included in Investments in the Statement of Financial Position (in 000s)
Investee money market funds administered by BCI	1	$ 1,699,706	$ 85,666

	December 31, 2017		
Entity	Number of Investee Funds	Total Net Assets of Investee Funds (in 000s)	Carrying amount included in Investments in the Statement of Financial Position (in 000s)
Investee money market funds administered by BCI	1	$ 923,071	$ 15,828

CONSTRUCTION MORTGAGE FUND

Statement of Financial Position
(all amounts in thousands *except number of units*)

	Note	December 31, 2018	December 31, 2017
Assets			
Receivable from issuance of units		$ 41,000	$ 30,500
Investments		1,274,622	1,075,624
		1,315,622	1,106,124
Liabilities			
BCI cost recoveries payable	4	1,778	910
Other accounts payable		11	11
		1,789	921
Net assets attributable to holders of redeemable units		**$ 1,313,833**	**$ 1,105,203**
Number of redeemable units outstanding	5	*338.330*	*299.811*
Net assets attributable to holders of redeemable units per unit		**$ 3,883**	**$ 3,686**

Statement of Comprehensive Income
(all amounts in thousands)

	Note	Year Ended December 31, 2018	Year Ended December 31, 2017
Revenue:			
Interest income		$ 234	$ 121
Change in fair value of investments:			
Net realized gain		42,230	33,354
Net change in unrealized appreciation		23,790	10,382
Total revenue		66,254	43,857
Expenses:			
BCI cost recoveries	4	5,584	2,980
Administrative fees		36	39
Custodial fees		2	-
Legal fees		2	8
Total operating expenses		5,624	3,027
Increase in net assets attributable to holders of redeemable units from operations excluding distributions		60,630	40,830
Distributions to holders of redeemable units:			
From net investment income		6,283	2,012
From net realized gains on investments		(42,383)	(33,415)
		(36,100)	(31,403)
Increase in net assets attributable to holders of redeemable units		**$ 24,530**	**$ 9,427**

[S] Gordon J. Fyfe

Gordon J. Fyfe
Chief Executive Officer
Chief Investment Officer

See accompanying Notes to the Financial Statements.

BRITISH COLUMBIA INVESTMENT MANAGEMENT CORPORATION
POOLED INVESTMENT PORTFOLIOS

CONSTRUCTION MORTGAGE FUND

Statement of Changes in Net Assets Attributable to Holders of Redeemable Units
(all amounts in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Balance, beginning of year	$ 1,105,203	$ 971,873
Increase in net assets attributable to holders of redeemable units	24,530	9,427
Redeemable unit transactions:		
Proceeds from issuance of units	471,000	343,500
Reinvestment of distributions	36,100	31,403
Amounts paid for units redeemed	(323,000)	(251,000)
Net increase from redeemable unit transactions	184,100	123,903
Balance, end of year	**$ 1,313,833**	**$ 1,105,203**

Statement of Cash Flows
(all amounts in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Operating activities:		
Increase in net assets attributable to holders of redeemable units	$ 24,530	$ 9,427
Adjustments for:		
Interest income	(234)	(121)
Net realized gain from investments	(42,230)	(33,354)
Net change in unrealized appreciation from investments	(23,790)	(10,382)
Non cash distributions	36,100	31,403
Proceeds from sale of investments	959,246	568,340
Amounts paid for purchase of investments	(1,092,224)	(564,628)
BCI cost recoveries	868	683
Other accounts payable	-	11
Interest received	234	121
	(137,500)	1,500
Financing activities:		
Proceeds from issue of redeemable units	460,500	313,000
Payments on redemption of redeemable units	(323,000)	(314,500)
	137,500	(1,500)
Net increase (decrease) in cash	-	-
Cash, beginning and end of year	$ -	$ -

See accompanying Notes to the Financial Statements.

CONSTRUCTION MORTGAGE FUND

Schedule of Investments
as at December 31
(all amounts in thousands)

	2018		2017	
	Fair Value	Cost	Fair Value	Cost
Mortgage Investments [1]	$ 1,273,609	$ 1,104,604	$ 1,074,936	$ 929,721
Money Market Investments:				
Units in BCI Pooled Investment Portfolio:				
Fund ST1	1,013	1,014	688	689
Total Investments	$ **1,274,622**	$ **1,105,618**	$ **1,075,624**	$ **930,410**

[1] The mortgage investments are held through a private corporation.

See accompanying Notes to the Financial Statements.

CONSTRUCTION MORTGAGE FUND

Financial Risk Management Discussion
as at December 31

The investment objectives, eligible investments and general information on the financial risks related to the Construction Mortgage Fund are described in note 6 of the financial statements. The information contained in this Financial Risk Management Discussion pertains specifically to the Construction Mortgage Fund.

The Fund holds most of its investments through a corporation. The corporation holds the following investments and other net receivables:

(in 000s)	2018 Total	2018 % of Total	2017 Total	2017 % of Total
Variable-Rate Mortgages	$ 1,052,554	82.6 %	$ 883,326	82.2 %
Fixed-Rate Mortgages	160,705	12.6 %	135,654	12.6 %
Money Market Funds	56,735	4.5 %	53,241	4.9 %
Other Net Receivables	3,615	0.3 %	2,715	0.3 %
Total Net Assets of Mortgage Corporation	$ 1,273,609	100.0 %	$ 1,074,936	100.0 %

The Fund's activities expose it to a variety of financial risks. For purposes of describing the financial risks of the Fund, the composition of the investments held by the corporation have been considered.

Credit Risk

The majority of the Fund's holdings are in uninsured first mortgages where the possibility of a borrower defaulting on payment obligations exists. To reduce default risk, the Fund invests in uninsured mortgages with conservative loan to value ratios. No uninsured mortgages will be entered into, and no A/B Notes will be purchased, if they exceed a 75% loan-to-value ratio at inception and no insured mortgages will be entered into if they exceed a 95% loan-to-value ratio at inception. Also, all mortgages will include additional collateral and guarantees from borrowers. The fair value of the Fund's mortgage and money market investments represents the Fund's maximum exposure to credit risk.

Financial Risk Management Discussion (continued)
as at December 31

Credit Risk (continued)

Mortgages by Industry Sector

Investments in the Fund are diversified across industry sectors. Sectors to which the Fund had exposure as at December 31 are as follows:

INDUSTRY SECTOR (in 000s)	2018 Total	2018 % of Total	2017 Total	2017 % of Total
Office	$ 102,648	8.5 %	$ 102,044	10.0 %
Residential	791,506	65.2 %	623,293	61.2 %
Land lease communities	319,105	26.3 %	293,643	28.8 %
Total Mortgages	$ 1,213,259	100.0 %	$ 1,018,980	100.0 %

INDUSTRY SECTOR (Number of Mortgages)	2018 Total	2018 % of Total	2017 Total	2017 % of Total
Office	1	4.0 %	1	6.3 %
Residential	19	76.0 %	11	68.7 %
Land lease communities	5	20.0 %	4	25.0 %
Total Mortgages	25	100.0 %	16	100.0 %

Liquidity Risk

The Fund's liabilities are due within three months of the year-end of the Fund.

CONSTRUCTION MORTGAGE FUND

Financial Risk Management Discussion (continued)
as at December 31

Interest Rate Risk

The Fund invests in construction mortgages with terms ranging from 1 to 10 years. The duration of the Fund is 1.1 years (2017 - 1.1 years). As at December 31, the Fund invested in mortgages with the following terms to maturity:

MORTGAGES BY MATURITY DATE (in 000s)	2018			2017		
		Total	Average Effective Yield %		Total	Average Effective Yield %
Floating Rate Mortgages:						
Within 1 year	$	355,133	n/a	$	215,050	n/a
1 to 5 years		572,621	n/a		668,276	n/a
5 to 10 years		124,800	n/a		-	n/a
Fixed Rate Mortgages:						
Within 1 year		26,210	4.7 %		10,048	3.2 %
1 to 5 years		134,495	5.2 %		125,606	5.1 %
Total Mortgages	$	1,213,259	5.1 %	$	1,018,980	5.0 %

Construction mortgages are usually extended with floating interest rates based on bank prime lending rates plus a risk and liquidity premium. Therefore, the floating-rate construction mortgages do not have significant exposure to interest rate risk.

If prevailing interest rates increased or decreased by 1% (100 bps), with all other variables held constant, net assets would have decreased or increased, respectively, by approximately $2,517,000 (2017 - $3,436,000), representing 0.2% of the Fund's net assets (2017 - 0.3%).

Currency Risk

The Fund is not exposed to significant currency risk as the Fund’s assets and liabilities are denominated in Canadian dollars.

Financial Risk Management Discussion (continued)
as at December 31

Other Price Risk

The Fund is not exposed to significant other price risk since the Fund's assets and liabilities are fixed income instruments.

Management monitors the concentration of risk for mortgage securities based on counterparties and industries and geographic location. The Fund’s industry sector exposure is presented in the Credit Risk section.

Investments by Geographic Region

All of the Fund’s motgage investments are exposed to the Canadian market.

CONSTRUCTION MORTGAGE FUND

Fair Value Measurement Discussion as at December 31

As described in note 7 of the financial statements, a three-tier hierarchy is used as a framework for disclosing fair value based on inputs used to value the Fund's financial instruments.

The table below analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the Statement of Financial Position.

All fair value measurements noted in the tables below are recurring.

(in 000s)	December 31, 2018 Level 1 (Quoted Price in Active Market)	Level 2 (Significant Observable Inputs)	Total
Mortgage Investments	$ -	$ 1,213,259	$ 1,213,259
Money Market Funds	57,748	-	57,748
Net Investment-Related Receivable	-	3,615	3,615
Total Investments	$ 57,748	$ 1,216,874	$ 1,274,622

(in 000s)	December 31, 2017 Level 1 (Quoted Price in Active Market)	Level 2 (Significant Observable Inputs)	Total
Mortgage Investments	$ -	$ 1,018,980	$ 1,018,980
Money Market Funds	53,929	-	53,929
Net Investment-Related Receivable	-	2,715	2,715
Total Investments	$ 53,929	$ 1,021,695	$ 1,075,624

Involvement with Structured Entities as at December 31

The carrying amount of the Fund's net assets attributable to holders of redeemable units also approximates fair value as it is measured at redemption amount and is classified as Level 2 in the fair value hierarchy.

During 2018 and 2017, there were no significant transfers between the three levels in the hierarchy.

CONSTRUCTION MORTGAGE FUND

Involvement with Structured Entities
as at December 31

A structured entity is an entity that has been designed so that voting or other similar rights are not the dominant factor in determining who controls the entity. The Fund holds interests in structured entities. These structured entities are comprised of investee funds organized as unit trusts. These investee funds have been constituted to manage assets on behalf of third party investors and are financed through the issue of units to these investors. Accordingly, the Fund's interests in these entities is reflected through the holdings of units issued by the investee funds. During 2018 and 2017, the Fund did not provide additional financial or other support to these structured entities, other than through its investment in units of these entities. Furthermore, these structured units are not subject to restrictions over operations or redemptions, other than certain investment related restrictions in accordance with maintaining their investment objectives. The tables below sets out the interests held by the Fund in these structured entities:

	December 31, 2018		
Entity	Number of Investee Funds	Total Net Assets of Investee Funds (in 000s)	Carrying amount included in Investments in the Statement of Financial Position (in 000s)
Investee money market funds administered by BCI	1	$ 1,699,706	$ 57,748

	December 31, 2017		
Entity	Number of Investee Funds	Total Net Assets of Investee Funds (in 000s)	Carrying amount included in Investments in the Statement of Financial Position (in 000s)
Investee money market funds administered by BCI	1	$ 923,071	$ 53,929

1. The Portfolios

British Columbia Investment Management Corporation ("BCI") was established under the *Public Sector Pension Plans Act* as a trust company authorized to carry on trust business and investment management services. The address of BCI's registered office is 750 Pandora Avenue, Victoria, British Columbia, Canada. These financial statements have been prepared by BCI and are the responsibility of BCI management.

Under the *Public Sector Pension Plans Act* and the *Pooled Investment Portfolios Regulation*, B.C. Reg. 447/99 (the "Regulations"), BCI may establish and operate pooled investment portfolios "…. in which money from trust funds, special funds or other funds, other public money and the money of government bodies and designated institutions may be combined in common for the purpose of investment by means of investment units of participation in a pooled investment portfolio." In addition, pooled investment portfolios (the Funds) previously established under the *Financial Administration Act* and the *Pooled Investment Portfolios Regulation*, B.C. Reg. 84/86, were continued under the *Pooled Investment Portfolios Regulation*, B.C. Reg. 447/99, to be held in trust by BCI and invested by the Chief Investment Officer of BCI.

The Funds were established on the following dates:

Pooled Investment Portfolios	Dates Established
Fixed Term Mortgage Fund	June 30, 1995
Construction Mortgage Fund	December 1, 1995

2. Basis of preparation

(a) Statement of compliance

These financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS"). These financial statements were authorized for issue by the Chief Executive Officer / Chief Investment Officer on April 4, 2019.

(b) Basis of measurement

These financial statements have been prepared on a historical cost basis except for investments, which are measured at fair value.

(c) Functional and presentation currency

These financial statements are presented in Canadian dollars which is the Funds' functional currency.

2. Basis of preparation (continued)

(d) Use of estimates and judgment

The preparation of 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. Financial results as determined by actual events could differ from those estimates and assumptions, and the difference could be material.

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

3. Significant accounting policies

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

(a) Financial instruments

(i) Recognition and measurement

Financial instruments are required to be classified into one of the following categories: amortized cost, fair value through other comprehensive income (“FVOCI”) or fair value through profit or loss (“FVTPL”). All financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods depends on the classification of the financial instrument. Transaction costs are included in the initial carrying amount of financial instruments except for financial instruments classified as FVTPL in which case transaction costs are expensed as incurred.

Financial assets and financial liabilities are recognized initially on the trade date, which is the date on which the Funds become a party to the contractual provisions of the instrument. The Funds derecognize a financial liability when its contractual obligations are discharged, cancelled or expire.

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

A financial asset is measured at amortized cost if it meets both of the following conditions:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset is measured at FVOCI if it meets both of the following conditions:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

3. Significant accounting policies (continued)

(a) Financial instruments (continued)

(i) Recognition and measurement (continued)

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL. On initial recognition the Funds irrevocably elect to measure financial assets that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL when doing so results in more relevant information.

Financial assets are not reclassified subsequent to their initial recognition, unless the Funds change their business model for managing financial assets, in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

The Funds have not classified any of its financial assets as FVOCI.

A financial liability is generally measured at amortized cost, with exceptions that may allow for classification as FVTPL. These exceptions include financial liabilities that are mandatorily measured at fair value through profit or loss, such as derivative financial liabilities. On initial recognition the Funds irrevocably designate a financial liability as measured at FVTPL when doing so results in more relevant information.

(ii) Fair value through profit and loss

Financial instruments classified as FVTPL are subsequently measured at fair value at each reporting period with changes in fair value recognized in the statement of comprehensive income in the period in which they occur. The Funds' investments and redeemable units are classified as FVTPL.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial assets and liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Funds' policy is to recognize transfers into and out of the fair value hierarchy levels as of the date of the event or change in circumstances giving rise to the transfer.

The fair value of financial assets and liabilities that are not traded in an active market, is determined using valuation techniques. Valuation techniques include the use of comparable recent arm’s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and others commonly used by market participants and which make the maximum use of observable inputs. Should the value of the financial asset or liability, in the opinion of BCI, be inaccurate, unreliable or not readily available, the fair value is estimated on the basis of the most recently reported information of a similar financial asset or liability.

3. Significant accounting policies (continued)

(a) Financial instruments (continued)

(iii) Amortized Cost

Financial assets and liabilities classified as amortized cost are recognized initially at fair value plus any directly attributable transaction costs. Subsequent measurement is at amortized cost using the effective interest method, less any impairment losses. The Funds classify receivable for issuance of units, payables for redemption of units, other accounts payable and BCI cost recoveries payable as amortized cost.

The effective interest method is a method of calculating the amortized cost of a financial asset or liability and of allocating interest income or expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments through the expected life of the financial asset or liability, or where appropriate, a shorter period.

(b) Redeemable units

The Funds classify financial instruments issued as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. In accordance with the Regulations, each Fund is required to distribute, to unitholders of the respective Fund's redeemable units, the taxable income and taxable capital gains of the Fund at least annually. Accordingly, such units are classified as financial liabilities at FVTPL and measured at redemption amount. Distributions to holders of redeemable units are recognized in comprehensive income when they are authorized and no longer at the discretion of BCI.

(c) Issue and redemption of units

Participation in each Fund is expressed in units. The initial value of a unit on inception is $1 million. For each subsequent unit issuance and redemption, the unit value is determined by dividing the fair value of the net assets of the portfolio by the total number of units outstanding. Where one Fund invests in another Fund, the unit issuances and redemptions are transacted on the same basis as client transactions. All unit transactions are recorded on a trade date basis. All of the Funds were open-ended Funds throughout the year where the number of units available for issue was unlimited and the proportion of units issued or redeemed by each client on a particular valuation date depended on changes to their desired asset allocation.

(d) Revenue recognition

Interest income is recognized on an accrual basis using the effective interest method. Dividend income is recognized on the date that the right to receive payment is established, which for quoted equity securities is usually the ex-dividend date. Portfolio transactions are recorded on the trade date. Realized gains and losses arising from the sale of investments are determined on the average cost basis of the respective investments. Commissions and other identifiable transaction costs that are directly attributable to the acquisition or disposal of an investment are expensed as incurred. Pursuit costs are charged to net income of the respective Funds in the period incurred.

3. Significant accounting policies (continued)

(e) Income taxes

The Funds qualify as inter-vivos trusts under section 108(1) of the *Income Tax Act (Canada)*. All of the Funds' net income for tax purposes and net capital gains realized in any period are required to be distributed to unitholders such that no income tax is payable by the Funds. As a result, the Funds do not record income taxes. Income taxes associated with any of the Funds' underlying investments are accounted for in determining the fair value of the respective investments.

(f) Change in accounting policy:

The Funds have adopted IFRS 9 *Financial Instruments* ("IFRS 9") with a date of initial application of January 1, 2018. The requirements of IFRS 9 represent a significant change from IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 specifies the accounting for financial instruments, including: classification and measurement, impairment, and hedge accounting. The adoption of IFRS 9 has been applied retrospectively. The nature and effects of the key changes to the Funds' accounting policy are summarized below.

(i) Classification and measurement of financial assets and liabilities:

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, FVOCI and FVTPL. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. The Fund may also, at initial recognition, irrevocably designate a financial asset as measured at FVTPL when doing so results in more relevant information. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available-for-sale.

A financial liability is generally measured at amortized cost, with exceptions that may allow for classification as FVTPL. These exceptions include financial liabilities that are mandatorily measured at fair value through profit or loss, such as derivatives liabilities. The Fund may also, at initial recognition, irrevocably designate a financial liability as measured at FVTPL when doing so results in more relevant information.

The adoption of IFRS 9 did not result in any measurement differences in the Funds' financial assets and liabilities as at the transition date. The following table shows the original classification and measurement categories under IAS 39 and the new classification and measurement categories under IFRS 9 for each class of the Funds' financial assets and financial liabilities as at January 1, 2018.

3. Significant accounting policies (continued)

(f) Change in accounting policy (continued):

(i) Classification and measurement of financial assets and liabilities (continued):

	Original Classification under IAS 39	**New Classification under IFRS 9**
Financial assets		
Receivable from issuance of units	Loans and receivables	Amortized cost
Investments	FVTPL	FVTPL
Financial liabilities		
Payable for redemption of units	Other financial liabilities	Amortized cost
BCI cost recoveries payable	Other financial liabilities	Amoritized cost
Other accounts payable	Other financial liabilities	Amoritized cost
Redeemable units	FVTPL	FVTPL

(ii) Impairment of financial assets:
IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. As the Funds measure its financial assets at FVTPL and hold only short-term financial assets at amortized cost, the impairment requirements under the new standard do not impact these financial statements.

(iii) Hedge accounting
As permitted by IFRS 9, an election is available to continue to apply the hedge accounting requirements of IAS 39. However, the Funds have not applied hedge accounting under either standard. Therefore, the hedge accounting requirements under the new standard do not impact these financial statements.

3. Significant accounting policies (continued)

(g) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations as listed below are not yet effective for the period ended December 31, 2018, and have not been applied in preparing these financial statements. None of these will have a significant effect on the financial statements of the Funds.

Effective on January 1, 2019:

- IFRS 16 Leases
- IFRIC 23 Uncertainty over Tax Treatments
- Prepayment Features with Negative Compensation (Amendments to IFRS 9)
- Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)
- Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)
- Annual Improvements to IFRS Standards 2015-2017 Cycle - various standards

Effective on January 1, 2020:

- Amendments to References to Conceptual Framework in IFRS Standards

Effective on January 1, 2021:

- IFRS 17 Insurance Contracts

4. Related party transactions

Third party costs that are attributable to a specific Fund are charged to that Fund. Other costs initially borne by BCI are recovered from the various Funds. BCI cost recoveries and the corresponding payable are disclosed in each Fund’s statement of comprehensive income and statement of financial position, respectively.

5. Redeemable units

The Funds are authorized to issue an unlimited number of units. Units issued and outstanding represent the capital of each Fund. The Funds are not subject to any internally or externally imposed restrictions on their capital. BCI manages the capital of each Fund in accordance with the respective Fund's investment objectives, including managing the redeemable units to ensure a stable base to maximize returns to all investors, and managing liquidity in order to meet redemptions. The following is a summary of the changes in redeemable units outstanding during the year ended:

	FIXED TERM MORTGAGE FUND		**CONSTRUCTION MORTGAGE FUND**	
	2018	**2017**	**2018**	**2017**
Outstanding, beginning of year	385.024	393.507	299.811	274.526
Issued for cash	98.637	43.035	123.877	95.018
Issued on reinvestment of distributions	16.253	14.724	9.520	8.729
Consolidation of units	(16.253)	(14.724)	(9.520)	(8.729)
Redeemed	(59.664)	(51.518)	(85.358)	(69.733)
Outstanding, end of year	423.997	385.024	338.330	299.811

6. Financial risk management

(a) Risk management framework

Each Fund has its own investment objectives. The Funds' overall risk management program seeks to minimize the potentially adverse effect of risk on the Funds' financial performance in a manner consistent with the Funds' investment objectives. In the normal course of business, each Fund is exposed to financial risks including credit risk, liquidity risk, and market risk (including interest rate risk, currency risk and other price risk). The level of risk varies depending on the investment objective of the Fund and the type of investments it holds. The mandates and investment policies are described below.

<u>Fixed Term Mortgage Fund</u>
The investment objective of the Fixed Term Mortgage Fund (the Fund) is to increase returns relative to the Fund's benchmark, the BAML 1-10 Canada Government Bond Index plus 120 basis points (to compensate for illiquidity and credit risk relative to the bond index). The perfomance objective of the Fund is to exceed the benchmark return by 32 basis points per annum net of all investment expense incurred.

The Fund is actively managed. Portfolio managers utilize a multi-factor risk rating model to assess risk levels of individual investment opportunities. The risk factors that are evaluated include location, structure quality, tenant quality, borrower and covenantor's financial strength, loan to value levels, debt servicing ability, and borrower's experience. This information is used to determine the risk premium for each mortgage investment. The Fund maintains a prudent level of diversification by property type, geographic location, investment size, and risk.

The Fund invests in the following securities:

- Canadian fixed term first, second, and third mortgages, on income-producing commercial properties and income-producing land.
- Canadian first mortgage bonds
- A/B Notes, providing noteholders with pro rata interest in first mortgage loan or loans, with security in favour of holders of B Notes subordinated to the security in favour of corresponding A Notes.
- Government debt securities with a maximum term to maturity of 5 years, and
- Units of BCI's Pooled Investment Portfolios: ST1, ST2 and Floating Rate Funds.

The following restrictions apply to the Fund:

- Mortgages must be eligible investments under the *Pensions Benefits Standards Act*.
- Mortgages are not eligible to be lent under BCI's security lending program
- No mortgages will be made without a site inspection, current market appraisal and a current environmental audit.
- No mortgages will be made on raw land.
- The Fund may not invest in derivatives with the exception of securities noted above.
- The maximum duration of the Fund is 5 years.
- In the event of a default, the Funds may hold assets that otherwise would not be permitted provided the holdings are approved by the CIO and accepting the assets are deemed to be in the best interest of pool participants.

6. Financial risk management (continued)

(a) Risk management framework (continued)

Construction Mortgage Fund
The investment objective of the Construction Mortgage Fund (the Fund) is to increase returns relative to the Fund’s benchmark, CDOR plus 160 basis points (to compensate for illiquidity and credit risk relative to the index). The performance objectives of the Fund is to exceed the benchmark return by 42 basis points per annum, net of all investment expense incurred. Portfolio managers utilize a multi-factor risk rating model to assess risk levels of individual investment opportunities. The risk factors that are evaluated include location, structure quality, tenant quality, green building features, borrower and covenantor’s financial strength, loan to value levels, loan to cost levels, debt servicing ability, and developer’s experience. This information is used to determine the risk premium for each mortgage investment.

The risks associated with construction projects are mitigated by requiring the involvement of only experienced developers, obtaining construction engineer evaluations, requiring specified pre-sales/pre-leasing levels and sufficient profit margin levels, as well as obtaining additional security provisions from borrowers.

The Fund invests in the following securities:
- Canadian construction first, second, and third mortgages,
- Canadian first, second and third mortgages on land held for development
- A/B Notes, providing noteholders with a pro rata interest in a first mortgage loan or loans, with the security in favour of holders of B Notes subordinated to the security in favour of corresponding A Notes
- units in BCI’s Pooled Investment Portfolios: ST1, ST2, and Floating Rate Funds.

The following restrictions apply to the Fund:
- Mortgages must be eligible investments under the *Pensions Benefits Standards Act*.
- The Fund shall maintain a prudent level of diversification.
- Mortgages are not eligible to be lent under BCI's security lending program.
- Publicly traded securities are eligible to be lent under BCI's security lending program.
- The Fund may not invest in derivatives with the exception of securites noted above.
- No mortgages will be made without a site inspection, current market appraisal and a current environmental audit.
- The maximum duration of the Fund is 1.5 years.
- In the event of default, the Fund may hold assets that otherwise would not be permitted providing the holdings are approved by the CIO and accepting the assets are deemed to be in the best interset of pool participants.

6. Financial risk management (continued)

(b) Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Funds, resulting in a financial loss to the Funds. It arises principally from debt securities held, cash and other receivables due to the Funds. The carrying value of these financial instruments as recorded in the statements of financial position reflects the Funds' maximum exposure to credit risk.

To avoid undue credit risk, BCI management has established specific investment criteria, such as minimum credit ratings for investees and counterparties. Counterparty risk represents the credit risk from current potential and future exposure related to transactions. In order to minimize counterparty risk, counterparties are required to provide adequate collateral and meet minimum credit rating requirements. BCI management frequently monitors the credit rating of its counterparties as determined by credit rating agencies and assesses mortage investments for impairment, including significant changes in credit risk.

The Funds’ activities may also give rise to settlement risk. Settlement risk is the risk of loss due to failure of an entity to honour its obligations to deliver cash, securities, or other assets prior to the settlement of the transaction as contractually agreed. All investment transactions are settled or paid upon delivery with approved brokers. The risk of default is mitigated since the delivery of securities sold is made simultaneously with the broker receiving payment. Payment is made on a purchase once the securities have been received by the broker. The trade fails if either party fails to meet its obligations.

See additional discussion of credit risk in the Financial Risk Management Discussion in the notes specific to each Fund.

(c) Liquidity risk

Liquidity risk is the risk that the Funds will encounter difficulty in meeting the obligations associated with their financial liabilities that are settled by delivering cash or another financial asset. BCI’s approach to managing liquidity risk is to ensure, as far as possible, that each Fund has sufficient liquidity to meet its liabilities when due. Each Fund is exposed to the liquidity risk associated with the requirement to redeem units. Units of the Funds may only be acquired by eligible clients or client groups in accordance with the respective Fund’s purchasing limits that may be established by the Chief Investment Officer (CIO). In order to protect the interest of all clients, the CIO may also establish redemption limits for each Fund. The purchase and redemption limits may vary depending on market circumstances, client demand, and the liquidity of the underlying investments.

The Funds’ cash position is monitored on a daily basis. In general, investments in cash and BCI Money Market Funds are expected to be highly liquid. BCI management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. The Funds’ liquidity position is monitored daily by taking into consideration future forecasted cash flows. This attempts to ensure that sufficient cash reserves are available to meet forecasted cash outflows.

See additional discussion of liquidity risk in the Financial Risk Management Discussion in the notes specific to each Fund.

6. Financial risk management (continued

(d) Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and equity prices will affect the Funds' income or the fair value of their holdings of financial instruments. Each Fund's strategy for the management of market risk is driven by the Fund's investment objective. Investment objectives for the Funds are outlined in the notes specific to each Fund.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of financial instruments will fluctuate as a result of changes in market interest rates.

The money market investments, and mortgages are subject to interest rate risk. The Funds have established duration bands based on their relevant benchmarks to avoid undue active interest rate risk. Money market funds invest in short-term investments and have low interest rate risk.

See additional discussion of interest rate risk in the Financial Risk Management Discussion in the notes specific to each Fund.

(ii) Other price risk

Other price risk is the risk that the fair value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or currency risk), whether caused by factors specific to an individual investment or its issuer or factors affecting all instruments traded in the market.

All financial instruments are subject to other price risk and a potential loss of capital. The maximum risk is determined by the market value of the financial instruments. There are established investment criteria for each Fund related to diversification of investments and investment mandates for external managers to avoid undue market risk.

See additional discussion of other price risk in the Financial Risk Management Discussion in the notes specific to each Fund.

7. Fair value of financial instruments

(a) Fair value hierarchy

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Funds determine fair values using other valuation techniques.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

The Funds measure fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements.

Level 1 inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
Level 2 inputs other than quoted prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices).
Level 3 inputs that are unobservable.

See additional discussion on the three-tier hierarchy in the Fair Value Measurement Discussion in the notes specific to each Fund.

(b) Valuation models

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Funds use widely recognized valuation methods for determining the fair value of common and more simple financial instruments such as foreign currency contracts and money market instruments that use only observable market data which requires little management judgment and estimation. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exists and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other factors used in estimating discount rates, money market prices, and foreign currency exchange rates in estimating valuations of foreign currency contracts.

Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange-traded derivatives and simple OTC derivatives. The availability of observable market prices and model inputs reduces the need for management judgment and estimation and reduces the uncertainty associated with the determination of fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

7. Fair value of financial instruments (continued)

(c) Valuation framework

When third party information, such as broker quotes or pricing services, is used to measure fair value, then management assesses and documents the evidence obtained from third parties to support the conclusion that such valuations meet the requirements of IFRS. This includes:

- ♦ verifying that the broker or pricing service is approved by the Funds for use in pricing the relevant type of financial instrument;
- ♦ understanding how the fair value has been arrived at and the extent to which it represents actual market transactions;
- ♦ when prices for similar instruments are used to measure fair value, how these prices have been adjusted to reflect the characteristics of the instrument subject to measurement; and
- ♦ if a number of quotes for the same financial instrument have been obtained, then how fair value has been determined using those quotes.

(d) Financial instruments not measured at fair value

The carrying value of receivable from issuance of units, payable for redemption of units, BCI cost recoveries payable, and other accounts payable approximates their fair value given their short-term nature. These financial instruments are classified as Level 2 in the fair value hierarchy because while prices are available, there is no active market for these instruments.

8. Taxes

Net cumulative capital losses and non-capital losses for each Fund having such losses are as follows:

Pooled Investment Portfolios (in $000s)	**As of December 31, 2018**	
	Net Capital Losses	**Non-capital Losses**
Fixed Term Mortgage Fund	590	-
Construction Mortgage Fund	108	-

Net capital losses are available to be carried forward indefinitely and applied against future net realized capital gains. Non-capital losses may be carried forward up to 20 years to reduce future taxable income.

9. Subsequent event

Effective April 1, 2019, the administration of BCI's mortgage program transitioned to QuadReal Property Group LP, a subsidiary of a Fund managed by BCI.