MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of February 27, 2018. This discussion should be read in conjunction with the audited consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2017. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These other measures such as "Pre-FMV EBITDA" and "After-tax Pre-FMV Dividend Payout Ratio" should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with IFRS as an indicator of performance or as a measure of liquidity and cash flow. These measures do not have standard meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Company is available in First National Financial Corporation's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

General Description of the Company

First National Financial Corporation is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $101 billion in mortgages under administration ("MUA"), First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the mortgage broker distribution channel.

The First National Mortgage Investment Fund (the "Fund") was terminated in December 2017 by the trustee and the Company purchased the mortgage portfolio at fair value from the Fund for approximately $23 million. While the Fund operated, the Company consolidated the Fund's results in its earnings because of its status as sole seller to the Fund and its rights as promoter. Accordingly, the results of the Fund until the date of termination were consolidated with those of the Company. From an accounting perspective, the purchase of the mortgage portfolio represents the redemption of the non-controlling interest related to the Fund recorded within shareholders' equity.

2017 Results Summary

Management is pleased with the results of 2017. Despite a decline in new single-family origination as a result of the new mortgage insurance rules announced in late 2016, overall origination including renewals increased by 2%. This was due to growth in the commercial segment and higher volumes of renewals. The Company's earnings benefited from large gains on account of financial instruments recorded largely in the second and third quarters of the year. While most of these gains will negatively impact the income in future periods, a portion relates to $770 million of mortgages originally funded for its own securitization program which the Company placed with institutional investors. Accordingly, about $14.4 million of the gains offset lower placement fees and the Company believes these gains should be added back to 2017 pre-FMV earnings to properly account for them in operations.

- MUA grew to $101.6 billion at December 31, 2017 from $99.4 billion at December 31, 2016, an increase of 2%; the growth from September 30, 2017, when MUA was $100.2 billion, represented an annualized increase of 6%. The annual increase was just 2% because of lower new origination which declined 2% year over year. Lower MUA is also the result of the maturity of several CMBS transactions originally included in MUA in 2007. Because of scheduled maturities in this portfolio, CMBS MUA in the commercial segment is down by over $1.0 billion since the 2016 year end;
- Total new single-family mortgage origination was $11.1 billion in 2017 compared to $12.4 billion in 2016, a decrease of 10%. The Company believes this is a result of several regulatory changes including the new mortgage insurance rules announced in October 2016, increases in the cost of portfolio insurance and regional measures such as the foreign buyer tax in southern Ontario. The entire insured mortgage market shrank across the country and First National was affected to some extent in all regions. The commercial segment continued to grow with origination up 20% as volumes increased to $5.8 billion in 2017 from $4.8 billion in 2016. The Company attributes this positive performance to its expanded presence in the conventional market. Overall new origination decreased by 2%;
- The Company took advantage of opportunities in the year to renew $5.2 billion of single-family mortgages. In 2016, the Company renewed $4.6 billion of single-family mortgages. For the commercial segment, renewals increased to $1.1 billion from $1.0 billion;
- Revenue for 2017 increased to $1.1 billion from $1.0 billion in 2016. The increase is the result of a rising interest rate environment which affected interest revenue earned on securitized mortgages, mortgage investment income, gains on financial instruments and mortgage servicing revenue. These increases offset placements fees which were lower as the Company increased the amount of mortgages it used for securitization;
- Income before income taxes increased from $274.1 million in 2016 to $285.4 million in 2017. This measure increased largely because of changing capital markets conditions, which affected the Company's economic interest rate hedges. In 2017, the Company recorded an additional $28.5 million of gains on financial instruments compared to 2016; and
- The Company's earnings before income taxes, depreciation and amortization and gains and losses on financial instruments ("Pre-FMV EBITDA") for the year decreased by 8%, from $253.5 million in 2016 to $234.3 million in 2017. The decrease was the result of lower placement fees revenue negatively affected by capital market conditions. The Company calculates that placement fees were $14.4 million less than they would have been in a static interest rate environment. Because these transactions were economically hedged, the lower fees are effectively offset by a $14.4 million portion of the gains on financial instruments recorded in 2017. Adjusting for this item, 2017 Pre-FMV EBITDA was lower by 2% year over year because of tighter mortgage spreads and higher broker fees.

Selected Quarterly Information

Quarterly Results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net Income for the period	Pre-FMV EBITDA for the period [1]	Net Income per Common Share	Total Assets
2017					
Fourth Quarter	$270,015	$45,948	$61,093	$0.75	$32,776,278
Third Quarter	$284,315	$58,809	$51,826	$0.96	$31,548,130
Second Quarter	$292,200	$68,768	$68,275	$1.13	$30,832,883
First Quarter	$232,238	$36,127	$53,084	$0.58	$29,901,289
2016					
Fourth Quarter	$290,754	$71,797	$61,064	$1.18	$30,394,465
Third Quarter	$273,754	$51,440	$67,469	$0.84	$30,527,361
Second Quarter	$253,915	$41,251	$68,187	$0.67	$31,011,683
First Quarter	$231,395	$37,341	$56,819	$0.59	$28,194,301

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on the mortgages pledged under securitization. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as weighted average mortgage rates. Although mortgage rates have not changed significantly in the last two years, the Company has generally increased MUA and its portfolio of securitized mortgages over the last 24 months. Net income is partially dependent on conditions in the debt markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the Company's core business (primarily conditions in the bond markets). By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

Generally, in the years prior to 2017, the Company grew its origination volumes which provided larger servicing and securitization portfolios. This longer-term strategy has been successful and Pre-FMV EBITDA has trended upwards. The table above shows a trend of growing income reflecting typical Canadian seasonality: slower first and fourth quarters and stronger mid-year quarters. The first and fourth quarters of 2017 and the first quarter of 2016 did not have significant fair value gains or losses and are more consistent with normalized earnings for the Company. The fourth quarter of 2016 and second and third quarters of 2017 featured large fair values gains as bond prices decreased as a result of positive economic expectations. This had a large impact on net income. By excluding fair value gains and losses, Pre-FMV EBITDA provides a more comparable performance metric. For third quarter 2017, Pre-FMV EBITDA decreased compared to the third quarter of 2016 as placement fees were negatively affected by a rising interest rate environment. By adjusting this measure and adding the $14.4 million which was primarily recorded as a gain on holding short bonds in the second quarter 2017, the amount is more consistent with the Pre-FMV EBITDA recorded in third quarter 2016. Generally, earnings are marginally lower in 2017 due to lower single-family origination and tighter mortgage spreads.

Outstanding Securities of the Corporation

At December 31, 2017 and February 27, 2018, the Corporation had 59,967,429 common shares; 2,887,147 Class A preference shares, Series 1; 1,112,853 Class A preference shares, Series 2; and 175,000 April 2020 notes outstanding.

Selected Annual Financial Information and Reconciliation to Pre-FMV EBITDA

($000s, except per share amounts)

	2017	2016	2015
For the Year ended December 31, Income Statement Highlights			
Revenue	1,078,768	1,049,818	915,315
Interest expense – securitized mortgages	(511,939)	(495,681)	(488,659)
Brokerage fees	(83,260)	(103,719)	(107,045)
Salaries, interest and other operating expenses	(193,032)	(169,129)	(161,821)
Add (deduct): realized and unrealized (gains) losses on financial instruments	(56,259)	(27,750)	52,143
Pre-FMV EBITDA[1]	234,278	253,539	209,933
Amortization of capital assets	(5,135)	(4,660)	(4,114)
Amortization of intangible assets	—	(2,500)	(5,000)
Add (deduct): realized and unrealized gains (losses) on financial instruments	56,259	27,750	(52,143)
Provision for income taxes	(75,750)	(72,300)	(39,245)
Net income	209,652	201,829	109,431
Common share dividends declared	184,400	98,946	90,451
Per Share Highlights			
Net income per common share	3.42	3.28	1.71
Dividends per common share	3.08	1.65	1.51
At Year End Balance Sheet Highlights Total assets	32,776,278	30,394,465	27,926,732
Total long-term financial liabilities	174,693	174,556	174,420

Notes:

(1) Pre-FMV EBITDA is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

Vision and Strategy

The Company provides mortgage financing solutions to the residential and commercial mortgage markets in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is the leading non-bank mortgage lender in the industry. The Company intends to continue leveraging these strengths to lead the "non-bank" mortgage lending industry in Canada, while appropriately managing risk. The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions for Canadian single-family and commercial customers; growing assets under administration; employing technology to enhance service to mortgage brokers and borrowers, lower costs and rationalize business processes; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. The Company is considered by most of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

Key Performance Drivers

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of mortgages;
- Raising capital for operations; and
- Employing innovative securitization transactions to minimize funding costs.

Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, longer-term value from servicing fees, mortgage administration fees, renewals and the growth of the customer base for marketing initiatives. As at December 31, 2017, MUA totalled $101.6 billion, up from $99.4 billion at December 31, 2016, an increase of 2%. This compares to $100.2 billion at September 30, 2017, representing an annualized increase of 6%. Despite the maturity of over $1.0 billion of CMBS mortgages in 2017 which had been in MUA since 2007, the Company was still able to grow MUA.

Growth in Origination of Mortgages

Direct origination by the Company

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. By growing origination, not only can the Company satisfy demand from its institutional customers, but it can also produce volume for its own securitization programs. In 2017, the Company felt the impact of the new mortgage insurance rules enacted in October 2016. Generally, these rules had the effect of shrinking the availability of insured mortgages particularly because of the limitations on insurance for refinance transactions and the more onerous qualification rules. For the Company, this meant lower origination across the country with decreases from volumes recorded by the following offices in 2016: Vancouver (18%), Calgary (15%) and Montreal (27%). The Toronto office had better results and had slightly higher volume than in 2016. In total, the Company's single-family origination decreased in 2017 by 10%. The commercial segment continued to show strong growth as volume increased 20% over 2016. Together, overall new origination for 2017 decreased by 2% year over year.

Third Party Mortgage Underwriting and Fulfillment Processing Services

In 2015, the Company launched its third party underwriting and fulfillment processing services business with a large Canadian schedule I bank ("Bank"). The business is designed to adjudicate mortgages originated by the Bank through the single-family residential mortgage broker channel. First National employs a customized software solution based on its industry leading MERLIN technology to accept mortgage applications from the Bank in the mortgage broker channel and underwrite these mortgages in accordance with the Bank's underwriting guidelines. The Bank funds all the mortgages underwritten under the agreement and retains full responsibility for mortgage servicing and the client relationship. Management considers the agreement a way to leverage the capabilities and strengths of First National in the mortgage broker channel and add some diversity to the Company's service offerings.

Raising Capital for Operations

Bank Credit Facility

The Company uses a $1.06 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In the first quarter of 2017, the Company extended the term of the facility by almost two years such that the new maturity is in March 2022. In the 2017 third quarter, the Company added another bank lender to the syndicate, increasing the commitment under the facility by $60 million. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than the senior unsecured notes, which are fully drawn during their term; (3) the five-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Preferred Share Issuance

On February 24, 2016, the Company announced that it would not exercise its right to redeem the 4,000,000 Class A Series 1 preference shares issued in 2011. It also advised shareholders of their rights under the shares which allow for a one-for-one conversion from Series 1 shares which have a fixed rate dividend into Series 2 shares which have a floating rate dividend. Pursuant to these rights, a portion of Series 1 shareholders elected to convert 1,112,853 of the Series 1 shares into Series 2 shares. Accordingly, effective April 1, 2016, 1,112,853 Series 1 shares converted to Series 2 shares leaving 2,887,147 Series 1 shares outstanding. The Series 1 shares will continue to trade as FN.PR.A on the TSX, while the Series 2 shares began trading as FN.PR.B on April 1, 2016. The Series 1 shares provide an annual dividend rate of 2.79% effective April 1, 2016. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Director approval and are redeemable at the discretion of the Company such that after the five-year term ending on March 31, 2021, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While the investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (or vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital and classifies the shares as equity on its balance sheet. Management believes this capital has provided the Company with the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

Employing Securitization Transactions to Minimize Funding Costs

Approval as both an Issuer of NHA-MBS and Seller to the Canada Mortgage Bonds Program

The Company has been involved in the issuance of NHA-MBS as an administrator since 1995. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA-MBS and as a seller into the CMB program. Issuer status has provided the Company with direct and independent access to reliable and low-cost funding.

Mortgage spreads can be illustrated by comparing posted five-year fixed single-family mortgage rates to a similar-term Government of Canada bond as listed in the table below.

Period	**Average five-year Mortgage Spread for the Period**
2006	1.12%
2007	1.50%
2008	2.68%
2009 - 2013	1.79%
2014	1.57%
2015	1.87%
2016	1.76%
2017	1.36%

The table shows an average spread of 1.12% in 2006. With the credit crisis, this spread ballooned to as high as 3.46% in 2008. Between 2009 and 2013, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels. In 2015, mortgage spreads quickly widened as a slowdown in economic growth and the Bank of Canada rate cut reduced bond yields dramatically. This trend continued into 2016, as optimism about the economy was mixed such that spreads remained at levels in excess of 1.8% until the third quarter when increased competition made for tighter spreads. With the recent strength in the economy and tougher mortgage rules, competition has further increased and spreads tightened significantly. While funding spreads have also improved, generally the advantage of securitization compared to placement with investors is not as distinct as it was in the previous 10-year period. In 2017, the Company originated and renewed for securitization purposes approximately $7.1 billion of single-family mortgages and $1.1 billion of multi-unit residential mortgages. In the year, the Company securitized through NHA-MBS approximately $5.7 billion of single-family mortgages and $0.7 billion of multi-unit residential mortgages.

In August 2013, CMHC announced that it would be limiting the amount of guarantees it would provide on NHA-MBS pools created for sale to the "market". CMHC indicated that the amount of guarantees it was providing for such market pools (generally any pool not sold to the Canada Housing Trust ("CHT") for the CMB) was growing significantly. To better control the absolute amount of risk that it takes on in this respect, CMHC has implemented policies to allocate the amount of guarantees to issuers. The maximum amount allocated under the process has exceeded First National's requirements in every quarter since inception. The process was amended in July 2016 to combine both NHA MBS for sale to the market and to CHT under one allocation. The available guarantees to be allocated were increased to accommodate issuance to CHT and continue to exceed the Company's current needs.

Canada Mortgage Bonds Program

The CMB program is an initiative sponsored by CMHC whereby the CHT issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. Pursuant to the Company's approval as a seller into the CMB, the Company is able to make direct sales into the program. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations. Beginning in July 2016, CHT effectively increased the price of the timely payment guarantees which CMB participants are required to purchase with the issuance of each CMB transaction. Although nominally CMB fees were decreased, these rules require guarantee fees to be levied on the creation of NHA MBS pools being sold to the CMB. Prior to this rule change, the NHA MBS pools to be sold into the CMB were exempt from such fees. In aggregate, guarantee fees have increased between 25% and 50% for CMB participants. This increase translates to approximately five basis points of cost over the term of the

securitization. At the same time, CMHC has also modified the tiered NHA MBS guarantee fee pricing structure, increasing the issuance threshold for increased fees from $6.0 billion to $7.5 billion.

In 2017, the Company was approved by CMHC as a "small repo counterparty" for the CMB program. Essentially, this allows the Company more flexibility when investing the cash held in trust by CHT and may increase the yield the Company receives when it reinvests funds in replacement accounts associated with its CMB transactions. Also in 2017, a subsidiary of First National, First National Asset Management Inc. was given conditional approval by CMHC to become an "aggregator" for CMB purposes. An aggregator has the ability to sell into the CMB with the caveat that it must share the CMB allocation with its parent and typically purchases mortgages from arms-length originators. The Company believes this approval will allow it to leverage on the expertise it has gained over the past 10 years as a CMB participant. With the current environment of narrow mortgage interest spreads, the Company does not foresee using this vehicle to any significant extent in 2018. As the marketplace adjusts in the longer term, the value of this vehicle may increase.

Key Performance Indicators

The principal indicators used to measure the Company's performance are:

- Earnings before income taxes, depreciation and amortization, and losses and gains on financial instruments ("Pre-FMV EBITDA" (1)); and
- Dividend payout ratio.

Pre-FMV EBITDA is not a recognized measure under IFRS. However, management believes that Pre-FMV EBITDA is a useful measure that provides investors with an indication of income normalized for capital market fluctuations. Pre-FMV EBITDA should not be construed as an alternative to net income determined in accordance with IFRS or to cash flows from operating, investing and financing activities. The Company's method of calculating Pre-FMV EBITDA may differ from other issuers and, accordingly, Pre-FMV EBITDA may not be comparable to measures used by other issuers.

	Quarter ended		Year ended	
	December 31, 2017	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**
For the Period		**($000s)**		
Revenue	270,015	290,754	1,078,768	1,049,818
Income before income taxes	63,158	97,697	285,402	274,129
Pre-FMV EBITDA (1)	61,093	61,064	234,278	253,539
At Period end				
Total assets	32,776,278	30,394,465	32,776,278	30,394,465
Mortgages under administration	101,589,153	99,391,490	101,589,153	99,391,490

Note:

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets, but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been considered a high-yielding dividend paying company. Over this period, the Company has paid almost $1.1 billion of dividends/distributions to common shareholders/unitholders. With a large MUA which generates continuing income and cash flow and a business model which is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders which represent a relatively large ratio of its earnings. The Company calculates the dividend payout ratio as dividends declared on common shares over net income attributable to common shareholders. This measure is useful to shareholders as it indicates the percentage

of earnings which have been paid out in dividends. Similar to the performance measure for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV EBITDA.

Determination of Common Share Dividend Payout Ratio

	Quarter ended		Year ended	
	December 31, 2017	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**
For the Period		**($000s)**		
Net income attributable to common shareholders	44,972	70,639	205,331	196,531
Total dividends paid or declared on common shares	102,694	25,486	184,400	98,946
Dividends paid or declared on common shares, excluding special dividend	27,735	25,486	109,441	98,946
Total Common Share Dividend Payout Ratio	228%	36%	90%	50%
Regular Common Share Dividend Payout Ratio [1]	62%	36%	53%	50%
After-tax Pre-FMV Dividend Payout Ratio [2]	65%	60%	67%	56%

Notes:

(1) This ratio is calculated by excluding the payment of the special dividend declared in November 2017.

(2) This non-IFRS measure adjusts the net income used in the calculation of the dividend payout ratio to after tax Pre-FMV earnings so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments. The Company uses its aggregate effective tax rate to tax affect the impact of the valuation of financial instruments on this ratio. For 2017 this ratio excludes the special dividend declared in November 2017.

For the year ended December 31, 2017, the common share payout ratio was 90% compared to 50% in 2016. However, in November 2017, the Company declared a special dividend which represented the distribution of excess retained earnings generated over the past several years. This distorts the payout ratio calculated in 2017. If the special dividend is excluded from the calculation, the payout ratio in 2017 would have been 53%. In 2017, the Company recorded large gains on account of the changes in fair value of financial instruments. The gains are recorded in the period in which the prices on Government of Canada bond yields change; however, the offsetting economic impact is largely to be reflected in narrower spreads in the future from the mortgages pledged for securitization. Accordingly, management does not consider this revenue to be available for dividend payment. If the gains on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2017 would have been 67% compared to 56% in 2016.

The Company also paid $2.7 million of dividends on its preferred shares in 2017 compared to $3.2 million in 2016.

Revenues and Funding Sources

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2017, new origination volume decreased from $17.2 billion to $16.9 billion, or about 2%, compared to 2016.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA-MBS, CMB and Asset-backed Commercial Paper ("ABCP"). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for sale recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company's $23.2 billion of new originations and renewals for the year ended December 31, 2017, $8.2 billion was originated for its own securitization programs.

Placement Fees and Gain on Deferred Placement Fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "placement fees". The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a "deferred placement fee". A deferred placement fee arises when mortgages with spreads in excess of a base spread are sold. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a "deferred placement fee receivable" that is amortized as the fees are received by the Company. Of the Company's $23.2 billion of new originations and renewals in 2017, $14.3 billion was placed with institutional investors.

For all institutional placements and mortgages sold to institutional investors for the NHA-MBS market, the Company earns placement fees. Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. In addition, under certain circumstances, additional revenue from institutional placements and NHA-MBS may be recognized as "gain on deferred placement fees" as described above.

Mortgage Servicing and Administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrowers' property tax escrows, reserve escrows and mortgage payments. As acknowledged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant additional servicing revenue.

In addition to the interest income earned on securitized mortgages and deferred placement fees receivable, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale or securitization, mortgage and loan investments and purchased mortgage servicing rights.

The Company provides underwriting and fulfilment processing services to a mortgage originator using the mortgage broker distribution channel. The Company earns a fee based on the dollar value of funded mortgages. These fees are recognized at the time a mortgage funds and is included in "Mortgage servicing income" in the consolidated statement of comprehensive income.

Results of Operations

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

	Quarter ended		Year ended	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	($ millions)			
Mortgage Originations by Segment				
New single-family residential	2,787	2,700	11,133	12,424
New multi-unit and commercial	1,645	1,398	5,770	4,811
Sub-total	4,432	4,098	16,903	17,235
Single-family residential renewals	1,124	1,058	5,219	4,553
Multi-unit and commercial renewals	257	349	1,127	974
Total origination and renewals	5,813	5,505	23,249	22,762
Mortgage Originations by Funding Source				
Institutional investors – new residential	1,254	1,707	6,240	7,701
Institutional investors – renew residential	564	656	2,688	2,148
Institutional investors – multi/commercial	1,271	1,469	5,342	4,717
NHA-MBS/ CMB/ABCP securitization	2,449	1,580	8,199	7,682
Internal Company resources/CMBS	275	93	780	514
Total	5,813	5,505	23,249	22,762
Mortgages under Administration				
Single-family residential	77,423	77,152	77,423	77,152
Multi-unit residential and commercial	24,166	22,239	24,166	22,239
Total	101,589	99,391	101,589	99,391

Total new mortgage origination volumes decreased in 2017 compared to 2016 by 2%. Single-family volumes decreased by 10% and commercial segment volumes increased by 20% year over year. The decrease in the single-family segment is evident across the country as the Company's Vancouver, Calgary and Montreal offices reported an average decrease of about 19% over 2016 volumes. In Ontario and the Maritimes, the Company's volume was marginally higher than the volume recorded in 2016. When combined with renewals, total production increased from $22.8 billion in 2016 to $23.2 billion in 2017, or by 2%. The Company believes lower new single-family origination is the result of the new mortgage insurance rules which have reduced the amount of insured mortgages available in the overall market. In the fourth quarter of 2017, the Company's single-family origination grew by 3%. Management believes this may be the result of new B-20 mortgage qualifying rules announced in 2017 which are effective beginning in 2018. Generally, these rules reduce the amount of mortgage a borrower can take on and so has encouraged buyers to accelerate their purchase of real estate into 2017. The low interest rate environment together with the Company's expertise in mortgage underwriting drove higher commercial segment origination volumes. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volume of $8.2 billion in 2017. The Company used such securitization funding to a greater degree than institutional placements in 2016. Generally, the Company maintained a balance between these funding sources despite the reduction in profitability of securitization in a tight spread environment. The Company's long-term strategy has always been to maintain diverse funding sources.

Net Interest - Securitized Mortgages

Comparing the year ended December 31, 2017 to the year ended December 31, 2016, "net interest – securitized mortgages" increased by 2% to $146.8 million from $144.3 million. The increase is due to growth in the Company's securitization programs and the rising interest rate environment. The portfolio of securitized mortgages grew to $27.6 billion by the end of 2017 or about 5%. Interest expense – securitized mortgages is affected by the cost of indemnities payable to debtholders when mortgages prepay prior to their scheduled maturity date. The indemnities are calculated to make whole debtholders who are assumed to reinvest the prepayment principal at risk free reinvestment rates. With the recent increase in interest rates, the cost of such indemnity has decreased significantly. The Company calculates that because of the decrease in indemnity costs, that it has earned an additional $8.4 million in net interest margin. This increase has been offset by the effect of the Company's hedging program. As gains and losses are recorded in the period in which bond prices change, the offsetting economic impact is reflected in wider or narrower spreads on the mortgages pledged for securitization and are realized in net interest margin over the terms of the mortgages. In 2014 and 2015, the Company recorded large losses on financial instruments totaling $87 million. This implies that wider securitization spreads than anticipated will be earned as the related mortgages are securitized. The Company estimates that in 2017, net interest – securitized mortgages benefitted from this timing issue by an amount of approximately $12.2 million. This trend reversed in 2016 when large gains related to short bonds were realized in the fourth quarter of 2016 and the second and third quarters of 2017. To the extent these gains pertained to securitized mortgages, the offset will be narrower securitization spreads earned on future securitizations. The Company estimates that in 2017, there was perhaps a slight loss in interest – securitized mortgages from the aggregate impact of all previous gains and losses. Accordingly, the accounting treatment of gains and losses on hedging activity suggest a $12.4 million decrease in this item. The amortization of deferred origination and other costs that are capitalized on securitized mortgages also have an effect on net interest. The Company has recently securitized more single-family renewals which do not have such costs and create wider spreads which positively impacted this quarter's net interest margin.

Placement Fees

Placement fee revenue decreased by 18% to $144.6 million from $176.9 million in 2016. The decrease is explained largely by new residential origination volume for institutional customers, excluding renewals, which decreased from $7.7 billion in 2016 to $6.2 billion in 2017 or by 19%. Placement fees per unit were lower due to the interest rate environment. With interest rates rising steadily over the past year, the value of mortgages held for securitization decreased during the holding period between origination and placement. Accordingly, when these mortgages were sold to institutional investors in the third quarter of 2017, the per unit fee was lower than in an otherwise static interest rate period. However, the Company economically hedged the exposure to such movements in interest rates, and the benefit of these contracts is recorded in "realized and unrealized gains (losses) on financial instruments." Management believes that the two transactions should be regarded together in order to determine the financial result of its decision making. In the third quarter, the Company calculated that approximately $10.9 million of revenue recorded as gains on financial instruments economically pertain to residential placement transactions recorded in the 2017 third quarter. For the commercial segment, this amount was $3.5 million. By adding the aggregate of $14.4 million, placement fee revenue for 2017 becomes $159.0 million or just 10% lower than in 2016. While the same issues existed throughout the year, only the impact in the third quarter was significant. Although single-family renewals increased, the additional origination was securitized by the Company and placement fees did not benefit materially from the increased volume. The commercial segment had significant origination growth in the quarter, but revenue in placement fees increased by just 10% as the Company originated more for its own securitization programs and spreads were tighter in a more competitive market.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue decreased 39% to $10.0 million from $16.3 million. The gains relate to multi-unit residential mortgages originated and sold to institutional NHA-MBS issuers. Although volumes for these transactions decreased by just 10% from 2016, spreads on these transactions tightened such that the Company realized lower per unit gains.

Mortgage Servicing Income

Mortgage servicing income increased 7% to $140.8 million from $131.4 million. This increase was due to revenue earned on the underwriting and fulfillment processing services business which the Company launched in January 2015 and has successfully grown since then. Without this revenue, mortgage servicing income grew in line with the MUA growth.

Mortgage Investment Income

Mortgage investment income increased 19% to $68.3 million from $57.5 million. The increase is due largely to an increase in the Company's commercial bridge loan program offset by an increased loan loss provision. The commercial bridge loan portfolio grew by about $130 million from December 2016 to December 2017 providing more investment income. The Company provided for losses of another $4.0 million (2016 - $3.5 million) regarding four non-performing properties in the commercial bridge portfolio in 2017. In addition, the interest rates associated with the Company's mortgages warehoused prior to securitization were higher this year such that more interest income is earned during the warehousing period than in 2016.

Realized and Unrealized Gains (Losses) on Financial Instruments

For First National, this financial statement line item typically consists of two components: (1) gains and losses related to the Company's economic hedging activities, and (2) gains and losses related to holding term assets derived using discounted cash flow methodology. Much like the short bonds that the Company uses for hedging, the term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to estimate the fair value of the Company's deferred placement fees receivable and mortgages designated as held for trading). The following table summarizes these gains and losses by category in the periods indicated:

	Quarter ended		Year ended	
Summary of realized and unrealized gains (losses) on financial instruments	**December 31, 2017**	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**
		($000s)		
Gains on short bonds used for the economic hedging program	1,383	27,371	35,467	10,897
Losses on mortgages held at fair value	(7,171)	(14,900)	(25,311)	(4,597)
Gains on interest rate swaps	9,276	26,064	47,133	21,915
Other gains (losses)	137	(667)	(1,030)	(465)
Total gains on financial instruments	3,625	37,868	56,259	27,750

As 2016 began, economic sentiment was uncertain and 5-year bond prices increased which meant generally the Company recorded losses on its hedging program. In the fourth quarter of 2016, with the promise of increased economic stimulus from the election of the Republican candidate in the United States, the bond market moved dramatically and bond prices decreased significantly. While this momentum subsided in the first quarter of 2017, with economic optimism in the second quarter, bond prices decreased significantly again such that First National's short bond position, which is used to economically hedge mortgages, experienced a large increase in value through to the end of the year. The

bond markets were relatively flat until the last few weeks of June 2017, when economic data turned more positive and there were signs that the Bank of Canada might increase short term interest rates shortly. This caused bond yields to increase and 5-year bond prices to decrease. This occurred again in September 2017 with another increase in the overnight rate by the Bank of Canada. The consequences for the Company were large gains on the Company's short bond position.

The Company uses short Government of Canada bonds (including CHT-issued bonds) together with repurchase agreements, to create synthetic forward interest rate contracts to hedge the interest rate risk associated with fixed-rate mortgages originated for its own securitization programs. For accounting purposes, these do not qualify as interest rate hedges as the bonds used are not derivatives but cash-based financial instruments. These gains or losses are recorded in the period in which the bond prices change; however, the offsetting economic gains or losses are generally not recorded in the same period. Instead, the resulting economic gain (or loss) is usually reflected in wider or narrower spreads on the mortgages pledged for securitization and will be realized in net interest margin over the terms of the mortgages and the related debts. On occasion, the Company will place mortgages initially originated for securitization with institutional customers. In these cases, the economic value of any gains or losses on account of financial instruments will be offset in the same period as the placement fee to the institution is determined, with reference to the current interest rate environment. In 2017, the Company recorded gains on these instruments of $35.5 million (2016 – $10.9 million). While the gains increased net income earned in the years, there will be an offsetting negative impact to revenues as the hedged mortgages are placed or securitized in the future. For placement transactions, the impact will be immediate as the mortgages are placed with institutional investors. This was evident in the third quarter of 2017. The effect on earnings for mortgages which are securitized will be more prolonged. Generally, the Company will issue securitization-related debt at higher relative interest rates than it would have prior to the movement in bond yields. Accordingly, the negative impact will be realized over the full term of the securitization. In order to adequately hedge its interest rate exposure, the Company had more than $1.8 billion of bonds sold short as at December 31, 2017.

The portion of the Company's mortgages which is held at fair value (primarily those funded through ABCP) is also affected by changes in bond prices. Generally, higher bond yields decrease the relative value of these mortgages. However, this mortgage portfolio is much smaller than the Company's short bond position, such that the impact to earnings is typically lower. The mortgages were positively affected by a moderate tightening of mortgage funding credit spreads experienced in 2017. In 2016, these credit spreads widened to offset the positive impact of lower bond yields on such mortgages. Altogether, these mortgages lost $25.3 million of fair value in 2017 (2016 - $4.6 million). The valuation of interest rate swaps, which are used to augment the Company's short Canada hedging program, as well as to manage the interest rate exposure from fixed-rate mortgages in the ABCP portfolio, was positively affected in 2017 by changing bond yields such that unrealized gains of $47.1 million were recorded in 2017 (2016 - $21.9 million).

Brokerage Fees Expense

Brokerage fees expense decreased 20% to $83.3 million from $103.7 million. This decrease is explained almost entirely by lower origination volumes of single-family mortgages for institutional investors, which decreased by 19%. Generally, per unit broker fees for insured mortgages increased with competition in 2017. However, as the Company securitizes a significant amount of its insured single-family volume, such costs are capitalized and are amortized into income against net interest – securitized mortgages.

Salaries and Benefits Expense

Salaries and benefits expense increased by 12% to $97.8 million from $87.7 million. Salaries were higher despite lower overall headcount which decreased by 1% from 949 employees at the end of December 2016 to 936 as of the end of December 2017. The increase in overall costs relates primarily to higher compensation earned by commercial sales staff on higher volumes, which accounts for $6.7 million or 8% of the 12% increase. Although overall headcount is lower, the change represents reductions in lower salaried positions offset by new higher paying roles as the Company invests in technology. The regular cost of living increases between the years also had an impact. Management salaries were paid to the two senior executives (Co-founders) who together control about 74% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO").

Interest Expense

Interest expense increased 21% to $46.4 million from $38.3 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor or funding with a securitization vehicle. The Company used the senior unsecured notes together with a $1.06 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense has increased from the prior period due to higher short-term interest rates pursuant to Bank of Canada announcements which effectively increased borrowing rates by 0.50% beginning in the third quarter of 2017. The Company also held marginally higher balances of mortgages accumulated for sale or securitization, which required greater use of the Company's credit facilities.

Other Operating Expenses and Amortization of Intangibles Expenses

Other operating expenses increased by 7% to $53.9 million from $50.3 million. The amortization of intangible assets recognized on the IPO was $5.0 million per year until mid-2016 when they became fully amortized. Accordingly in 2016, the amortization expense was $2.5 million for the year but nil in 2017. Other operating expenses increased by $6.1 million related almost entirely to higher hedge expenses which increased in step with higher bond yields and a larger hedge book. Because of more mortgages originated for securitization, the Company increased notional hedges by $900 million between the 2016 year end and the 2017 year end. In addition, the rising interest rate environment has created a steeper yield curve which makes it more expensive to carry the short bonds the Company employs to mitigate interest rate risk associated with the Company's commitment and funded warehouse pipeline.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes increased 4% to $285.4 million from $274.1 million. This increase was affected by changing capital markets, which had a favorable impact on the Company's economic interest rate hedges. In 2017, the Company recorded $56.3 million of gains on financial instruments as bond prices fell. In 2016 the results were also positive but lower and the Company recorded $27.8 million of gains on financial instruments. The change in these amounts accounts for a $28.5 million increase in income before income taxes. Pre-FMV EBITDA, which eliminates the impact of gains and losses on financial instruments, decreased by 8% to $234.3 million from $253.5 million. The decrease was due in part to the movement of interest rates through the second and third quarters of 2017. The Company calculates that $14.4 million of gains recorded in the second quarter 2017 relate to placement fees transactions entered into in the third quarter of 2017. By allocating such income to match the economics of the transactions, as opposed to the required accounting convention, management considers the 2017 comparative to 2016's pre-FMV EBITDA to be approximately $248.7 million or down 2% from the prior year. This normalized decrease generally pertains to tighter spreads on deferred placement fees and higher hedging expenses.

Provision for Income Taxes

The provision for taxes increased by 5% to $75.8 million from $72.3 million. The provision is higher due to the higher net income before income taxes earned in 2017. The overall effective tax rate is consistent between the years.

Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages); and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below:

	Operating Business Segments			
	Residential		Commercial	
	($000s except percent amounts)			
For the year ended	**December 31, 2017**	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**
Originations and renewals	16,352,753	16,976,808	6,897,582	5,785,378
Percentage change	*(4%)*		*19%*	
Revenue	827,160	820,029	251,608	229,789
Percentage change	*1%*		*9%*	
Income before income taxes	215,370	210,995	70,032	63,134
Percentage change	*2%*		*11%*	
As at	**December 31, 2017**	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**
Identifiable assets	25,653,160	24,718,010	7,093,342	5,646,679
Mortgages under administration	77,422,655	77,152,605	24,166,498	22,238,885

Residential Segment

Overall residential origination including renewals decreased by 4% between 2017 and 2016, while residential revenues increased by about 1%. A significant part of the change in revenue is due to the change in gains and losses on financial instruments. Excluding these changes, revenue decreased by 1% as rising interest rates decreased placement fees by an estimated $10.9 million. The net change in gains and losses on financial instruments for the residential segment of $12.6 million also affected net income before income taxes. Without the impact of this fair value change, net income before income taxes for the residential segment decreased by 5% year over year. This is also a function of rising interest rates as lower placement revenue directly affected earnings. With the exception of the issue on placement fees, the Company increased securitization income and mortgage servicing such that income before income taxes would have grown 1% year over year. Identifiable assets increased from December 31, 2016, as the Company increased its investment in mortgages pledged under securitization by about $900 million and bonds purchased under resale agreements for hedging purposes by $400 million. This growth was offset by a decrease in mortgages accumulated for securitization by about $300 million.

Commercial Segment

2017 commercial revenues increased by about 9% compared to 2016, but increased by 3% if the impact of changes in gains and losses on the fair value of financial instruments is excluded. Generally, lower deferred placement fees revenue on tighter spreads and the impact of rising rates have resulted in the drop in revenue. Excluding fair value gains and losses, net income before tax was 14% lower than in 2016, but 9% lower if adjusted for the $3.5 million impact from rising rates on placement fees as described previously. This change represents a decrease of about $5.5 million, most of which is explained by $6.3 lower deferred placement fees and $6.7 million higher sales compensation. These unfavorable variances

are offset by higher mortgage investment income of $3.5 million, increased placement fees and mortgage servicing income of $1.0 million. Loan losses were $0.8 million lower than in 2016 as the Company recovered $1.3 million of provisions originally recorded almost 10 years ago in the credit crisis. Identifiable assets increased from those at December 31, 2016, as the Company invested about $400 million in bonds purchased under resale agreements for hedging purposes, $120 million in net new mortgage investments, $550 million in mortgages pledged for securitization and $275 in mortgages accumulated for securitization.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets faltered and only the highest-quality assets were bid. As the Company's results in those years demonstrated, First National had little trouble finding investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of the $175 million unsecured notes and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) the origination costs associated with securitization, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of eleven financial institutions for a total credit of $1.06 billion. This facility was extended in March 2017 for a five-year term maturing in March 2022. In September, another bank joined the syndicate with a commitment of $60 million. At December 31, 2017, the Company entered into repurchase transactions with financial institutions to borrow $1.2 billion related to $1.2 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2017, outstanding bank indebtedness was $643.8 million (December 31, 2016 - $622.9 million). Together with the unsecured notes of $175 million (December 31, 2016 – $175 million), this "combined debt" was used to fund $556.1 million (December 31, 2016 - $800.3 million) of mortgages accumulated for sale or securitization. At December 31, 2017, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $41.3 million (December 31, 2016 – $43.9 million) and (2) mortgage and loan investments of $379.7 million (December 31, 2016 - $255.2 million). The difference between "combined debt" and the mortgages accumulated for sale or securitization funded by it, which the Company considers a proxy for "true leverage", has increased between December 31, 2016 and December 31, 2017, and now stands at $262.4 million (December 31, 2016 – no true leverage). This represents a debt-to-equity ratio of approximately 0.48: 1. This has increased from December 31, 2016 when there was no "debt", as generally, the Company invested $124 million in net new mortgage and loan investments, replaced $75 million of equity with debt after payment of the special dividend, invested $43 million in cash collateral to support the growing ABCP program, and paid off the non-controlling interest related to the Fund. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

The Company funds a portion of its mortgage originations for institutional placement on the same day as the advance of the related mortgage. The remaining originations are funded by the Company on behalf of institutional investors or pending securitization on the day of the advance of the mortgage. On specified days, the Company aggregates all mortgages warehoused to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs prior to arranging for term funding through securitization. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this warehouse period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for six- to 18-month terms, to bridge existing borrowers in the interim period between long-term financing solutions. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization as well as other miscellaneous longer-term financing needs.

The Company has used ABCP as an efficient source of funding primarily for short-term insured mortgages. In the May 2013 federal budget, the government announced it was going to take steps to limit the securitization of government insured mortgages to CMHC sponsored programs. As ABCP is not sponsored by CMHC, such a limitation would impact the Company. Almost two years after the announcement, legislation was passed and detailed transition information was published. With the change in the federal government, the legislation was reconfirmed in February 2016 with some delayed application dates. Generally, the regulations make mortgage default insurance invalid for any single-family mortgages with maturity dates beyond December 31, 2021 in a non-CMHC sponsored securitization vehicle. Accordingly, existing single-family mortgages in ABCP conduits as at December 31, 2016 can be funded by ABCP until their maturity, not to exceed 5 years and new insured single-family mortgages can be sold in as long as the maturity date of the mortgage is prior to January 1, 2022. As this date approaches, the Company must find other funding sources for the insured mortgages it has historically funded with ABCP. The Company is considering various alternatives including whole loan sales and selling short-term NHA-MBS pools to ABCP conduits. The Company may also adjust its renewal offering to provide incentives to borrowers to select five year terms as opposed to shorter terms. These alternatives may not be as economical to the Company as ABCP. A portion of the Company's capital has been employed to support its ABCP and NHA-MBS programs, primarily to provide credit enhancements as required by rating agencies. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2017, the investment in cash collateral was $66.4 million (December 31, 2016 - $22.9 million).

The Company's Board of Directors has elected to pay dividends, when declared, on a monthly basis on the outstanding common shares and on a quarterly basis on the outstanding preference shares. For purposes of the enhanced dividend tax credit rules contained in the *Income Tax Act* (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by the Company to Canadian residents on both common and preference shares after December 31, 2010, are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as "eligible dividends" for the purposes of such rules. For the preference shares, the Company has elected to pay any tax under Part VI.1 of the *Income Tax Act*, such that corporate holders of the shares will not be required to pay tax under Part VI.1 of the *Income Tax Act* on dividends received on such shares.

Financial Instruments and Risk Management

The Company has elected to treat deferred placement fees receivable, certain mortgages pledged under securitization that have been funded with ABCP and NHA-MBS debt and several mortgages within mortgage and loan investments, as financial assets measured at "fair value through profit or loss" such that changes in market value are recorded in the consolidated statement of comprehensive income. Effectively, these assets are treated much like bonds earning the Company a coupon at the discount rates used by the Company. The discount rates used represent the interest rate associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the asset's residual cash flows. As rates in the bond market change, the carrying values of these assets will change. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company enters into fixed-for-float swaps to manage the interest rate exposure of fixed mortgages sold to ABCP conduits. These instruments will also be treated as fair value through profit or loss. While the Company has attempted to exactly match the principal balances of the fixed mortgages over the next five-year period to the notional swap values for the same period, there will be differences in these amounts. Any favourable or unfavourable amounts will be recorded in the statement of comprehensive income each quarter.

The Company believes its hedging policies are suitably designed such that the interest rate risk of holding mortgages prior to securitization is mitigated. From an accounting perspective, any gains or losses on these instruments are recorded in the current period, as the Company's economic hedging strategy does not qualify as hedging for accounting purposes. The Company uses synthetic bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is transferred to the securitization vehicle and the matched term debt is arranged. As interest rates change, the value of these short bonds will vary inversely with the value of the related mortgages. As interest rates increase, a gain will be recorded on the bonds, which should be offset by a tighter interest rate spread between the interest rates on mortgages and the securitization debt. This spread will be earned over the term of the related mortgages. For single-family mortgages, primarily mortgages for the Company's own securitization programs, only some of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2017, the Company had more than $1.5 billion of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund, and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages for transfer to the Company's other securitization vehicles. As at December 31, 2017, the Company had entered into $348 million of notional value forward bond sales for this segment. The total net value of realized and unrealized gains and losses on account of all notional hedges pertaining to 2017 was a $35.5 million gain. This amount has been included in revenue in the statement of comprehensive income.

The Company is party to three interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at December 31, 2017, the aggregate notional value of these swaps was $16.4 million. During 2017, the value of these swaps decreased by $0.9 million. The swaps mature between June 2021 and December 2026.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company takes some credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the date of sale or securitization. This can be illustrated by the Company's experience with commercial mortgages originated for the CMBS market in the spring of 2007. These mortgages were originated at credit spreads designed to be profitable to the Company when sold to a bank-sponsored CMBS conduit. Unfortunately for the Company, when these mortgages funded, the CMBS market had shut down. The alternative to this channel was more expensive, as credit spreads elsewhere in the marketplace for this type of mortgage had widened. The Company adjusted for market-suggested increases in credit spreads in 2007 and 2008, adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from what it was at the end of 2008. Overall credit spreads stopped widening such that the Company applied the same spreads to these mortgages and the Company did not record any additional unrealized losses or gains related to credit spread movement. Despite entering into effective economic interest rate hedges, the Company's exposure to credit spreads remained. This risk is inherent in the Company's business model and cannot be economically hedged.

The same exposure to risk is inherent in the Company's securitization through ABCP. The Company is exposed to the risk that 30-day ABCP rates are greater than 30-day BA rates. Prior to the financial crisis, the Company considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the Company and the strong covenant of the bank-sponsored conduits with which the Company transacted. In 2008, 30-day ABCP traded at approximately 1.10 percentage points over BAs; but by the end of June 2011 and continuing through the current period, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. The success of this approach has been demonstrated through the increase in volume and profitability of the NHA-MBS program and significant increases in gains on deferred placement fees from the sale of prime insured

mortgages. As at December 31, 2017, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were almost $1.8 billion of mortgages that are susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model consists of the origination and placement or securitization of financial assets. Generally, placement activities do not require much capital investment as the Company acts primarily in the capacity of a broker. On the other hand, the undertaking of securitization transactions may require significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the "Liquidity and Capital Resources" section above. For fixed assets, the business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the year ended December 31, 2017, the Company purchased new computer equipment and leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $5.0 million annually.

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year leases of premises for its six offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully-serviced basis, and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

			Payments Due by Period		
	Total	0-1 Years	1-3 Years ($000s)	4-5 Years	After 5 Years
Lease Obligations	25,473	6,697	13,319	5,458	-

Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions that it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. The significant accounting policies of First National are described in Note 2 to the Company's annual consolidated financial statements as at December 31, 2017. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement fees requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future cash flows) in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by

reviewing portfolio prepayment experience on a monthly basis. The Company uses different rates for its various programs, which average approximately 11% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The method of determining the assumptions underlying the estimates used for the quarter ended December 31, 2017 continue to be consistent with those used for the year ended December 31, 2016 and the quarters ended September 30, June 30 and March 31, 2017.

The Company has elected to treat certain of its financial assets and liabilities, including deferred placement fees receivable, specific mortgages pledged under securitization, some mortgage and loan investments and bonds sold short, at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of its securitized mortgages has a significant impact on earnings. The Company uses different prepayment rates for its various programs, which average approximately 10% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages. Actual prepayment experience has been consistent with these assumptions. The Company has also assumed discount rates based on Government of Canada bond yields plus a spread that the Company believes would enable a third party to purchase the mortgages and make a normal profit margin for the risk involved.

Future Accounting Changes

The following accounting pronouncements issued by the IASB, although not yet effective, may have a future impact on the Company:

IFRS 9 – *Financial Instruments*

In July 2014, the International Accounting Standard Board ["IASB"] issued the final version of IFRS 9 – *Financial Instruments*, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a model for classification and measurement, a single, forward-looking "expected loss" impairment model and a substantially-reformed approach to hedge accounting. Under this standard, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The accounting model for financial liabilities is largely unchanged from IAS 39, except for the presentation of the impact of own credit risk on financial liabilities, which will be recognized in other comprehensive income ["OCI"], rather than in profit and loss as under IAS 39. The new general hedge accounting principles under IFRS 9 are aimed to align hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness; however, it is expected to provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

Classifications and Measurement

IFRS 9 requires that all financial assets are to be measured at either at FVTPL, fair value through OCI ["FVOCI"], or amortized cost. Based on its business models, the Company has determined which measurement convention is most appropriate for its mortgage assets as summarized below with a comparison to the classification and measurement under IAS 39:

	IAS 39	IFRS 9
Mortgages accumulated for securitization	Loans and Receivable	Amortized Cost
Mortgages accumulated for sale	FVTPL	FVTPL
Mortgages pledged under securitization	FVTPL or Loan and Receivables	Amortized Cost
Mortgage and loan investments	Loans and Receivable	FVTPL

As at December 31, 2017, the mortgages pledged under securitization which were classified as FVTPL had a mark to market discount to par of $1,763. This amount will be amortized to interest revenue over the term of the related mortgages.

Impairment

IFRS 9 introduces an expected credit loss ["ECL"] model applicable to all debt instrument within financial assets classified as amortized cost or FVOCI and certain off-balance sheet loan commitments. The model has three stages: Stage 1 – the credit risk has not increased significantly since initial recognition such that an allowance for credit loss is recognized and maintained equal to 12 months of expected credit loss: Stage 2 – the credit risk has increased significantly since initial recognition, and the allowance for credit loss is increased to cover full lifetime expected credit loss; and Stage 3 – a financial asset is considered credit-impaired and the allowance for credit loss continues to be the full lifetime expected credit loss, with interest revenue calculated on the carrying amount (net of the allowance for credit loss), rather than the gross carrying value of the financial assets.

The Company's ECL model will be built on an unbiased and probability-weighted method, determined by evaluating a range of possible outcomes. The model will consider the time value of money. Based on the initial analysis, the Company is not expecting a significant impact from the adoption of the impairment loss policy on its consolidated financial statements due to the high proportion of government insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends.

Hedge Accounting

The Company is planning to adopt hedge accounting for certain mortgage commitments and funded mortgages.

For multi-unit residential commercial segment mortgages, the Company will apply cash flow hedge accounting by hedging the anticipated future debt to be arranged on these mortgages. The Company will use short sales of Government of Canada bonds at the time of mortgage commitment as the hedging instrument. When effective hedging is achieved, any gains or losses will be recorded in OCI and amortized into interest expense over the term of the hedged debt.

For residential mortgages accumulated for securitization, the Company will apply fair value hedge accounting to minimize the exposure to changing interest rates by selling short Government of Canada bonds at the time these mortgages are funded. The Company will re-balance and evaluate the hedge effectiveness on an ongoing basis. For an effective hedge, the gains or losses on the hedging instrument will be offset by the losses or gains on the hedged mortgages. At hedge unwind, the changes in the value

of the hedging instrument will be adjusted to the carrying value of the hedged mortgages, and amortized into interest revenue over the term of the hedged mortgages. Any changes in the market value of the ineffective hedge will be immediately recorded in the Company's regular income.

The Company will continue to evaluate the impact of IFRS 9 on the Company's consolidated financial statements, but is not expecting any restatement of comprehensive income for prior years.

IFRS 15 – *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15 – *Revenue from Contracts with Customers*, replacing IAS 11 – *Construction Contracts*, IAS 18 – *Revenue*, IFRIC 13 – *Customer Loyalty Programs*, IFRIC 15 – *Agreements for the Construction of Real Estate*, IFRIC 18 – *Transfer of Assets from Customers*, and SIC 31 – *Revenue – Barter Transactions Involving Advertising Services*. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step revenue recognition process to determine the nature, amount, timing and uncertainty of revenue and cash flows from the contracts with customers. IFRS 15 is effective for fiscal years beginning on or after January 1, 2018, and can be applied on a retrospective basis or using a modified retrospective approach.

The Company plans to apply the standard on January 1, 2018, using the modified retrospective approach. The main revenue stream that will be affected by IFRS 15 is mortgage servicing revenue, including the ongoing measurement of servicing liabilities. Based on the initial analysis, the Company does not currently expect a material impact of IFRS 15 on its consolidated financial statements, and is not expecting any restatement of comprehensive income for prior years.

IFRS 16 – *Leases*

In January 2016, the IASB issued IFRS 16 – *Leases*, replacing IAS 17 – Leases. IFRS 16 requires lessees to recognize assets and liabilities for most leases instead of previous categories of finance leases, which are reported on the balance sheet, or operating leases, which are disclosed only in the notes to the financial statements, under IAS 17. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15. The Company is currently assessing the impact of this standard on the Company's consolidated financial statements.

Disclosure Controls and Internal Controls Over Financial Reporting

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2017, management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, management concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, were effective as of December 31, 2017.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in

accordance with reporting standards; however, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

Management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and, based on that evaluation, concluded that the Company's internal control over financial reporting was effective as of December 31, 2017 and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2017. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Risks and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company. In addition to the risks addressed elsewhere in this discussion and the financial statements, these risks include: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance, CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, and environmental liability. In addition, there are risks associated with the structure of the Company including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions. The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as ''may'', ''will'', ''should'', ''expect'', ''plan'', ''anticipate'', ''believe'', ''intend'', ''estimate'', ''predict'', ''potential'', ''continue'' or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime, and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, and changes in interest rates as outlined in the ''Risk and Uncertainties Affecting the Business'' section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the ''Risk and Uncertainties Affecting the Business'' section, which may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of February 27, 2018, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

Management is pleased with the results of 2017. As expected, the market for high ratio insured mortgages slowed as a result of the October 2016 mortgage insurance rules announced by the Department of Finance. Although single-family mortgage originations for the Company were down 10% from 2016, commercial mortgage origination increased by 20% and single-family renewals grew by 15% to $5.2 billion. Altogether, origination including renewals was up 2% and earnings, adjusted for fair value considerations, were lower by 2%. The combination of consistent revenue from both securitization and servicing departments and the value inherent in the Company's renewal opportunities continued to support earnings. Management believes that fourth quarter new single-family origination, which increased year over year by 3%, benefited from new mortgage qualification rules announced for 2018. The new rules require conventional mortgage borrowers to qualify at interest rates higher than the actual rate of the mortgage. Accordingly, the new rules reduce the relative size of mortgage that a borrower could otherwise have taken on under the previous rules. The Company believes this pushed some borrowers to accelerate their decision to purchase real estate into 2017, so as to qualify under the old rules which has had a positive impact on these volumes.

Going into 2018, the Company is optimistic and anticipates similar seasonal origination in the residential segment as experienced in 2017. Despite the impact of new qualifying mortgage rules announced in late 2017, which will have a dampening effect on origination volumes, the Company currently foresees a strong economy which will offset these effects. The Company sees growth in single-family renewals and a stable commercial segment muted by a rising interest rate environment and some increased competition.

The Company earned almost $56 million in gains on financial instruments in 2017. While this revenue increased 2017 net income, the offsetting economic impact will be felt in the Company's future earnings. Net securitization margins will be lower on new securitizations as the Company issues NHA-MBS with coupons that will be higher than the period when the securitized mortgages were initially funded. The negative impact will be recognized over the five- and 10-year terms of the securitization. However, to the extent that the funded mortgages are placed with institutional customers, as the Company did in 2017, the impact will be immediate with lower placement fees in current period earnings. Depending on how the Company elects to fund these mortgage assets, the negative impact associated with the large gains recorded in 2017 could be spread over five- or 10-year terms or it could be realized in the upcoming fiscal year.

The Company will continue to generate income and cash flow from its $27 billion portfolio of mortgages pledged under securitization and $74 billion servicing portfolio, and focus on the value inherent in its significant single-family renewal book.