Fundamental Research Corp.

Investment Analysis for Intelligent Investors

Siddharth Rajeev, B.Tech, MBA, CFA
Analyst

Daniel Iwata, BA
Research Associate

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Bancorp Balanced Mortgage Fund II Ltd. - Residential and Commercial Mortgages in BC and AB

Sector/Industry: Alternative Investments **www.bancorpfinancial.com**

Summary of Offering	
Issuer	Bancorp Balanced Mortgage Fund II Ltd.
Date of the OM	28-Mar-13
Offering	Minimum - $0 / Maximum: $25 million
Securities Offered	Class A, D, E and F shares
Unit Price	$1.00 per share
Minimum Subscription	$10,000
Annual Management Fee (Class D)	1.50%
Priority Dividends (Class D)	2-year GOC Bond Yield + 4.0%
Profit Sharing	75% Investor: 25% Management after paying out priority dividends
Auditor	Mackay LLP, Chartered Accountants
Registered Plans	RRSP and RRIF Eligible

** This offering is available to residents of BC, AB, or ON only.*

FRC Rating	
Expected Annual Yield	6.00% - 6.50%*
Rating	2-
Risk	3

**Based on the current BoC overnight rate of 1%*

- see back of report for rating definitions

Investment Highlights

- Bancorp Balanced Mortgage Fund II Ltd. ("BBMFII", "the company", "the fund") primarily invests in first mortgages secured on residential, commercial, land for development, office and industrial properties in British Columbia ("BC") and Alberta ("AB"), Canada.
- The company was set up and managed by Bancorp Financial Services Inc. ("Bancorp"), based in Vancouver, BC. Established in 1975, Bancorp has originated $5+ billion of mortgage products since inception, and $1.4 billion since 2001. Bancorp has managed five funds since 1996. Bancorp currently manages assets totalling approximately $152 million.
- The target yield for investors ("priority dividends") of Class D shares of this offering is the two-year Government of Canada bond yield plus 4%. All the profits left after paying out management fees, operational expenses and investors' priority dividends are shared 75% investor / 25% management.
- Mortgage terms are typically 6-24 months, minimizing real estate price fluctuation risk, interest rate risk, and duration.
- The current portfolio has 21 loans, with a total principal outstanding of $19.3 million.
- Management owns 6% of the shares outstanding.
- Dividend yields have been higher than the priority returns in every year since inception in 2009.

Risks

- Shareholders' principal and quarterly distributions are not guaranteed.
- Redemptions are based on availability of cash and management discretion.
- Investments are exposed to credit risks. Investments are also exposed to interest rate risks, but they are minimal as most of the investments are short-term investments with fixed rates.
- The company is not restricted from investing in second mortgages, with a loan-to-value ("LTV") of up to 75%.
- Timely deployment of capital is critical.
- The manager is paid 25% of income over priority returns - this is an incentive for the management to acquire mortgages with high interest rates; however, mortgages with higher interest rates may carry higher default risk.
- The fund currently utilizes a $3 million line of credit to bridge mortgage funding; leverage can increase the exposure of the fund to negative events.

Overview

Bancorp Balanced Mortgage Fund II Ltd., incorporated in July 2009, invests primarily in first mortgages secured on residential, commercial, land for development, office and industrial properties in BC and AB. **The borrowers are typically owners, and/or developers of properties,** who require funds to finance inventory, development, redevelopment or renovation of properties, acquisition/development of land, etc. The fund does not typically lend to individual home owners. The mortgages underwritten are typically first mortgages, and at times second mortgages, where the total of the two mortgages do not exceed a 75% LTV.

BBMFII's current portfolio has 21 loans with a total principal outstanding of $19.3 million. The fund's current portfolio has a major focus on Vancouver and residential properties. Although there is no restriction geographically, the fund's mortgages are all secured on properties located in BC and AB**. Vancouver (51%), Victoria (13%), Calgary (11%), and Edmonton (7%), combined, account for 82% of the current portfolio.** 82% of the portfolio is secured on properties in BC. Mortgages on residential properties, and housing projects, account for 74% of the current portfolio.

The company qualifies as a mortgage investment corporation ("MIC"), defined under section 130.1 of the Income Tax Act (Canada), and therefore, the shares are eligible investments for registered plans. MICs can distribute profits to shareholders without payment of corporate income tax. In order for an entity to maintain its status as a MIC, it has to comply with several rules; a few of the key rules are listed below.

- invest at least 50% of its assets in residential mortgage loans;
- have a minimum of 20 shareholders, and no shareholder can own 25%+ of the total outstanding shares;
- all investments must be in Canada

The company's strategy, like other private mortgage lenders, is to **provide short-term mortgages (typically 6 – 24 months)** that do not conform within the strict lending guidelines of banks and other traditional lenders. Private lenders are more flexible in their lending guidelines, and therefore, can offer individually structured loans to meet the specific requirements of a borrower. Also, banks have lengthy due diligence processes and are typically not able to meet borrowers' quick capital needs. The company is usually able to structure, complete its due diligence, approve and fund loans within 1 – 4 weeks. All the above reasons allow private lenders to charge a higher interest rate on their loans compared to banks/institutional lenders.

Purpose

The purpose of this report is to evaluate the risk/rewards of this offering.

Management Team

The company was set up by Bancorp Financial Services Inc., based in Vancouver. Established in 1975, Bancorp is a real estate finance and fund management company focused on offering financing options to residential and commercial owners and developers in Western Canada. According to management, the company has originated $5+ billion of mortgage products since inception, and $1.4 billion since 2001. The founder of the company is now retired. It is a privately held company, with the current management team and related parties owning approximately 6% of the outstanding shares. We have viewed the audited financial statements of all of the funds under management. Results are provided later on in this report.

As the manager, Bancorp originates mortgage loans that meet the fund's objectives. Bancorp currently has 13 employees. In addition to the President, and VP / Investor Relations & Administration, there are five Licensed Mortgage Brokers responsible for loan origination, underwriting and management of each loan, two manage the loan administration department, and four manage the accounting department.

Overall, we believe the fund has a strong management team with extensive experience in the mortgage lending space. We were impressed with their transparency, and their willingness to provide us all the information related to the funds under management, enabling us to properly verify their track record.

Brief biographies of the senior management team, as provided by the company, follow.

Douglas Bentley - Principal, President and CEO
Doug joined Bancorp in 2001 and was appointed President and CEO in April 2011. Prior to that, he was the Chief Operating Officer of Bancorp, with various responsibilities including loan origination, loan underwriting, loan administration, loan management and fund management. Doug has a law degree from the University of British Columbia and practised law from 1980 to 1984. Between 1984 and 1988, he worked with a Canadian trust company and was responsible for a varied loan portfolio in B.C. and Arizona. In 1988, he joined a major Canadian real estate pension advisory firm where he held senior positions, established and managed a top performing lending fund and was president from 1995 to 1997, when the company was sold. From 1998 until 2001, he successfully operated his own real estate development and lending business. He is a long-standing member of real estate organizations including the Urban Development Institute and the Mortgage Investment Association of B.C. He is also a member of the Law Society of BC.

Arnold E. Miles-Pickup - Principal and Chairman
Arnie has worked in the banking and financial services industry since 1969. Between 1969 and 1986, he held a series of senior positions with the Bank of British Columbia (now HSBC). He then founded and was President and CEO of Aetna Trust Company, a highly successful residential and commercial real estate lender, financial intermediary and personal trust operation, which was sold to Canadian Western Trust in 1996. In September 2001, he joined Bancorp as its President and CEO, and subsequently worked very closely with Bancorp's investor clients. Arnie was appointed chairman of Bancorp's Board of Directors in 2011. Arnie holds a BA in economics and psychology from the University of British Columbia.

Marianne Dobslaw - Principal and Vice-President
Marianne has been in the real estate finance industry since 1988 and joined Bancorp in 2004. Prior to joining Bancorp, Marianne was director for Western Canada at GE Capital and vice-president with Citibank Canada where she was responsible for deal origination,

structuring, underwriting and closing of debt and equity transactions. Marianne also served as vice-president with CB Richard Ellis where she specialized in mortgage brokerage. Marianne holds an MBA from the University of British Columbia and a B.Sc. in civil engineering from the University of Alberta.

John L. (Lockie) McKinnon - Principal and Vice-President
Lockie has more than 35 years of experience in real estate financing and real estate development. Prior to joining Bancorp in 2000 he worked with a Victoria based real estate lender in the early 1990's and then became the President and managing principal of a Victoria based mortgage fund that he merged with Bancorp in 2000. Lockie started his real career in the late 1970's with and became a vice-president and partner in real estate development company. Lockie holds a BA in economics from the University of Victoria and has completed several postgraduate courses in advanced real estate finance at the University of British Columbia.

Richard K. Nicholson - Principal and Vice-President
Rick has been with Bancorp since 1984. He was the vice-president of operations for Bancorp's offices in Phoenix, Arizona, and subsequently opened the company's Toronto office. He served as vice-president there until 1990, when he relocated to Bancorp's Victoria office. In 1997, Rick became a principal in a Victoria based mortgage company with John McKinnon. There he managed the mortgage portfolio until it merged with Bancorp in 2000. Throughout his real estate career, Rick has had primary responsibility for loan origination, underwriting and monitoring. Rick is responsible for loan origination in both British Columbia and Alberta. Rick holds a BA in economics from the University of Victoria.

Mark D. Silverwood - Principal and Vice-President
Mark originally joined Bancorp in 1990 and worked for the company for seven years as a broker. He subsequently became a commercial lender for MCAP and CareVest Capital Inc. where he was primarily responsible for deal origination, loan structuring and underwriting. Mark rejoined Bancorp in 2007. He is a graduate of the University of British Columbia with a degree in geography.

Wendy Herdin - VP, Investor Relations and Administration, Director & CFO
Wendy joined the Bancorp team in April 2007. She is responsible for shareholder relations and for managing administration of the company, its subsidiaries and associated mortgage investment corporations (MICs). Wendy has more than 30 years of experience working in the financial services sector with HSBC (formerly the Bank of BC) and Canadian Western Trust (formerly Aetna Trust). Prior to joining Bancorp, she spent seven years working for TAP Solutions, a business management consultant that provides IT solutions to financial services companies.

Management Track Record

The company has **managed five funds since 1996** - Bancorp Growth Mortgage Fund Ltd (1996), Bancorp Balanced Mortgage Fund Ltd. (1998), Bancorp Income Mortgage Fund Ltd. (2003), Bancorp Balanced Mortgage Fund II Ltd. (2009), and Bancorp Growth Mortgage Fund II Ltd. (2009). **All of the funds were/are set up as MICs.**

A summary of the structure of the five funds is shown below.

	Inception	Management Fee	Profit Sharing	Priority Dividend
Bancorp Growth Mortgage Fund Ltd	1996	1.75%	25%	greater of 10% or the two-year GOC Benchmark Bond Rate plus 7%
Bancorp Balanced Mortgage Fund Ltd.	1998	1.50%	25%	two-year GOC Benchmark Bond Rate plus 4%
Bancorp Income Mortgage Fund Ltd.	2003	0.75%	25%	five-year GOC Benchmark Bond Rate plus 2%
Bancorp Growth Mortgage Fund II Ltd.	2009	1.75%	25%	two-year GOC Benchmark Bond Rate plus 7%
Bancorp Balanced Mortgage Fund II Ltd.	2009	1.50%	25%	two-year GOC Benchmark Bond Rate plus 4%

At their peaks, the Growth Mortgage Fund was managing approximately $93 million, the Balanced Mortgage Fund was at $142 million, and the Income Mortgage Fund was at $41 million.

The company is currently winding up the first three funds. The decision to wind up the first two funds was made in 2008/2009, due to the following reasons, according to management:

"With the economic downturn in 2008, the funds experienced an increase in default on payments and there was great uncertainty in the markets. Real values were hard to determine. As a result of this, it was difficult to properly evaluate the Net Asset Value (NAV) of the funds – which presented a difficult issue regarding share redemptions - too high a value to shareholders that were redeeming would have been unfair to remaining shareholders, and too low a value would be unfair to shareholders redeeming. Management and shareholders of the first two funds considered many options, and in the end determined by way of 99% shareholders' vote for each fund that the fairest way to treat all shareholders was to stop funding new loans and to wind up the two funds. As loans are repaid, all shareholders would be redeemed pro rata and no group would get treated unfairly. Balanced II and Growth II funds were established at this time as replacement funds, and have been in operation since October 1, 2009.

A decision to wind up the third fund, Bancorp Income Mortgage Fund Ltd., established in 2003, was made in 2011. The fund was primarily created to meet the investment criteria of one large financial planner who decided to re-adjust his portfolio holdings which included redeeming his shares in the fund."

Here is a quick summary of the status of the five funds under management – all the information below have been verified by us through audited financial statements.

Bancorp Balanced Mortgage Fund – 90% of the capital has been returned; the final windup is expected to take place in 2014. BBMFII is the successor of this fund. The anticipated wind up value is approximately 98% of the invested capital.

Bancorp Growth Mortgage Fund – 97% of the capital has been returned; the final windup is expected to take place in 2013. Bancorp Growth Mortgage Fund II is the successor of this fund. The wind up value is approximately 84% of the invested capital.

Bancorp Income Mortgage Fund – 98% of the capital has been returned; the final windup is expected to take place in 2013. The wind up value is 99% of the invested capital.

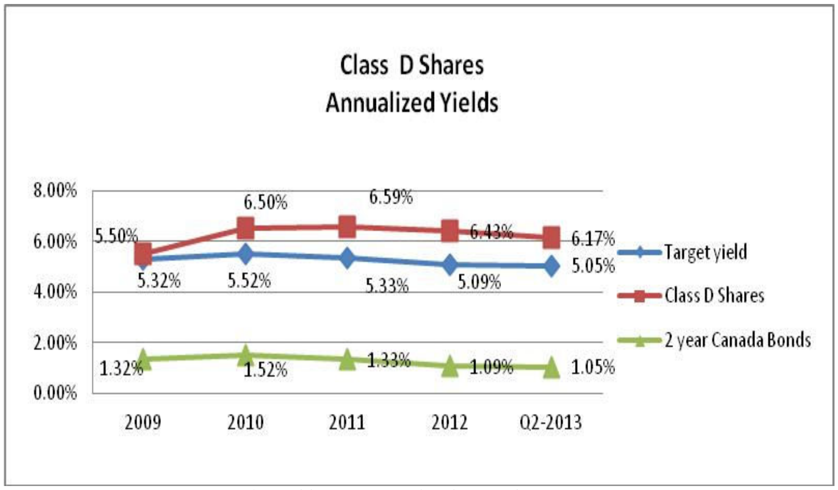
The yields generated by the first three funds are shown in the table below (verified by us through audited financial statements). As shown in the table below, the first three funds provided very attractive yields from inception to 2008. **Like most other MICs, all three funds were negatively impacted by the recession. Although these funds did not pay out any distributions to investors in the past few years, we believe management has done a good job in being able to return most of the principal back to investors.** As mentioned above, the anticipated wind up value as a percentage of the invested capital is 98%+ for the Bancorp Balanced Mortgage Fund and the Bancorp Income Mortgage Fund. The Bancorp Growth Mortgage Fund, being a more riskier fund (as its focus is on second mortgages), has a lower anticipated wind up value of 84%.

	Growth	Balanced	Income
1996	11.02	n/a	n/a
1997	14.75	n/a	n/a
1998	11.03	12.96	n/a
1999	11.12	11.57	n/a
2000	10.15	9.65	n/a
2001	10.01	8.35	n/a
2002	5.47	8.19	n/a
2003	11.14	8.61	6.66
2004	11.51	9.14	6.75
2005	11.64	9.82	6.28
2006	12.59	9.51	7.02
2007	12.17	9.90	7.53
2008	*11.17	6.98	6.79
2009		1.18	5.80
2010		2.46	5.40
2011			4.49

** 11 month yield as YE changed from July 31 to June 30*

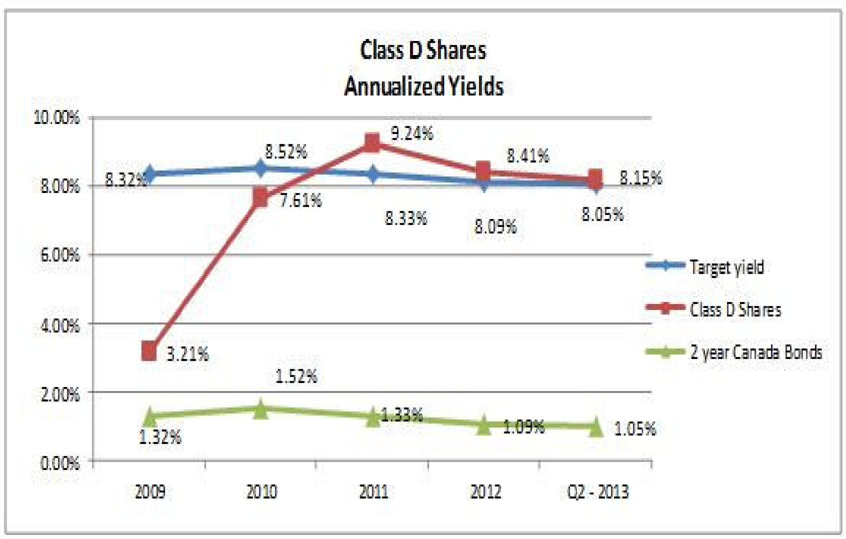
In 2009, the Balanced Fund, and the Growth Fund, ceased operations, and were replaced with Balanced Mortgage Fund II and Growth Mortgage Fund II. The returns of Balanced Mortgage Fund II and Growth Mortgage Fund II are shown in the table below. (verified by us through audited financial statements)

Historic Yield Balanced II



*Fund began operation in October 2009
*Q2-2013 unaudited returns

Historic Yield Growth II



*Fund began operation in October 2009.
*Q2-2013 unaudited returns

Source: Company

Balanced Fund II and Growth Fund II, combined, currently manage $35 million of mortgages. The primary differences between the funds are – 1) Balanced Fund II invests primarily in first mortgages, while Growth Fund II invests primarily in second mortgages, and carries higher risks, and 2) Growth Fund II has higher priority returns to compensate for the higher risk profile.

Bancorp also manages mortgages for syndicated investors - a group of high net worth investors. According to management, in order to eliminate any conflict of interests, only those opportunities that are not funded by Balanced Fund II, or Growth Fund II, are offered to the syndicate investors.

Overall, Bancorp currently manages assets totalling approximately $152 million – $98M for the syndications, $19M in the first three funds that are currently being wound up, and $35M in the Balanced Fund II, and the Growth Fund II.

Borrower Profile

BBMFII's borrowers are primarily real estate developers. These borrowers approach private lenders, such as Bancorp, instead of bank or traditional lenders for a variety of reasons including:

- speed in which a private lender can approve the mortgage
- private lenders can offer tailor made loan solutions that meet borrowers' specific requirements
- higher loan to values
- the quality of the service and flexibility private lenders offer

The Canadian Association of Accredited Mortgage Professionals (CAAMP) estimated that private mortgage companies, and other **private lenders, accounted for less than 3% of residential mortgage funding in 2012**.

According to management, on average, five of every six loans that are funded have been sourced by management directly with their client base in BC and AB. Bancorp also deals with a select group of Commercial Mortgage Brokers, who management have typically dealt with for many years.

Current Portfolio

The current portfolio of BBMFII is comprised of 21 loans with a total principal outstanding of $19.3 million.

The loans typically have maturities with terms of 6 – 24 months, and are interest only loans (paid monthly). The terms are extendable in certain cases subject to the borrowers meeting certain criteria. **A significant part of management's due diligence is to verify whether they have a viable exit strategy to recoup their principal.** Generally, borrowers borrow from BBMFII to improve and add value to their property, with the plan to either sell or refinance the property (from a more traditional lender) in a 24 month period or shorter term.

The mortgages bear interest at a fixed rate of interest or a specified rate over the prime lending rate, and are often subject to a minimum rate of interest. The table below shows a summary of the outstanding mortgages as of June 30, 2013. The average LTV was 56%. The weighted average interest was 8.8% p.a.

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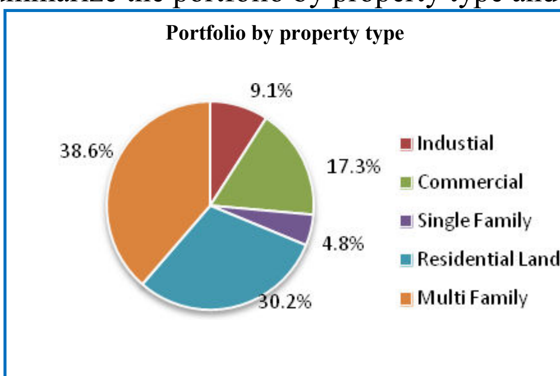
No.	Region	Principal Outstanding	BBMFII Principal	BBMF II %	Initial Funding Date	Maturity Date	Appraised Value	Loan to Value	Interest Rate
1	Port Coquitlam, BC	$5,910,000	$1,749,719	29.61%	14-Mar-11	31-Mar-14	$14,000,000	42.21%	CI Pr + 3.00% Min 9.75%
2	North Vancouver, BC	$2,397,036	$1,643,987	68.58%	31-May-11	31-Aug-13	$3,920,000	61.15%	Fixed 9.00%
3	Vancouver, BC	$9,500,000	$1,800,000	18.95%	30-Aug-11	31-May-14	$13,900,000	68.35%	CI Pr + 4.00% Min 8.75%
4	Colwood, BC	$750,000	$750,000	100.00%	30-Nov-11	M/M	$1,581,000	47.44%	CI Pr + 4.00% Min 8.50%
5	North Vancouver, BC	$2,500,000	$588,743	23.55%	29-Mar-12	M/M	$3,540,000	70.62%	CI Pr + 4.00% Min 8.75%
6	Calgary, AB	$7,000,000	$855,000	12.21%	08-Jun-12	31-Oct-13	$15,000,000	46.67%	NB Pr + 4.50% Min 9.50%
7	Courtenay, BC	$4,150,000	$931,494	22.45%	01-Jun-12	31-May-13	$9,175,000	45.23%	CI Pr + 4.00% Min 9.00%
8	Vancouver, BC	$2,500,000	$1,250,000	50.00%	15-Jun-12	M/M	$4,100,000	60.98%	CI Pr + 4.00% Min 8.75%
9	Calgary, AB	$625,150	$466,078	74.55%	06-Jul-12	30-Jun-13	$1,620,000	38.59%	Fixed 9.00%
10	Comox, BC	$2,850,387	$1,000,000	35.08%	05-Sep-12	31-Aug-13	$6,000,000	47.51%	NB Pr + 4.00% Min 8.75%
11	North Saanich, BC	$1,687,500	$1,387,500	82.22%	31-Jul-12	31-Jul-13	$2,400,000	70.31%	CI Pr + 4.00% Min 8.75%
12	Vancouver, BC	$1,800,000	$450,000	25.00%	02-Aug-12	31-May-14	$2,850,000	63.16%	CI Pr + 4.00% Min 8.75%
13	Langley, BC	$1,202,720	$456,874	37.99%	10-Oct-12	30-Sep-13	$2,543,400	47.29%	CI Pr + 4.00% Min 8.50%
14	Abbotsford, BC	$3,349,230	$1,158,903	34.60%	20-Sep-12	30-Sep-13	$6,415,900	52.20%	CI Pr + 4.00% Min 8.50%
15	Surrey, BC	$2,493,513	$699,918	28.07%	02-Nov-12	31-Oct-13	$4,304,529	57.93%	CI Pr + 4.00% Min 8.75%
16	Coquitlam, BC	$1,100,000	$250,000	22.73%	06-Dec-12	06-Jun-14	$1,650,000	66.67%	CI Pr + 4.00% Min 8.75%
17	Victoria BC	$1,075,000	$525,000	48.84%	26-Nov-12	30-Nov-13	$1,530,000	70.26%	CI Pr + 4.00% Min 8.75%
18	Sherwood Park, AB	$2,500,000	$700,000	28.00%	07-May-13	07-Nov-14	$3,450,000	72.46%	Fixed 7.50%
19	Courtenay, BC	$4,686,000	$453,700	9.68%	22-Mar-13	31-Aug-14	$9,600,000	48.81%	CI Pr + 4.00% Min 8.75%
20	View Royal , BC	$5,633,801	$809,389	14.37%	22-Apr-13	01-May-14	$7,972,100	70.67%	BMO Pr +4.75%Min 7.75%
21	Edmonton, AB	$1,364,810	$1,364,810	100.00%	24-Jun-13	21-Dec-13	$1,844,382	74.00%	CI Pr + 4.00% Min 8.25%
		$65,075,147	**$19,291,115**				**$117,396,311**		

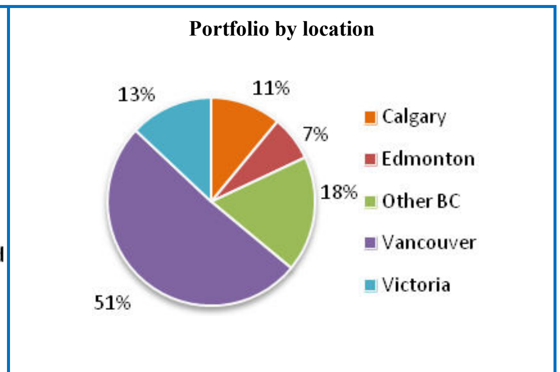
Source: Company

- *The portfolio contains one second mortgage.*
- *'M/M' implies renewals on a month to month basis after initial maturity date expired.*
- *No.9 – the Calgary project, with a maturity date of June 30, 2013, has been repaid in full*

Approximately a third of the loans in the current portfolio have been renewed, of which three are on a month to month basis. Renewals and extensions are normal in the MIC business, as the borrowers have to execute an exit (refinancing or property sale) to repay the principal to the lenders at maturity. It is normal to have delays in exits, and lenders are typically willing to extend the loans, as long as the exit strategy seems to be still viable, and borrowers continue to make their monthly interest payments on time. **In BBMFII's case, the audited financial statements do not indicate any default in interest payments. Management indicated that none of its loans in the fund have ever been in default.**

BBMFII's principal amount of the current loans range between approximately $250k and $1.80 million; **the average loan size is $919k.** Of the 21 outstanding loans, 15 loans are from repeat borrowers, and three borrowers have two loans each in the portfolio. Of the 21 loans, 19 are shared with other MICs and Bancorp's syndicated investors. The charts below summarize the portfolio by property type and location.





Number of Loans in Portfolio: 21

Average Loan to Value: 56%

Source: Company

The fund generates revenues from the interest charged on mortgages. Mortgage originations include an upfront commitment/renewal/discharge fee of up to 2% of the principal, which is retained by the manager, and not included in the fund. Management also receives a 1.5% p.a. management fee. The manager bears all staff, premises, overhead, trailer fee commissions, and other internal expenses incurred in providing services to the fund, with the exception of fund audit, legal and bank charges. **The fund's expenses (excluding management fees) have averaged about $70k - $80k per year, or 0.4% of the mortgages outstanding, in the past few years which, we believe, is very reasonable.**

Lending Criteria

BBMFII's lending criteria is as follows:

- loans do not exceed 75% of appraised value
- maximum loan to any one borrower is $2 million or 15% of the total capital
- maximum loan to any one property is $2 million, or 10% of the total capital
- all loans are made to arm's length borrowers
- the status of the fund is always maintained as a MIC
- will only make investments in Canada (which is a prerequisite for all MICs)

The loans typically fall into the following major loan categories –

- Interim loans - advanced to completed or substantially completed buildings with unsold units remaining, or commercial buildings in the process of being leased up
- Land loans - advanced to fund land acquisition and/or development
- Construction loans
- Term loans - advanced to cash-flowing completed properties

The exit strategy of all the above is typically either asset sales or refinancing with a term lender.

Investment Process

An Investment Committee, which is comprised of five directors/officers of the company, gives the final approval on any particular loan opportunity. The final loan approval requires unanimous approval from at least three members of the Investment Committee. According to management, the entire process from reviewing requests to the final loan approval, and funding, takes an average of 3 to 4 weeks.

Bancorp's main duties are the following:

- *Sources, reviews and analyses all potential new loans for the fund to ensure they meet the fund requirements;*
- *Completes all due diligence for each approved new loan including appraisals and required consultant reports;*
- *On-going management and administration of each loan held by the fund;*

- *All accounting and shareholder matters including record-keeping and statements*

Private Lending Market

The private mortgage lending market is a highly competitive market. The current low interest rate environment has been attracting a lot of investors to higher yield opportunities, such as MICs. About 10 MIC or Mortgage Investment Funds (MIF) were listed on the TSX, as of early 2013, versus just three in 2011.

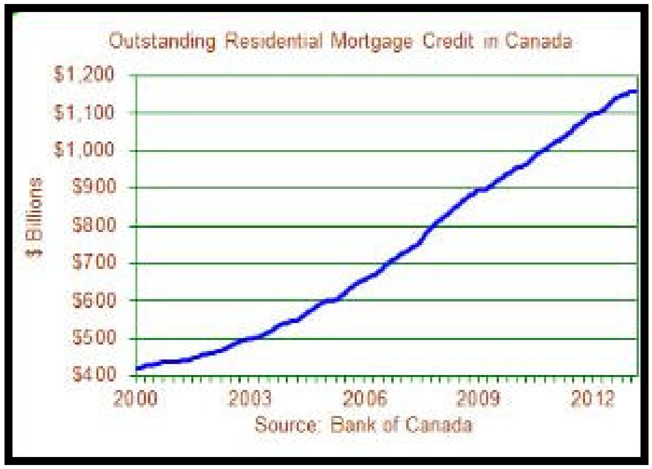
According to Bancorp management, their key differentiating factor is the "high quality service" provided to borrowers. This is evident from the significant number of repeat borrowers in the current portfolio.

The structure of BBMFII mortgages make it so their income is minimally affected by home prices and interest rates in the short term. These factors would normally be a significant concern with traditional mortgage lenders. The term of a loan for BBMFII is 6 - 24 months, with the current average being about 13 – 14 months, allowing them to re-price interest rates almost annually. They also utilize a maximum LTV of 75%, with their current portfolio averaging 56%. There would have to be a significant one year shift in home prices to cause the LTV to rise to levels where the underlying property was valued at less than the mortgage.

In the long term, real estate prices will impact deal flow to BBMFII. Real estate prices will affect the amount of mortgage volume, sales activity and impact real estate starts and development. **If prices decrease, there will be less activity, as people hold off purchasing and selling until the market stabilizes.** Not only do buyers slow their activity, developers and builders limit housing starts until demand growth returns. With the decreased activity comes lower mortgage volume and deal flow. If home prices decline, people will have less collateral to borrow with.

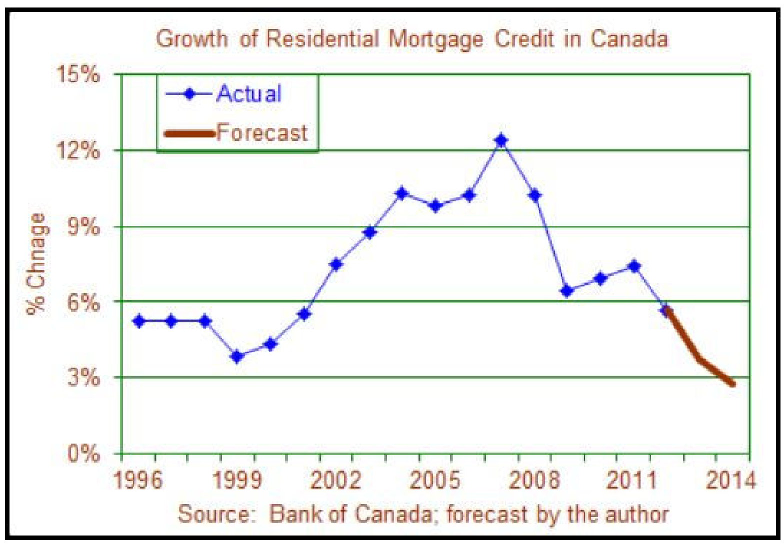
As most of BBMFII's mortgages in the current portfolio are secured against BC (Vancouver particularly) residential *(70% - 75% of the portfolio is secured on multi-family, single-family, and residential land),* the following section discussed our outlook on the overall health of the residential market in BC. **The health of the residential market is important for BBMFII as developers/builders of residential units will be willing to take on mortgages only if the market is healthy.**

The following chart shows the Canadian residential mortgage market size from 2000 to 2012.



Source: CAAMP

The table below displays the annual YOY growth in the mortgage market.



Source: CAAMP

In 2012, the mortgage market expanded by just under 6.0%. The forecast is that the market will continue to expand, but at a decreasing rate. The anticipated growth in 2013 is 4.5% - 5%, followed by 3% in 2014 (Source: CAAMP). Even though private mortgages make up a small portion of the mortgage market, the above estimates give an indication of the opportunities in the market.

The following looks at key indicators of economic growth.

GDP

The GDP of Greater Vancouver is forecasted to grow at 3% annually over the next 4 years (Source: Conference Board of Canada). BC's growth is expected at 1.8% in 2013, and 2.6% in 2014 (BCREA).

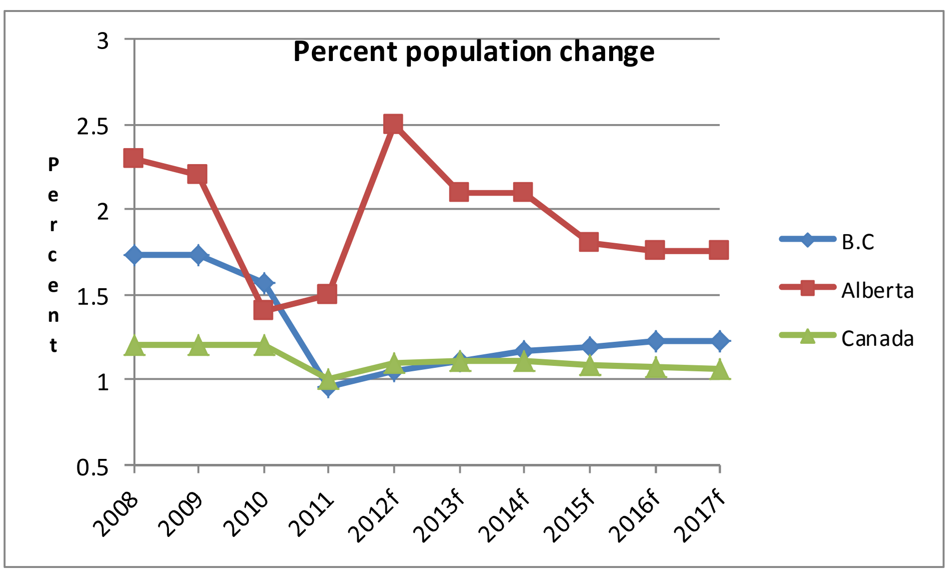
Unemployment

The unemployment rate for the month ended April 2013, was 6.8% for the Vancouver metropolitan area, and 6.4% for BC, compared to the national rate of 7.2%. We are expecting the unemployment rate to decrease in 2013, and 2014, as the economy strengthens.

Source: Statistics Canada

Population

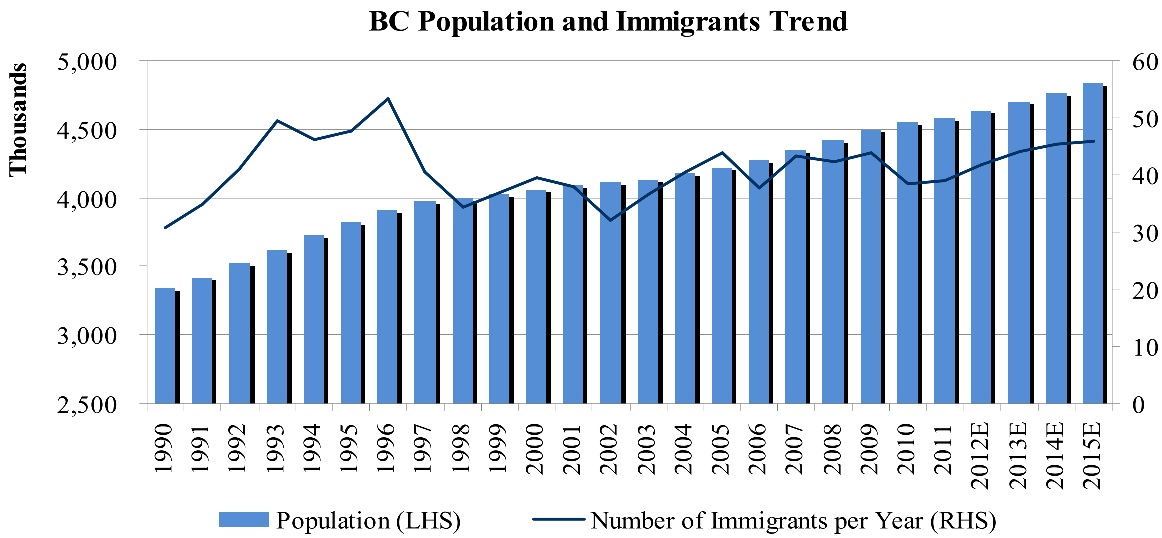
One of the main drivers of housing demand is population growth; the higher the population growth, the more the demand for housing units and mortgages. **Over the period 2006-2011, the population of Greater Vancouver increased by 9.3%; outpacing the national growth rate of 5.9%.** Interprovincial migration and immigration are fueling the higher population growth as compared to the Canadian average. With the forecasted population increasing in Bancorp's key operating areas, real estate demand should be stable. The following shows YOY growth in the population from 2008, along with forecasts through 2017.



Source: Statistics Canada

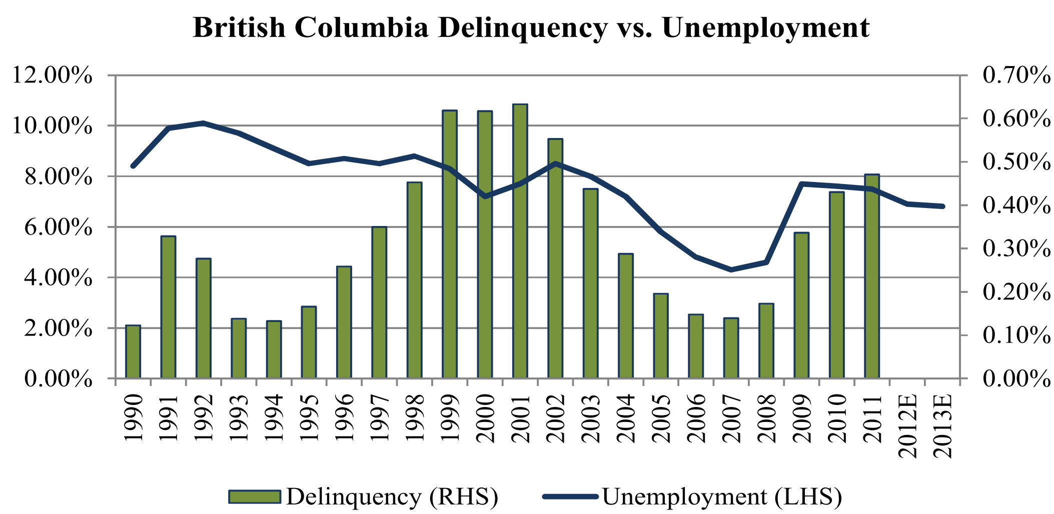
Immigration

Net international migration to both Alberta and British Columbia is set to be on the rise over the next few years. BC is third, and Alberta is fourth in Canada for international migration behind Quebec and Ontario. The below shows the immigration trend in BC.



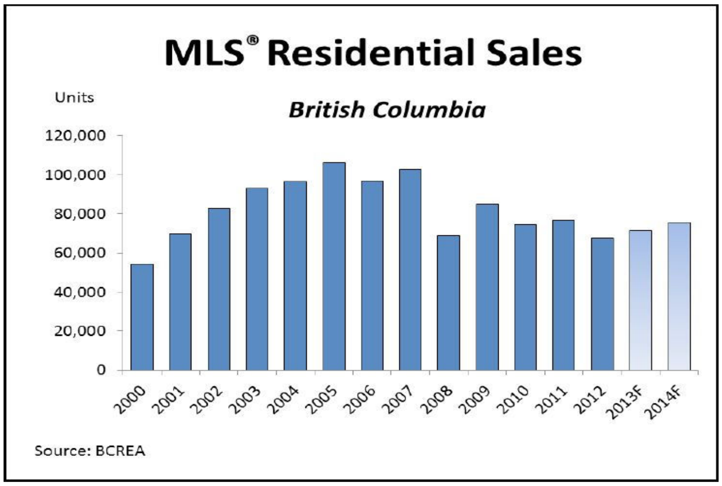
Source: Statistics Canada

Delinquency As can been seen in the chart below, since 2002, mortgage delinquency has been highly linked to the unemployment rate across BC. With the decreasing unemployment rates, defaults are likely to decrease due to the strong correlation between the two.



Source: Statistics Canada and BC Statistics

BC Housing Sales activity slowed in BC in 2012, but is forecasted to recover in the short term (see chart below). BCREA estimates a 3.9% increase in sales activity in 2013, and 6.1% in 2014. The average home price is expected to increase by 3.3%, and 2.2%, in 2013 and 2014, respectively.



Vancouver experienced a substantial sales activity decline of 22.7% in 2012, but is expected to increase by 6.9% in 2013, and 8.5% in 2014 (Source: BCREA). Home prices are expected to increase by 3.6% in 2013, and 1.6% in 2014.

AB Housing

The table below summarizes the key housing market indicators of Alberta:

	2011	2012	2013(E)	2014(E)
GDP (Percentage Change)	5.1	3	2.2	2.8
Employment (Percentage Change)	3.8	2.7	1.8	1.8
Unemployment (%)	5.5	4.6	4.6	4.6
Net Immigration	42,673	85,978	59,600	58,400
Housing Starts (Percentage Change)	25,704 (-5.1)	33,396 (29.9)	32700 (-2.1)	33,100 (1.2)
Residential Resales (Percentage Change)	53,756 (8.1)	60,369 (12.3)	61,600 (2.0)	63,300 (2.8)
Average Residential Resale Price (Percentage Change)	$353,394 (0.3)	$363,208 (2.8)	$347,000 (3.0)	$381,900 (2.1)

* Residential - Single and Multi-Family Units

Source: CMHC (Q2-2013)

Key highlights of the above table are presented below:

- Alberta's **economic growth** will remain above the national average, as **real GDP** is forecasted to rise by 2.2%, and 2.8%, in 2013, and 2014, respectively, as compared to the national average growth of 1.6% and 2.4%, respectively.
- Residential vacancy rates dropped in 2012 primarily because of a record rate of **net immigration** of 85,978 people. Going forward, due to increasing international migration, a net inflow of 59,600, and 58,400, people during 2013, and 2014, respectively, is expected.
- In Q1-2013, the average weekly earnings in Alberta surged by 6% YOY. Also, the **employment situation** is expected to remain strong, at least for the next 2 years. Employment growth is projected at 1.8% p.a., which is higher than national average of 1.3%, for both 2013 and 2014.
- **Housing starts** experienced strong growth of about 30%YOY in 2012.
- The average residential resale price is expected to increase by 3% in 2013, and 2.1% in 2014.

Overall, we believe the economic indicators are strong enough to keep the residential market healthy in the areas BBMFII operates.

Structure of Fund

The following table shows the structure of the fund:

Share Capital	30-Jun-13	% of Total
Common Shares	1,100	
Class D Shares	15,340,938	74%
Class A Shares	2,409,282	12%
Class F Shares	2,923,838	14%
Class E Shares	-	
Total	20,675,158	100%

The fund issues Class D, A, F and E shares. Class D shares are available to investors on a direct purchase basis. Class A shares are sold by investment dealers who receive a trailer fee of 1.0% p.a. (paid by the manager). Class F shares are sold by investment firms who charge a fee to their clients for managing their portfolio. A new class of share, the Class E share, has just been created, primarily targeting exempt market dealers. The manager will pay a sales commission of 1% - 4% at the time of purchase to the dealers/agents for Class E shares.

Class A, D, F and E shareholders have limited voting rights.

Management owns all the common shares which have voting rights. **As of June 2013, management combined, owned 1.31 million Class D shares, which is approximately 6.3% of the total outstanding number of shares (all categories).** Management's ownership is a good sign as it aligns investors and management's interests.

Management fees, paid monthly, associated with the offering is shown below – this is **in**

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line with the average fees in the MIC space, which ranges between 1% and 3% p.a.

	Management Fee (paid monthly)
Class D	1.50% p.a.
Class A	2.00% p..a
Class F	1.00% p.a.
Class E	2.00% p..a

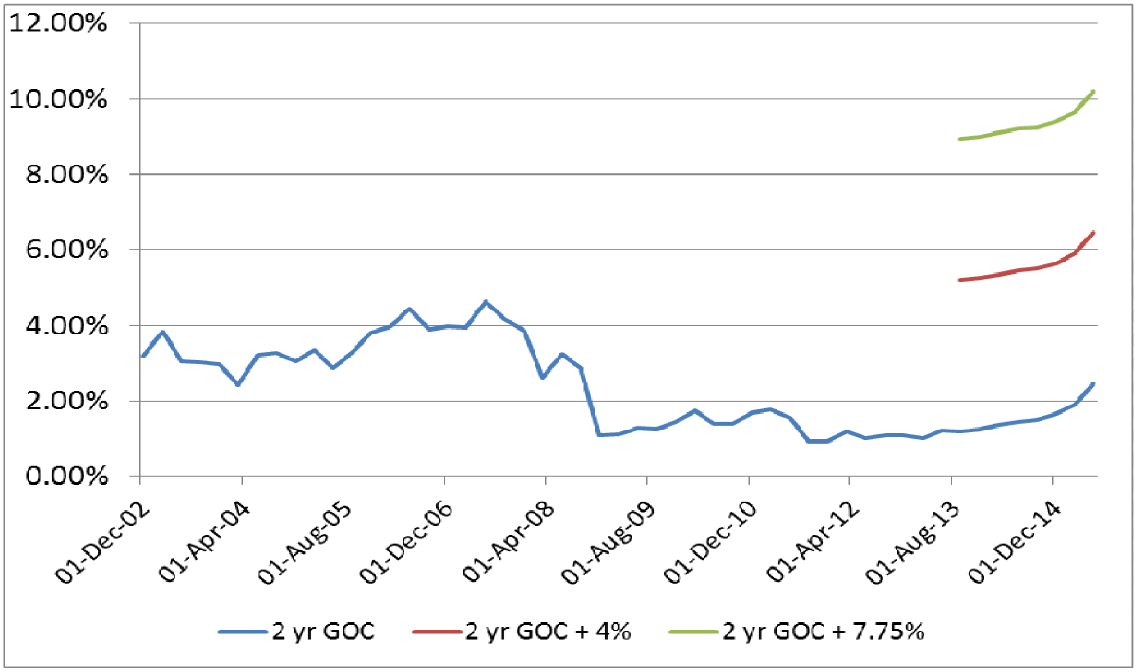
Distributions - The following table shows the target dividends (paid quarterly) for the different classes of shares. Dividends will be paid after the fund's expenses and management fee.

	Dividends (paid annually)
Class D	2-year GOC Bond Yield + 4.0%
Class A	2-year GOC Bond Yield + 3.5%
Class F	2-year GOC Bond Yield + 4.5%
Class E	2-year GOC Bond Yield + 3.5%

Net profits remaining after the priority dividends are paid will be divided 75% investors: 25% to management. The typical incentive fee for MICs is 20%.

A lot of comparable MICs set a fixed preferred return (or priority dividends), instead of the floating structure set by BBMFFI, shown above. We believe a floating structure better aligns management and investors' incentives, as it prevents management from taking additional risk in a low-interest rate environment.

The following table shows the historic 2-year GOC bond yields and their forecasts, along with forecasts for investors' expected priority yields on Class D shares (2 year GOC + 4%), and the average interest rate charged by BBMFII on its loans. The current portfolio has an average interest rate of 8.78%, which is approximately 7.75% above the 2 year GOC bond yields. We assumed the premium will stay the same going forward.



Source: Bank of Canada and FRC

Redemption – Redemption with notice period of 60 days is possible subject to availability of funds. Redemptions will not be allowed if – *a) the number of holders of shareholders would be less than 20 after redemptions, b) the company ceases to qualify as a MIC, c) as a result of redemptions, one holder of shares, or a related group of holders of any class of shares, would hold more than 25% of the outstanding shares.*

The redemption price will be reduced by 5% of the original issuance price if redeemed in less than a year, by 3.5% if between 1 and 2 years, by 2.5% if between 2 and 3 years, and by 0% if redeemed after 3 years. The fund has waived such reductions for shares redeemed after a year of their issuance for Class A, D and F shares purchased before March 28, 2013.

The company paid out $0.71 million in 2012, and $0.25 million in 2011, in redemptions.

Financials The following table shows a summary of the company's income statements since inception.

Income Statement YE - December 31	2010	2011	2012	2013 (6M)*
Revenue				
Interest Income	$709,118	$1,263,398	$1,599,194	$865,763
Total Revenue	**$709,118**	**$1,263,398**	**$1,599,194**	**$865,763**
Expenses				
Accounting and Legal	$14,998	$38,943	$30,633	$19,352
Interest + Bank Charges	$1,941	$24,309	$30,561	$13,448
Management Fee	$143,430	$250,744	$308,472	$164,101
Office and Misc	$2,941	$11,086	$11,747	$9,512
Performance Incentive	$25,956	-	$48,332	$37,493
Share Issue Cost	$6,819	$8,887	$5,461	$900
Total	**$196,085**	**$333,969**	**$435,206**	**$244,806**
Income from Operations	**$513,033**	**$929,429**	**$1,163,988**	**$620,957**
Dividends	$512,968	$929,429	$1,163,988	$558,791
Net Income	**$65**	-	-	62,166

**Unaudited*

Revenues grew from $0.71 million in 2010, to $1.60 million in 2012. Net Income before dividends grew from $0.51 million in 2010, to $1.16 million in 2012.

Interest income as a percentage of mortgage receivables dropped from 9.42% in 2010, to 8.30% in 2012. The dividend yield (dividends as a percentage of invested capital) also dropped accordingly from 6.94% to 6.46%; the drop in yields is in line with the drop in lending rates post-recession. **As shown in the table below, dividend yields have been higher than priority returns in every period.**

% of Mortgage Receivable	2010	2011	2012	2013 (6M) - Annualized
Interest Income	9.42%	8.64%	8.30%	8.65%
Less:				
Management Fee	1.91%	1.71%	1.60%	1.64%
G&A Expenses	0.26%	0.51%	0.38%	0.42%
Net	**7.25%**	**6.41%**	**6.32%**	**6.59%**
** Expenses do not include Performance Incentive and Share Issue Costs*				
Dividends (% of Invested Capital)	6.94%	6.66%	6.46%	6.15%
2-year GOC	1.55%	1.30%	1.09%	1.10%
2-year GOC + 4%	5.55%	5.30%	5.09%	5.10%

- *Note that the above figures may be slightly different from the figures reported by Bancorp due to the difference in the method of calculation.*

Management anticipates the fund will generate a yield of 6.00% - 6.75% for Class D shares in 2013.

The following table shows a summary of the company's balance sheet.

Balance Sheet YE - December 31	2009 (January 1, 2010)	2010	2011	2012	2013-Q2*
Assets					
Cash	$27,770	$430,544	-	-	$1,762,217
Prepaid Expense	$0	$6,648	$10,895	$13,270	$16,093
Interest Receivable	$28,116	$91,651	$113,343	$155,565	$137,788
Mortgages Receivable (Current)	$3,582,143	$10,081,410	$14,684,794	$20,590,723	$16,772,605
	$3,638,029	**$10,610,253**	**$14,809,032**	**$20,759,558**	**$18,688,703**
Morgages Receivable	$0	$1,392,281	$3,097,500	$150,000	$2,518,510
Total Assets	**$3,638,029**	**$12,002,534**	**$17,906,532**	**$20,909,558**	**$21,207,213**
Liabilities					
Bank Indebtedness	$0	$0	$966,087	$354,083	-
Accounts Payable	$2,600	$7,801	$20,561	$18,767	$11,003
Dividends Payable	$34,252	$353,291	$583,936	$723,820	$394,483
Due to Fund Manager	$412,130	$43,410	$22,908	$75,850	$64,403
	$448,982	**$404,502**	**$1,593,492**	**$1,172,520**	**$469,889**
Class A, D & F Shares	$3,188,047	$11,597,032	$16,313,029	$19,735,938	$20,674,058
Class C Shares	$1,000	$1,000	$11	$1,100	$1,100
Retained Earnings					$62,166
Total Shareholders Equity+Liabilities	**$3,638,029**	**$12,002,534**	**$17,906,532**	**$20,909,558**	**$21,207,213**

* *Unaudited*

Total loans issued increased from $3.58 million at the end of FY2009, to $20.74 million at the end of 2012. The fund's cash position can vary from time to time as loans are paid out and new loans are funded. This is indicated by the high cash position of $1.76 million at the end of Q2-2013, and nil cash at the end of 2012.

Line of credit – The company has a $3 million (prime + 1.5%) line of credit from CIBC. This debt facility allows the company to borrow at lower rates than the cost of the shares. The line of credit requires the company to maintain a tangible net worth (defined as retained earnings + total shares issued) of $7 million at all times. At the end of June 2013, nil amount was withdrawn from this facility. The company intends to keep the amount withdrawn from this facility below 25% of the total mortgages outstanding.

The following table shows the expected yield of the Class D shares, assuming no debt or defaults.

Capital Raised (gross)	**$100.00**
Sales Commission	$0.00
Capital Deployed	$100.00
Interest Revenue (8.8% p.a.)	**$8.80**
Management Fee (1.5% p.a. of Investors' Capital)	-$1.50
Other Expenses (0.5% of Capital Deployed)	-$0.40
Defaults (0.0% of Capital Deployed)	$0.00
Net	**$6.90**
Investors Yield (priority dividends + profit share) *	*6.45%*

* assumes 2-year GOC - 1.10%

The sensitivity of expected yields to various factors is shown below:

Sensitivity					
Default Rate (%)	0.00%	1.00%	2.00%	3.00%	4.00%
Investors' Yield	**6.45%**	**5.70%**	**4.90%**	**3.90%**	**2.90%**
% of Capital Deployed	60.00%	70.00%	80.00%	90.00%	100.00%
Investors' Yield	**3.54%**	**4.38%**	**5.19%**	**5.82%**	**6.45%**
Lending Rate (% p.a.)	6.00%	7.00%	8.00%	9.00%	10.00%
Investors' Yield	**4.10%**	**5.10%**	**5.85%**	**6.60%**	**7.35%**

Risk

The following, we believe, are the key risks associated with this investment:

- Shareholders' principal and quarterly distributions are not guaranteed.
- Redemptions are based on availability of cash and management discretion.
- Investments are exposed to credit risks. Investments are also exposed to interest rate risks, but they are minimal as most of the investments are short-term investments with fixed rates.
- The company is not restricted from investing in second mortgages; note that the second mortgages will not exceed 75% LTV.
- Timely deployment of capital is critical
- The manager is paid 25% of income over priority returns ; this is an incentive for the management to acquire mortgages with high interest rates; however, mortgages with higher interest rates carry higher default risk.
- BBMFII's loans are interest only loans (paid monthly), which has higher risk than a 'principal + interest' payment structure.
- The fund currently utilizes a $3 million line of credit to bridge mortgage funding; but leverage can increase the exposure of the fund to negative events.

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Conclusion **Based on our review of the returns/risk features of the offering, we have assigned an overall rating of 2-, and a risk rating of 3 on BBMFII.**

FRC Rating	
Expected Annual Yield	6.00% - 6.50%*
Rating	2-
Risk	3

**Based on the current BoC overnight rate of 1%*

Fundamental Research Corp. Rating Scale:

Rating – 1: Excellent Return to Risk Ratio
Rating – 2: Very Good Return to Risk Ratio
Rating – 3: Good Return to Risk Ratio
Rating – 4: Average Return to Risk Ratio
Rating – 5: Weak Return to Risk Ratio
Rating – 6: Very Weak Return to Risk Ratio
Rating – 7: Poor Return to Risk Ratio
A "+" indicates the rating is in the top third of the category, A "-" indicates the lower third and no "+" or "-" indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk)
2 (Below Average Risk)
3 (Average Risk)
4 (Speculative)
5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	0%	Risk - 1	0%
Rating - 2	25%	Risk - 2	0%
Rating - 3	50%	Risk - 3	33%
Rating - 4	4%	Risk - 4	42%
Rating - 5	4%	Risk - 5	0%
Rating - 6	0%	Suspended	24%
Rating - 7	0%		
Suspended	17%		

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