

**DÉCIMO SEGUNDO FIDEICOMISO DE
BONOS DE PRÉSTAMOS HIPOTECARIOS**
(Twelfth Mortgage Backed Notes Trust)
(With Banco La Hipotecaria, S.A.
acting as Fiduciary)
(Panama, Republic of Panama)

Financial Statements

December 31, 2018

(With Independent Auditors' Report Thereon)

"This document has been prepared with the knowledge that its content will be made available to the public investors and general public."

(FREE ENGLISH LANGUAGE TRANSLATION
FROM SPANISH VERSION)

DÉCIMO SEGUNDO FIDEICOMISO DE BONOS DE PRÉSTAMOS HIPOTECARIOS
(With Banco La Hipotecaria, S. A., acting as Fiduciary)
(Panama, Republic of Panama)

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FREE ENGLISH LANGUAGE TRANSLATION FROM SPANISH VERSION

INDEPENDENT AUDITORS' REPORT

To the Fiduciary
Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios

Opinion

We have audited the financial statements of Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios ("the Trust") with Banco La Hipotecaria, S. A. acting as Fiduciary ("the Fiduciary"), which comprise the statement of financial position as at December 31, 2018, the statements of income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Décimo Fideicomiso de Bonos de Préstamos Hipotecarios with Banco La Hipotecaria, S. A. acting as Fiduciary as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Trust in accordance with International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Panama and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Allowance for loan losses
See Notes 4(c), 6 and 8 to the financial statements

Key audit matter	How the key matter was addressed in our audit
<p>The allowance for loan losses in loans at amortized cost requires the use of judgments and subjective assumptions made by the Fiduciary for the construction of expected credit loss model ('ECL'). The loan portfolio represents 97% of the Trust's total assets. The allowance for loan losses comprised the ECL as a result of the loan rating model and the mechanism to determine the probability of default of the loan according to the impairment stage in which it is assigned.</p> <p>The model to estimate the ECL is composed of estimates of the probability of default, loss given default, prospective analysis and exposure to default.</p> <p>The evaluation of whether or not a significant increase in the credit risk of the loans has been presented entails the application of important judgments in those methodologies. This is a challenge from an audit perspective due to the complexity in estimating the components used to perform these calculations and the application of Fiduciary's judgment.</p>	<p>Our audit procedures, considering the use of specialists, included:</p> <ul style="list-style-type: none"> • We assessed the key controls over delinquency calculations, internal customer risk ratings, accuracy review of customer and model information and the methodologies used. • For individual allowance model, a test of the cash flows calculation considering the value of the collateral in reference to specialists developed valuations. • Tests of the key inputs used in to calculate the collective impairment allowance model. • We assessed the judgments applied by management on assumptions related to the current conditions of the economy and the considerations on the prospective analysis that could change the level of ECL, based on our experience and knowledge of the industry. • Assessment of the delinquency profiles for mortgage and personal loans. • An independent assessment was made of the inputs used in the methodology, and a recalculation was carried out for the ECL estimation model. • The methodology applied by the Fiduciary in the ECL model were assessed in accordance with IFRS 9 Financial Instruments, through the inspection of policies, manuals and methodology documented and approved by the Fiduciary.

Responsibilities of Fiduciary for the Financial Statements

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

In preparing the financial statements, the Fiduciary is responsible for assessing the Trust's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Fiduciary and/or Trustees either intends to liquidate the Trust or to cease operations, or has no realistic alternative but to do so.

La Hipotecaria (Holding), Inc. (the 'Trustee'), is responsible for overseeing the Trust's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fiduciary's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Fiduciary.
- Conclude on the appropriateness of the Fiduciary's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Trust's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Trust to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Fiduciary regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provided the Fiduciary with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Fiduciary, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Jorge Castrellon.

KPMG (SIGNED)

Panama, Republic of Panama
March 29, 2019

DECIMO SEGUNDO FIDEICOMISO DE BONOS DE PRÉSTAMOS HIPOTECARIOS
(with Banco La Hipotecaria, S. A., acting as Fiduciary)
(Panama, Republic of Panama)

Statement of Financial Position

For the year ended December 31, 2018

(Stated in Balboas)

<u>Assets</u>	<u>Note</u>	<u>2018</u>	<u>2017</u>
Cash in banks	7	434,171	482,020
Residential mortgage loans, net	6, 8	50,469,333	55,382,741
Accrued interest receivable		56,421	57,898
Total residential mortgage loans at amortized cost		<u>50,525,754</u>	<u>55,440,639</u>
Accounts receivable		1,127,271	1,604,251
Foreclosed assets for sale		0	45,773
Total assets		<u>52,087,196</u>	<u>57,572,683</u>
<u>Liabilities and Equity</u>			
Liabilities:			
Bonds payable	9, 13	49,475,691	55,454,828
Accrued interest payable	10, 13	213,171	251,488
Total bonds payable at amortized cost		<u>49,688,862</u>	<u>55,706,316</u>
Accounts payable	13	2,392,025	1,861,367
Total liabilities		<u>52,080,887</u>	<u>57,567,683</u>
Equity:	2, 4		
Trust equity		5,000	5,000
Adjustment on initial application of IFRS 9		1,309	0
Total equity		<u>6,309</u>	<u>5,000</u>
Total liabilities and equity		<u>52,087,196</u>	<u>57,572,683</u>

The statement of financial position should be read along with the accompanying notes which are an integral part of the financial statements.

DÉCIMO FIDEICOMISO DE BONOS DE PRÉSTAMOS HIPOTECARIOS**(with Banco La Hipotecaria, S. A., acting as Fiduciary)**

(Panama, Republic of Panama)

Statement of Income

For the year ended December 31, 2018

(Stated in Balboas)

	<u>Note</u>	<u>2018</u>	<u>2017</u>
Interest income:			
Loans		3,048,251	3,200,906
Deposits in banks		1,212	1,284
Total interest income		<u>3,049,463</u>	<u>3,202,190</u>
Interest expense on bonds	13	<u>2,188,895</u>	<u>2,309,831</u>
Net interest income before provision		<u>860,568</u>	<u>892,359</u>
Provision for loan losses		<u>578</u>	<u>0</u>
Net interest income after provision		<u>859,990</u>	<u>892,359</u>
Oter income		38,422	30,464
Operating expenses:			
Commissions	2, 13	874,012	896,454
Other		24,400	26,369
Total operating expenses		<u>898,412</u>	<u>922,823</u>
Excess of income over expenses		<u><u>0</u></u>	<u><u>0</u></u>

The statement of income should be read along with the accompanying notes which are an integral part of the financial statements.

DECIMO SEGUNDO FIDEICOMISO DE BONOS DE PRÉSTAMOS HIPOTECARIOS
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Statement of Changes in Equity

For the year ended December 31, 2018

(Stated in Balboas)

	<u>2018</u>	<u>2017</u>
Trust equity		
Balance at December 31, 2017	5,000	5,000
Adjustment on initial application of IFRS 9	<u>1,309</u>	<u>0</u>
Balance at December 31, 2018	<u><u>6,309</u></u>	<u><u>5,000</u></u>

The statement of changes in equity should be read along with the accompanying notes which are an integral part of the financial statements.

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Statement of Cash Flows

For the year ended December 31, 2018

(Stated in Balboas)

	<u>2018</u>	<u>2017</u>
Operating activities:		
Adjustments to reconcile cash		
from operating activities:		
Provision for loan losses	578	0
Interest income	(3,049,463)	(3,202,190)
Interest expense	2,188,895	2,309,831
Changes in operating assets and liabilities:		
Residential mortgage loans	4,914,139	4,837,810
Accounts receivable	476,980	(45,465)
Accounts payable	530,658	525,242
Foreclosed assets	45,773	0
Cash generate from operations:		
Interest paid	3,050,940	3,205,981
Interest received	(2,227,212)	(2,403,719)
Cash flows from operating activities	<u>5,931,288</u>	<u>5,227,490</u>
Financing activities:		
Payments of bonds payable	(5,979,137)	(6,258,042)
Cash flows from financing activities	<u>(5,979,137)</u>	<u>(6,258,042)</u>
Net decrease in cash	(47,849)	(1,030,552)
Cash at the beginning of the year	<u>482,020</u>	<u>1,512,572</u>
Cash at the end of the year	<u><u>434,171</u></u>	<u><u>482,020</u></u>

The statement of cash flows should be read along with the accompanying notes which are an integral part of the financial statements.

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December 31, 2018

(Stated in Balboas)

(1) Incorporation of the Trust and Fiduciary

La Hipotecaria (Holding), Inc., a company incorporated under the laws of the British Virgin Islands, is the wholly owner of the shares issued with voting rights of Banco La Hipotecaria, S. A., among other companies. Main stockholder of La Hipotecaria (Holding), Inc. is Grupo ASSA, S. A. with a 69.01%.

Banco La Hipotecaria, S. A., (the 'Fiduciary' or 'Manager') (formerly La Hipotecaria, S. A.), was incorporated on November 7, 1996, under the laws of the Republic of Panama. As per resolution S.B.P. N° 120-2010 of June 4, 2010, the Superintendence of Banks of Panama granted a General Banking License to initiate operations officially as a Bank on June 7, 2010. Its principal activity is granting residential mortgages and personal loans, managing and securitizing residential mortgages and personal loans.

The Trust's business in Panama is regulated by the law No.1 of January 5, 1984, and the Executive Decree No.16 of October 3, 1997. In order to support the fiduciary operation, the Bank has government bonds in favor of the Superintendence of Banks with a nominal value of B/.225,000 and a deposit in the Banco Nacional de Panama amounted B/.25,000, both in guarantee for the due compliance of its obligations arising from the Fiduciary License.

By Public Deed of March 3, 2010, La Hipotecaria (Holding) Inc., as Trustor and Trustee and Banco La Hipotecaria S. A. as Fiduciary, constituted the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios (the Trust), with the objectives of, among others, to transfer a portfolio of mortgage loans to a guarantee trust (the 'Guarantee Trust') to support the payment of bonds to be issued by the fiduciary of the Décimo Fideicomiso de Bonos de Préstamos Hipotecarios. BG Trust, Inc. acts as Trustor of the Guarantee Trust, Banco La Hipotecaria, S. A. as the Manager in the Guarantee Trust and Banco General as paying agent.

The Manager, subject to the terms and conditions of the Management Agreement, is required to manage, for and on behalf of the fiduciary of the Guarantee Trust, the mortgage loans, including the setting up and operating the administrative and operating accounts, pay ordinary expenses and determine principal and interest payments of the bonds, among other duties. This Trust started its operations on July 2014.

The main office of the Fiduciary and Manager is located on Vía España, Plaza Regency, 13th floor, Panama City.

The issuance of these financial statements were authorized by the Manager of the Trust on March 29, 2019.

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(2) General Terms of the Trust

Below are presented the most important terms of the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios:

- The Equity of the Trust is an initial contribution of the Trustor of B/.5,000, and any other real estate or fixed asset, tangible or of any other nature, that from time to time be transferred in trust by the Trustor, or by third parties, to the Fiduciary.
- The Fiduciary may issue and sell mortgage loan bonds through a public offering up to the amount of seventy five million dollars (US\$75,000,000), legal currency of the United States of America; buy mortgage loans to Banco La Hipotecaria, S. A. with funds generated by the sale of mortgage loans bonds and, under these activities, exercise all the functions and responsibilities of the issuer of securities and mortgagee.
- The mortgage loan bonds will be issued in denominations of B/.1,000 or multiples of that amount, nominative and registered, without coupons attached, in two (2) series. The Bonds will be registered with the Superintendence of Securities Market in Panama and will be sold in initial public offerings through the Stock Exchange of Panama.
- The mortgage loans bonds will be secured solely by the assets of the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios and by the Guarantee Trust constituted by the Fiduciary of the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios, acting as Trustor and BG Trust, Inc. as Fiduciary of the Guarantee Trust, for the benefit of the bondholders whose assets are primarily mortgage loans.
- The Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios will use the proceeds from the placement of bonds mainly to pay to Banco La Hipotecaria, S. A. the agreed price for the transfer of residential mortgages or be able to pay that price through the issuance and delivery of the bonds to Banco La Hipotecaria, S. A.
- The Fiduciary of the Guarantee Trust shall exercise all the rights and actions granted as mortgagee and enter with a third party, an administration and servicing contract for the mortgage loans.
- The maturity of the mortgage loan bonds will be November 24, 2042 or the maturity date of the last mortgage loan, whichever occurs first. The Trust may make partial principal payments monthly on bonds of Series A, and once fully amortized Series A bond's principal will deliver the principal payments for Series B bonds, and once fully amortized Series B bond's principal will deliver the principal payments for Series C bonds.

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(2) General Terms of the Trust, continued

- The commission received by the Fiduciary for the management of the Trust is calculated on the basis of zero point forty five percent of one hundred (0.45%) per annum of the unpaid principal balance of the mortgage loans, payable monthly. The commission received by the Fiduciary of the Guarantee Trust will be calculated based on an annual eighth of one percent (0.125%) of the unpaid principal balance of the mortgage loans, payable monthly. The commission received by the Paying Agent of the Trust will be calculated based on an annual sixteenth of one percent (0.0625%) of the unpaid principal balance of the mortgage loans, payable monthly.
- During the year ended December 31, 2018, the Trust had paid in fees the amount of B/.340,467 (2017: B/.372,161) to the Fiduciary, the Guarantee Trust's Fiduciary and Paying Agent, recognized as commissions in the statement of profit or loss.

Besides the management fee, the Manager will receive as compensation for the services provided under the Administration Agreement the amounts debtors pay monthly as expenses for management under the terms of the loan agreements. In addition to the management fee and commission described above, the manager is entitled to receive (a) from the insurance companies any compensation agreed upon from time to time for the management of insurance policies, (b) the fees paid by customers regarding the renewal or restructuring of its loans agreements and (c) the penalties charged in connection with the late payment of mortgage loans. This commission will be paid directly to the manager by insurance companies or customers, as appropriate.

Ordinary expenses such as administrative expenses, secretarial, accounting, stationery, communications and post, incurred by the manager in the ordinary course of their obligations under the Administration Agreement will be borne by the Manager.

The Trust will remain in effect until the residential mortgage bonds issued and outstanding are redeemed and mortgage loans have been paid in full or have been transferred by the Trust; or if the Trust is terminated by mutual agreement.

La Hipotecaria (Holding) Inc., Banco La Hipotecaria, S. A., BG Trust, Inc., and their respective shareholders, subsidiaries or affiliates do not guarantee or be liable for the obligations of the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios including payment of mortgage loan bonds.

Subject to the terms of the Administration Agreement that establishes a priority of payments of the funds available, Banco La Hipotecaria S. A., in its capacity as Issuer Fiduciary may receive from the Trust a commission equivalent up to forty-five basis points (0.45%) per annum of the unpaid principal balance of the mortgage loans, accrued monthly and payable according to the availability of funds and in accordance with the conditions established in the Administration Agreement and other Agreement Documents. At December 31, 2018, the Trust had not paid the Fiduciary for this concept.

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(2) General Terms of the Trust, continued

Subject to the terms of the Administration Agreement that establishes a priority of payments of the funds available, Banco La Hipotecaria S. A., as Manager may receive monthly from the funds in trust an incentive for timely collection equivalent to the amount of funds available after meeting with all other obligations established in the Issuer Trust, and payable only if funds are available and in accordance with the conditions established in the Administration Agreement and other Agreement Documents. At December 31, 2018, the Trust had not paid the Manager, incentive fees for timely collection.

The income of the Trust allowed to register for the payment of these fees an amount of B/.2,362,378 (2017: B/.1,821,660) under accounts payable in the statement of financial position.

(3) Basis of Preparation

(a) *Statement of Compliance*

The financial statements have been prepared in conformity with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

(b) *Basis of Measurement*

The financial statements were prepared based on their historical cost.

(c) *Functional and Presentation Currency*

The financial statements are presented in Balboas (B/.), the monetary unit of the Republic of Panama, which is at par and freely exchangeable with the United States of America Dollar (US\$). The Republic of Panama doesn't issue its own paper currency and, instead, the dollar (US\$) of the United States of America is used as legal tender. The functional currency of the Trust is the Balboa.

(4) Summary of Significant Accounting Policies

Except for changes explained in Note 4(a.2), Note 4(e), Note 4(d) and Note 4(g), the accounting policies detailed below have been consistently applied by the Trust for all periods presented in these financial statements.

(a) *Financial Assets and Liabilities*

(a.1) *Recognition*

The Trust initially recognizes loans and receivables, and debt instruments issued on the date on which they are originated or date of settlement.

(a.2) *Classification*

Financial Assets – Policy applicable from January 1, 2018

The Trust classifies its financial assets as subsequently measured at amortized cost (AC), fair value through other comprehensive income (FVOCI), and at fair value through profit or loss (FVTPL), based on the business models of the Trust for the management of these financial assets and in accordance with their contractual cash flow characteristics.

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(4) Summary of Significant Accounting Policies, continued

A financial asset is measured at AC if it meets both of the following conditions and is not designated as at FVTPL:

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

A debt instrument is measured at FVOCI only if it meets both of the following conditions and has not been designated as a FVTPL:

- the asset is held within a business model which objective is achieved by both collecting contractual cash flows and selling financial assets; and;
- the contractual terms of the financial asset give rise on specific dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Trust may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis. All other financial assets are classified as measured at FVTPL.

Additionally, on the initial recognition, the Trust may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Trust makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. Those include, whether Trust's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- The risks affecting the performance of the business model (and the financial assets held in the business model) and the way in which such risks are managed.

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(4) Summary of Significant Accounting Policies, continued

Assessment of whether the contractual cash flows are solely payments of principal and interest

For the purpose of this assessment, "principal" is defined as the fair value of the financial asset at the time of initial recognition. "Interest" is defined as the consideration of the time value of money and the credit risk associated with the amount of the principal amount outstanding during a particular period of time and for other basic lending risk and costs (i.e. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payment of principal and interest, the Trust considers the contractual terms of the instrument. This includes whether the financial asset contains a contractual term that could change the timing or amount of the contractual cash flows such that it would not meet this condition.

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after changes are made to the business model for managing financial assets.

Financial assets – Policy applicable before January 1, 2018

The Trust classified its financial assets into the 'loans and receivables' category.

Financial liabilities

The Trust classifies its financial liabilities as measured at amortized cost.

(a.3) Derecognition of financial assets and financial liabilities

Financial assets

The Trust derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Trust neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

The guarantee on the transferred asset is measured as the lower between the original book value of the asset and the maximum amount of the consideration that the Trust could be obliged to pay.

DÉCIMO SEGUNDO FIDEICOMISO DE BONOS DE PRÉSTAMOS HIPOTECARIOS

(With Banco La Hipotecaria, S. A., acting as Fiduciary)

(Panama, Republic of Panama)

Notes to the Financial Statements

(4) Summary of Significant Accounting Policies, continued

Financial liabilities

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

(a.4) Modification of financial assets

Financial assets

If the terms of a financial asset are modified, then the Trust evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognized and a new financial asset is recognized at fair value.

(a.5) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Trust currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions, such as those derived from financial instruments held for trading.

(b) Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Trust has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Trust measures fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active, if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Trust uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

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(4) Summary of Significant Accounting Policies, continued

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Trust determines that the fair value on initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price. Subsequently, that difference is recognized in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

The Trust recognizes transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(c) Impairment

Policy applicable from January 1, 2018

The Trust recognizes loss allowances for 'expected credit loss' (ECL) on the following financial instruments that are not measured at FVTPL:

- Loans receivable.

The Trust measures loss allowances at an amount equal to lifetime ECL, except for other financial instruments on which credit risk has not increased significantly since their initial recognition, for which they are measured as 12-month ECL.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within 12 months after the reporting date.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- Financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Trust expects to receive);
- Financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows.

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(4) Resumen de Políticas de Contabilidad más Importantes, continuación

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Trust assesses whether financial assets carried at amortized cost are credit-impaired. A financial asset is 'credit impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as default or past due event;
- the restructuring of a loan or advance by the Trust on terms that the Trust would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for more than 180 days is considered credit-impaired.

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(4) Summary of Significant Accounting Policies, continued

Presentation of the allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at AC: as a deduction from the gross carrying amount of the assets; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

Write-off

Loans receivable are written off (either partially or in full) when there is no reasonable expectation of recovering in its entirety or a portion thereof. This is generally the case when the Trust determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off.

Financial assets that are written-off could still be subject to enforcement activities in order to comply with the Trust's procedures for recovery of amounts due.

Policy applicable before January 1, 2018

The Fiduciary assesses at each date of the statement of financial position whether there was objective evidence of impairment in a loan or loan portfolio. The amount of losses on certain loans during the period was recognized as an allowance for loan's impairment in the statement of profit or loss and increases an account allowance for impairment. The allowance was presented deducted from loans receivable in the statement of financial position. When a loan is determined to be uncollectible, the recoverable amount was deducted from the allowance account.

Impairment losses were determined using two methodologies to determine whether an objective evidence of impairment exists, individually for the loans that were significant individually and collective for loans that were not individually significant.

- *Individually Assessed Loans*

Impairment losses on individually assessed loans were determined on an evaluation of the exposures on a case by case basis. If it was determined that no objective evidence of impairment exists for an individually significant loan, it was included in a group of loans with similar characteristics and were collectively assessed for impairment. The impairment loss was calculated by comparing the current value of the expected future cash flows, discounted at the original effective interest rate of the loan, against its current carrying value. Any loss was recognized as an allowance for impairment in the statement of profit or loss. The carrying amount of impaired loans was reduced through the use of an allowance account.

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(4) Summary of Significant Accounting Policies, continued

- *Collectively Evaluated Loans*

For the purposes of a collective evaluation of impairment, consumer loans were grouped on the basis of similar credit risk characteristics. Those characteristics were relevant to the estimate of future cash flows for groups of such assets. Future cash flows in a group of loans that were collectively evaluated for impairment were estimated on the basis of the contractual cash flows of the assets in the group, the historical loss experience for assets with similar credit risk characteristics to those in the group and management's experienced judgment as to whether the current economy and credit conditions were such that the actual level of inherent losses was likely to be greater or less than the suggested historical experience. Default rates, loss rates and expected time for future recoveries were regularly compared with the real results to ensure they still appropriate.

- *Reversal of Impairment*

If, in a subsequent period, the amount of the impairment loss decreases and the decrease could be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss was reversed by reducing the allowance for impairment account. The amount of any reversal was recognized in the statement of profit or loss.

- *Renegotiated or Restructured Loans*

Loans that have been renegotiated or restructured were the ones that a renegotiation or restructuration has been made because of impairment in the borrower's financial condition, and when the Fiduciary considers granting a change in the terms of the credit.

(d) Loans

Loans are non-derivative financial assets with fixed determinable payments that are not quoted in the active market, and are generally originated by providing funds to debtors and the Trust does not intend to sell immediately or in the near term.

Loans are presented at amortized cost considering the principal amount and the interest receivable, less the loss allowance for ECL. The loans are measured initially at its fair value plus those incremental direct transaction costs; subsequently at their amortized cost using the effective interest rate method.

(e) Allowance for Expected Credit Loss

The allowance for 'expected credit loss' (ECL) is constituted to cover the losses derived from the Trust's credit granting process, inherent to the loan portfolio measured at AC, applying the model of ECL. Increases in the reserve for ECL is recognized with a charge to the statement of profit or loss. Write-offs are deducted from the reserve and subsequent recoveries are added. The reserve is also reduced for reversions with charges to profit or loss.

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(4) Resumen de Políticas de Contabilidad más Importantes, continuación

The losses allowance for ECL attributed to financial assets measured at AC is presented as a deduction from their gross carrying amount.

The Trust measures ECL as a way to reflect: (a) an unbiased probability-weighted estimate determined by assessing a range of possible outcomes; b) the value of money over time; and c) reasonable and sustainable information about past events, current conditions and forecasted future economic conditions, that is available without disproportionate cost or effort at estimation date.

The model of ECL reflects the general pattern of deterioration or improvement in the credit quality of financial assets. The amount of ECL recognized as a reserve or provision depends on the degree of credit deterioration since its initial recognition. The model of ECL have two measurement criteria:

- 12-month ECL (stage 1), which applies to all financial assets (on initial recognition), provided that there is no significant impairment in their credit quality, and
- Lifetime ECL (stages 2 and 3), which applies when the credit risk of the financial assets has increased significantly individually or collectively. In stages 2 and 3 interest income is recognized. In stage 2 (as well as in stage 1), there is a complete dissociation between the recognition of interest and impairment, and the interest income is calculated on the gross amount in books. In stage 3, is when the financial assets becomes impaired.

The allowance for ECL includes a specific active component and a component based on a formula. The specific active component, or of specific assignment, refers to the allowance for losses in financial assets considered impaired and assessed individually, case by case. A specific allowance is recognized when the discounted cash flows (or observable fair value of collateral) of the financial asset is less than the book value of that asset. The second component, which is based on a formula, covers the credit portfolio of the Trust classified as 'normal' and is determined through a process that estimates the probable loss inherent to the portfolio, based on Fiduciary's statistical analysis and qualitative judgment. This analysis takes into account the complete information that incorporates not only default data, but other relevant credit information, such as prospective macroeconomic information.

In order to determine whether there has been a significant increase in the credit risk of the financial asset, the assessment is based on quantitative and qualitative information. The Trust considers the following factors, although not exhaustive, in measuring the significant increase in credit risk:

- a) Significant changes in credit risk indicators as a result of a change in credit risk from the beginning;
- b) Significant changes in the value of collateral that supports the obligation.

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(4) Summary of Significant Accounting Policies, continued

As a cap, the Trust considers that a significant increase in credit risk occurs no later than when an asset has more than 180 days past due, for mortgage loans. The days due are determined by counting the number of days elapsed since the oldest due date with respect to which the total payment has not been received. The due dates are determined without considering any grace period that may be available to the debtor.

The Trust monitors the effectiveness of the criteria used to identify significant increases in credit risk through periodic reviews to confirm that:

The balances of the allowances for ECL are calculated by applying the following formula:

$$\text{ECL} = \sum (\text{EAD} \times \text{PD} \times \text{LGD}); \text{ in where:}$$

- Exposure at default (EAD): represents the expected exposure in the event of a default. The Trust derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract arising from amortization. The EAD of a financial assets is its gross carrying amount at the time of default.
- Probability of default (PD): represents the probability that a client does not comply with the total and timely payment of its credit obligations within a one-year horizon. The estimated PD for a period of 12 months is adjusted by the loss identification period to estimate the probability of default.

The probability of default of one year applied to the portfolio for expected losses less than 12 months and during the life-time for expected losses greater than 12 months, are based on the historical performance of the Trust's portfolio by credit grade category. The resulting default rates are supplemented by the probabilities of default obtained from an International Risk Rating Agency.

- Loss given default (LGD): is the magnitude of the likely loss if there is a default, which estimation uses a factor based on historical information.

(f) Debt Securities Issued

The Trust classifies the debt securities as financial liabilities, according to the substance of the contractual terms of the instrument. They are initially measured at fair value less incremental direct transaction costs, and subsequently are measured at amortized cost using the method of effective interest rate.

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(4) Summary of Significant Accounting Policies, continued

(g) Interest Income and Expense

Policy applicable from January 1, 2018

Effective interest rate

Interest income and expense are recognized in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortized cost of the financial liability.

When calculating the effective interest rate for financial instruments other than credit-impaired assets, the Trust estimates future cash flows considering all contractual terms of the financial instrument, but not the ECL. For credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or a financial liability.

Amortized cost and gross carrying amount

The 'amortized cost' of a financial asset or a financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The 'gross carrying amount of a financial asset' is the amortized cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the financial asset (when the asset is not credit-impaired) or to the amortized cost of the financial liability.

For the financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortized cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

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(4) Resumen de Políticas de Contabilidad más Importantes, continuación

Presentation

Interest income calculated using the effective interest rate method presented in the statement of profit or loss and the statement of OCI includes:

- Interest on financial assets and financial liabilities measured at amortized cost.

Policy applicable before January 1, 2018

Interest Income and Expense

Interest income and expenses are generally recognized in the statement of income for all financial instruments measured at amortized cost using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. When calculating the effective interest rate, the Trust estimates cash flows considering all the contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Transaction costs are origination costs, directly allocated to the acquisition, issuance or deposition of an asset or liability.

(c) Foreclosed assets for sale

Foreclosed assets for sale are recognized at the lower of carrying value of the outstanding loans and the estimated realizable market value of the properties. Management has judged necessary, as applicable, to maintain a reserve against any significant impairment loss affecting the properties unsold. The provision for impairment is recognized in the statement of profit or loss.

(d) New International Financial Reporting Standards (IFRS) and Interpretations not yet Adopted

IFRS 16 "Leases". On January 13, 2016, IFRS 16 "Leases", which replaces the current, IAS 17 "Leases" was issued. IFRS 16 eliminates classification of leases either as operating leases or finance leases for the lessee. Instead, all leases are recognized similarly to finance leases under IAS 17.

Leases are measured at the present value of future lease payments and are presented as either leased assets (right of use assets) or along with property, furniture and equipment.

IFRS 16 is effective for annual periods beginning on or after January 1, 2019, and due to the nature of the financial operations performed by the Trust, the Fiduciary has assessed that the adoption of this standard would not have a significant impact on the Trust's financial statements.

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(5) Use of Estimates and Judgments in Applying Accounting Policies

The Fiduciary prepares the Trust's financial statements in accordance with International Financial Reporting Standards. It has applied judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses during the period. Actual results may differ from these estimates.

The assumptions and decisions are continuously evaluated and are based on the historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Fiduciary evaluates the selection, disclosures and application of critical accounting policies in the mayor uncertain estimates. The information related to the presumptions and estimates that affect the reported amounts of assets and liabilities under the next fiscal year, and critical judgments in the selection and application of the accounting policies detailed as follows:

(a) *Classification of financial assets*

When determining the classification of financial assets, the Fiduciary uses its judgment to evaluate the business model within which the assets are held and whether the contractual terms of the financial asset are only payments of the principal, and interest on the outstanding principal amount.

(b) *Impairment of financial instruments*

The Fiduciary reviews the Trust's financial assets at each reporting date to determine whether the credit risk on the financial asset has increased significantly since the initial recognition.

(6) Financial Risk Management

A financial instrument is any contract that originates a financial asset in one entity and a financial liability or equity instrument in another entity. The statement of financial position is comprised mainly of financial instruments.

The Fiduciary of the Trust has the responsibility to establish and monitor the risk management policies of the financial instruments. For this purpose, it has established certain controls for the management and periodic monitoring of the risks to which the Trust is exposed.

These instruments expose bondholders to various types of risks. The main risks identified by the Fiduciary are credit, market and liquidity risks.

(a) *Credit Risk*

Is the risk that the debtor, issuer or counterpart of a financial asset owned by the Trust does not fully and timely comply with any payment due to the Trust, in conformity with the agreed upon terms and conditions, when the financial asset was acquired or originated by the Trust.

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(6) Financial Risk Management, continued

This risk is also conceived as a deterioration in the credit quality of the counterparty, the collateral and/or the initially agreed collateral.

The Fiduciary of the Trust meets in a monthly basis to evaluate the credit profiles of customers who have fallen into arrears during the month immediately preceding the date of the meeting.

The purpose of this meeting is to assess trends and customer behaviors that have fallen into arrears and make the necessary arrangements based on credit policies of the manager.

Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortized cost. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

	2018			2017
	Stage 1	Stage 2	Stage 3	
	12 month- ECL	Lifetime ECL (not credit impaired)	Lifetime ECL (credit impaired)	Total
Loans:				
A1, 2 - Normal or low fair risk	49,786,605	0	0	49,786,605
B1 – Watch list	338,570	0	0	338,570
B2 – Substandard	0	90,505	0	90,505
C1, 2 – Doubtful	0	63,589	0	63,589
D – Loss	0	0	193,601	193,601
Gross amount	50,125,175	154,094	193,601	50,472,870
Allowance for impairment loss	(995)	(663)	(1881)	(3,537)
Loans, net	50,124,180	153,433	191,720	50,469,333
Accrued interest receivable	56,421	0	0	56,421
Total loans at amortized cost	50,180,601	153,433	191,720	50,525,754
				55,440,639

The Trust maintains collaterals on loans granted to customers for mortgages on properties. The estimation of the collateral's fair value is based in the market value; at inception date of the mortgage and generally they are not updated except if the credit is individually impaired.

As of December 31, 2018, the estimated value of the collateral mortgage on properties amounted to B/.75,454,917 (2017: B/.79,714,717) and covered 100% (2017: 100%) of the portfolio's exposure.

Trust's mortgage loans are concentrated geographically in the Republic of Panama.

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(6) Financial Risk Management, continued

Deposits placed with Banks

At December 31, 2018, the Trust held deposits placed with banks for B/.434,171 (2017: B/.482,020). These deposits are held with a financial institution that is rated BBB+, based on Fitch Ratings Inc

Residential mortgage loans

The table below stratifies credit exposures from mortgage loans by ranges of 'loan-to-value' (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination.

<u>LTV Ranges</u>	<u>2018</u>	<u>2017</u>
0-20%	231,705	156,891
21-40%	1,632,164	2,025,751
41-60%	3,960,050	3,562,287
61-80%	31,835,652	28,347,842
81-100%	<u>12,813,299</u>	<u>21,294,240</u>
Total	<u>50,472,870</u>	<u>55,387,011</u>

The Trust does not update its collateral valuation routinely. The appraisals on the collaterals are updated for residential mortgage loans when their credit risk becomes significantly impaired and the loan is monitored more closely. For loans assessed and classified as doubtful to recover, appraisals are obtained by the Trust for their collateral, whose value is used as an input for measuring impairment.

Amounts arising from ECL

Significant increase in credit risk

When determining whether the credit risk on a financial instrument has increased significantly, the Trust considers the changes in its risk of default since the initial recognition.

For a financial instrument that incurs an event of default, management will consider the criteria based on the different defaulting stages as established for the implementation of the 'Expected Loss', while evaluating the application of other criteria used in the internal credit risk model, such as 'scoring' of behavior, bureau score and/or qualitative aspects and factors, when appropriate. At each reporting date, the Trust assess whether there is a significant increase in credit risk based on the change in default risk that occurs during the expected life of the credit instrument.

Notes to the Financial Statements

(6) Financial Risk Management, continued

In order to assess whether a significant credit deterioration has occurred, the Trust considers reasonable and sustainable information that is available without disproportionate cost or effort, comparing the default risk that occurs in the financial instrument on the reporting date.

Degree of credit risk for the credit portfolio

The Trust allocates each exposure to a credit risk grade based on the delinquency transitions that the operation generates. These migrations are assigned a 'Probability of Default' (PD) based on the results of 66 transition matrices that were reviewed at 1, 2 and 3 years, which gives a real default rate based on the default level at which the operation is. As explained above, the Trust is in the process of adapting other variables in addition to the actual rate of default, such as behavior scoring, bureau scoring and/or collective factors depending on the economic events that the sectors of the economy can present.

Credit risk grades are defined and calibrated so that risk of default occurring increases exponentially as credit risk deteriorates, for example, the difference in risk of default between credit risk grades 1 and 2 is lower than the difference between credit risk grades 2 and 3.

Each exposure is assigned to a credit risk grade in the initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

Consequently, and according to the risk impairment suffered by each instrument throughout its residual life, the Trust, periodically, from the date of the initial recognition, will establish the differences in the credit risk status in that respect of the one registered in that initial recognition. Depending on the assessment performed, the Trust will assign each instrument to 3 stages (impairment stages):

- Stage 1: Financial instruments with a low credit risk
- Stage 2: Financial instruments with significant impairment of credit risk
- Stage 3: Impaired financial instruments (high credit risk).

The objective of the assignment to different stages of credit risk is to adjust the algorithm for calculating expected losses, in such a way that the losses of the instruments that would have been assigned to Stage 1 will be determined for a horizon of 12 months. The losses for instruments assigned to Stage 2 or 3, will be calculated for the residual life of the instruments, that is, until their maturity or expiration ("lifetime").

The Trust, in the first phase of application of the Standard, while it did not have a structure of internal grades that would allow it to assess the impairment as an alternative, will adopt, as a general criterion, the one established by IFRS 9 in B5.5.17 (p.): "Past due Information, including the rebuttable presumption [...]".

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(6) Financial Risk Management, continued

The foregoing implies that the Trust will use for the assignment the scheme of past-due ranges, according to the following order of grades:

- A1 – Current (without arrears or delinquency) and from 1 to 30 days (normal)
- A2 – Delinquency range from 31 to 60 days (low-fair risk)
- B1 – Delinquency range from 61 to 90 days (watch-list)
- B2 – Delinquency range from 91 to 120 days (substandard)
- C1 – Delinquency range from 121 to 150 days (doubtful)
- C2 – Delinquency range from 151 to 180 days (doubtful)
- D – Delinquency range greater than 180 days (loss)

Generating the term structure of PD

Instrument treatment approach

Given the homogeneity of the profiles of the borrowers that comprise the Trust's credit portfolios, when determining their credit impairment it was established that in a general manner, except for certain exceptions, they will be treated under a collective approach. For practical purposes, this implies that the determined PD and LGD values will be shared collectively, either partially or totally, by all the instruments that participate in each identified segment.

The Trust's instruments present similar risk profiles in relation to the amount of exposure, interest rate, guarantees and other factors within the group to which they belong.

A dispersion statistics (volatility) of the values of such profiles were determined using average values. No instrument of the loan portfolio has been identified to be treated individually by management.

In order to determine the PD of the segments identified, and in the context of the collective treatment of credit portfolios, the Trust will focus the measurement based on the processes denominated 'Markov Chain', through which the probability (conditional) that an instrument, which is at a certain moment in a certain risk category, migrates to another in a time horizon that is also determined. Mathematically, it is expressed as the probability that an event A will occur, given another event B. The Trust's calculation process will determine the probability that an instrument that at the reporting date presents a certain grade will default for a horizon of time.

For the calculation of the PD, transition matrices have been structured that reflect the annual migration of the risk categories of the instruments taken monthly. For structuring the matrix, the historical series of grades of each instrument that makes up each portfolio segment of each country will be used, which will be arranged in historical series of five (5) years for each instrument. With this database, the grade (risk category) of an instrument is compared monthly at the end of a certain month, with the category of that instrument for the same months of different time horizons (1, 2, 3 or more years).

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(6) Financial Risk Management, continued

Through this process, "pairs" of categories corresponding to a historical period of five years will be formed within each segment. Each "pair" represents the risk grade of each instrument for a given month (T) and the same month of the following year (T + 12), the same month as other years (T + 24, T + 36, T + n), depending on the time horizon analyzed. With arranging the matrix pairs and calculating the frequencies of their occurrence, the conditional probability of migration between the current category of risk of the instrument and the category of non-compliance for different time horizons will be obtained.

The Trust uses statistical models to analyze the data collected and generate PD estimates of the remaining life of the exposures and how they are expected to change as a result of the passage of time.

General approach for determining default and refutation of presumptions

The behavior and payment commitment of the clients when it comes to taking care of their home, causes the delinquency of the loans granted by the Trust to be very low when compared to the behavior of other types of loans.

The previous hypothesis is reinforced by the implementation of adequate origination policies and an effective collection strategy. Undoubtedly, another important aspect about its low delinquency, is the high number of clients that pay by 'Direct Discount', which is one of the conditions for the approval of the credits that comprise the Trust's portfolio.

By virtue of the foregoing, to define "default" the different transitions of arrears shown by the credits according to delinquency heights (delinquency ranges) have been analyzed.

As a first approach to the identification of the level of non-compliance, the calculation was made for the height of arrears (by days of arrears) of each one of the operations in each segment made by the Trust, taking as a basis for the historical series of them.

Under this statistical approach, 66 intermediate matrices have been prepared, corresponding to each month for each segment and country between January 2012 and July 2017, containing the monthly roll-rates of delinquency of the Trust's loan portfolio according to their rates of delinquency. From these matrices, 2 matrices with average data were drawn up, corresponding to each credit segment by country, in such a way as to reflect a probability of occurrence of the arrears according to delinquency ranges.

The matrices show the probabilities that an instrument reaches a certain height of default according to the range of delinquency at the beginning of the period in a horizon of 1 year. Also shown are the accumulated percentage of arrears in which the instruments of the segment fall within a horizon of 12 months after the month of the start of the count.

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(6) Financial Risk Management, continued

The values allow to determine the range of delinquency in which it is estimated that the default would occur from a percentage considered as the acceptance limit. Based on this information, the Trust has decided that the default would be established from 180 days for mortgage-backed credit instruments.

The Trust intends to implement or incorporate other variables and elements to complement the PD or actual default rate. These elements may include the incorporation of a behavioral scoring, the incorporation of credit bureau scores and/or collective elements associated with economic situations.

Modification of financial assets

The contractual terms of a loan can be modified for several reasons, including changes in market conditions, customer retention and other factors not related to a current or potential credit impairment of the borrower. An existing loan whose terms have been modified can be derecognized and the renegotiated loan is recognized as a new loan at fair value in accordance with the accounting policy established in Note 4(c).

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects the comparison of:

- the risk of non-compliance for the remaining life based on the modified terms; with
- the risk of non-compliance for the remaining lifetime estimated based on the data in the initial recognition and the original contractual terms.

Impairment definition

The Trust considers that a financial asset is impaired when:

- It is unlikely that the debtor will pay its credit obligations to the Trust in its entirety, without the Trust resorting to actions such as the performance of the guarantees (if applicable); or
- the debtor is over 180 days past-due in mortgage loans;
- Significant changes in credit risk indicators as a consequence of a change in credit risk from the beginning.

When evaluating if a debtor is in default, the Trust considers indicators that are:

- Qualitative – breaches of contractual clauses.
- Quantitative – delinquency status and non-payment of another obligation of the same debtor to the Trust; and based on data developed internally.

The inputs used to assess whether a financial instrument is impaired and its importance may vary over time to reflect changes in circumstances.

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(6) Financial Risk Management, continued

Incorporation of forward-looking information

The incorporation of forward-looking information into the Trust's calculation process for 'Expected Losses' will be made based on the possible impact that could be recorded in the value of those losses, caused by expected changes in the short and medium term of the behavior of macroeconomic variables, that could affect the payment flow of the instruments.

In the Central American region and especially in the country in where the Trust's loans portfolio is geographically concentrated, statistics on macroeconomic aggregates are provided almost exclusively by state statistical agencies, and in practice they constitute the main source of information for obtaining values of macroeconomic indicators. In view of such limitations, the Trust, in order to identify those parameters that could have an impact on the payment behavior of financial instruments, has established that those that complied with at least a series of profiles that made them suitable for this type of measurement would be used; namely those: a) that are regularly available; b) that are accessible to the public in a relatively simple way; b) that are reasonably reliable. While there are no alternative sources to confirm or validate the information indicated in order to have acceptable data for the analysis, it was necessary to select among all the available variables, those that presented the indicated profiles of regularity, accessibility and reliability, and that were:

- a) Inflation (Consumer Price Index or 'CPI')
- b) Unemployment
- c) Social security contributors
- d) Gross Domestic Product (GDP)
- e) Monthly Index of Economic Activity (MIEA)
- f) Past due loan portfolio of the Trust
- g) Past due loan portfolio of the financial system.

The methodology used in the Trust to identify the 'forward-looking' variables (FL) that will participate in the process of incorporation of these to the determination of the 'Expected Losses', is based on the calculation of the Multiple Correlation Coefficient.

The process of defining the most significant variables among the universe of those that are available, consists of the following three steps:

- i. The Multiple Correlation and Explanation coefficients were calculated between the historical series of the annual percentage variations of the value of the Trust's 'Past Due Loan Portfolio' (taken as a dependent variable), and the historical series of the values of the inter-annual variations of GDP, MIEA, Inflation and Unemployment (considered independent variables). This calculation allows to determine if those last ones could explain and/or reasonably infer the possible impacts on the payment behavior of the instruments in the future.

Notes to the Financial Statements

(6) Financial Risk Management, continued

- ii. Once the existence of an acceptable degree of association between these variables was determined, the Trust proceeded to calculate the marginal contribution of each, separately, to the value of the multiple correlation, by neglecting the contribution of each one to the value of that correlation. This is achieved by recalculating the multiple correlation by sequentially eliminating each variable that participates in the original series. The new multiple correlation value after these eliminations, would allow to infer the contribution of each elimination to the originally calculated correlation value.
- iii. Finally, the results were compared with those corresponding to the existing correlation between the Trust's 'Past Due Loans Portfolio' and those of the Financial System of each country, in order to confirm the meaning of the associations.

As a result of the application of the methodology exposed in historical series corresponding to annual periods between 2012 and 2016, the following variable was identified by country and segment:

- Panama – Operations with Guarantees (Unemployment)

The Fiduciary incorporates forward-looking information in its assessment of whether the credit risk of a financial asset has increased significantly since its initial recognition and measurement of estimated credit losses.

Measurement of estimated credit losses (ECL)

The key inputs in the measurement of credit losses are the structure terms of the following variables:

- Probability at Default (PD);
- Loss Given Default (LGD);
- Exposure at Default (EAD).

These parameters are usually derived from internally developed statistical models and other historical data. They are adjusted to reflect the forward-looking information as described above.

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(6) Financial Risk Management, continued

As previously mentioned, for the determination of the PD of the identified segments, and in the context of the collective treatment of the credit portfolios, the Trust will focus the measurement from the processes denominated as 'Markov Chain'. The Trust estimates the PD parameters based on the history of recovery rates of claims against impaired counterparts. The PD models consider the structure, the guarantee, the antiquity of the claim, the counterpart industry and the recovery costs of any guarantee that is integral to the financial asset. For secured loans with properties, LTV ratios are a key parameter for determining the PD.

PD estimation

The calculation of the PD is implemented for each segment identified in each country, and requires comparing the amounts recovered in each of those against the unfulfilled amounts. The convenience of providing information on "closed" cases was established, that is, the data of noncompliance and recoveries will correspond to specific events, whose collection management has been determined as completed by the Trust, either due to the total recovery of the amounts owed or due to justified withdrawal from collection according to approved credit management policies. The final objective of the calculations is to establish the percentage ratio of recoveries over the value of unfulfilled exposures. The following are definitions relevant to the calculation of PD in the Trust.

PD of mortgage operations that have gone through legal process and/or in lieu of payment

For the calculation, a database was used where all the operations for which the Trust has received the asset, have been registered, either by means of in lieu of payment or by adjudication via legal process. This sheet is recorded when the loan starts the process and the good is received until it is sold, or is placed again in the figure of a credit to another customer. The legal expenses and repairs that for the recovery of the asset were incurred by the Trust are also taken into consideration. This will allow calculating the PD of operations received as in lieu payment or via legal process.

Exposure at Default (EAD)

EAD represents the expected exposure in case of default. The Trust determines the EAD of the current exposure of the counterparty and the possible changes in the current amount allowed under the contract, including amortization. The EAD of a financial asset is its gross value in books. For loan commitments and financial guarantees, the EAD includes the amount used, as well as the potential future amounts that may be used from the contract, which are estimated based on historical observations and forward-looking forecasts. For some financial assets, the EAD is determined by modeling the range of possible exposure outcomes at various points in time using scenarios and statistical techniques.

The EAD is the amortized cost of the exposed balances. The Trust determines the annual EAD over the remaining life of the instruments for subsequent weighting due to the respective marginal annual default probability.

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(6) Financial Risk Management, continued

At the Trust, the value of the nominal annual EAD will be calculated from the projection of the balances at amortized cost of the instruments. To calculate the EAD, the Trust periodically performs a projection of the amortization tables of the loans of each segment until their cancellation. Based on the above, the annual average of the residual (projected) capital balances is obtained annually, a value that is used as the annual EAD exposure projected for the life of the instruments. Finally, those balances are discounted at the annual effective rate.

Aggrupation is subject to periodic review to ensure that exposures within a particular group remain appropriately homogenous.

(b) Liquidity Risk:

The liquidity risk is defined as the inability of the Trust to comply with all its obligations because of, among other reasons, the impairment of the quality of the loans portfolio, the devaluation of securities, the excessive concentration of liabilities from one particular source, a gap between assets and liabilities, a shortage of asset liquidity, or financing of long-term assets with short-term liabilities.

Liquidity Risk Management

The Trust mitigates its liquidity risk, according to their maturity structure of liabilities for periods compatible with the maturities of its assets.

The table below analyzes the undiscounted cash flows of the financial assets and liabilities of the Trust, with respect to the contractual maturity date.

<u>2018</u>	<u>Carrying amount</u>	<u>Gross nominal (outflow)/inflow</u>	<u>Up to 1 year</u>	<u>From 1 to 5 years</u>	<u>From 5 to 10 years</u>	<u>More than 10 years</u>
Financial liabilities:						
Bonds payable at amortized cost	49,688,862	(60,877,603)	(6,446,006)	(21,153,461)	(17,834,871)	(15,443,265)
Total financial liabilities	<u>49,688,862</u>	<u>(60,877,603)</u>	<u>(6,446,006)</u>	<u>(21,153,461)</u>	<u>(17,834,871)</u>	<u>(15,443,265)</u>
Financial assets:						
Cash in Banks	434,171	434,171	434,171	0	0	0
Loans at amortized cost	50,525,754	83,959,256	4,527,339	17,771,968	21,423,969	40,235,980
Total financial assets	<u>50,959,925</u>	<u>84,393,428</u>	<u>4,961,510</u>	<u>17,771,968</u>	<u>21,423,969</u>	<u>40,235,980</u>
<u>2017</u>	<u>Carrying amount</u>	<u>Gross nominal (outflow)/inflow</u>	<u>Up to 1 year</u>	<u>From 1 to 5 years</u>	<u>From 5 to 10 years</u>	<u>More than 10 years</u>
Financial liabilities:						
Bonds payable at amortized cost	55,706,316	(60,792,310)	(6,446,959)	(21,126,854)	(20,402,600)	(12,815,897)
Total financial liabilities	<u>55,706,316</u>	<u>(60,792,310)</u>	<u>(6,446,959)</u>	<u>(21,126,854)</u>	<u>(20,402,600)</u>	<u>(12,815,897)</u>
Financial assets:						
Cash in Banks	482,020	482,020	482,020	0	0	0
Loans at amortized cost	55,440,639	96,777,290	4,771,667	19,019,420	21,509,072	51,477,131
Total financial assets	<u>55,922,659</u>	<u>97,259,310</u>	<u>5,253,687</u>	<u>19,019,420</u>	<u>21,509,072</u>	<u>51,477,131</u>

Loans receivables for B/.50,472,870 (2017: B/.55,387,011) are totally pledge as guarantee of the bonds payable issued by the Trust.

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(6) Financial Risk Management, continued

(c) Market Risk:

It is the risk that the value of a financial asset is reduced as a result of changes in interest rates, in monetary exchange rates, stock prices and other financial variables, as well as the reaction of market participants to political and economic events.

The Trust has no assets nor liabilities in other currencies different to its functional currency, therefore the Trust has no exchange rate risk.

Cash Flow's Interest Rate Risk

The interest rate risk of the cash flow is the risk of fluctuation of the future cash flows and the value of a financial instrument due to changes in market interest rates. The interest rate risk of the fair value is the risk of fluctuation of a financial instrument's value due to changes in interest market rates.

The Fiduciary reviews monthly performance of interest rates of assets and liabilities, measures the impact of mismatch on the results of the Trust and takes appropriate measures to minimize negative impact on the financial results of the Trust.

The basic analysis carried out every month by management consists in determining the impact caused on financial assets and liabilities by increases or decreases of 25 and 50 basis points in interest rates, considering as a premise, the minimum rate of 0.005% in cases that their results yield negative values to raise the actual values. The impact is summarized as follows:

	Increase of <u>25 bp</u>	Decrease of <u>25 bp</u>	Increase of <u>50 bp</u>	Decrease of <u>50 bp</u>
Sensitivity of projected net <u>interest income</u>				
2018	2,493	(2,493)	4,986	(4,986)
2017	3,686	(3,686)	7,373	(3,592)
Sensitivity of projected net <u>equity</u>				
2018	2,493	(2,493)	4,986	(4,986)
2017	3,686	(3,686)	7,373	(3,592)

The Trust mitigates significantly its exposure to the effects of fluctuations in interest rates, as a result of which the rates of the assets and the rates of its liabilities are variable and respond to the market movement.

(d) Capital management:

As of December 31, 2018, the Trust held primary capital of B/.6,309 (2017: B/.5,000). La Hipotecaria (Holding) Inc., Banco La Hipotecaria S. A., BG Trust, Inc., and their respective shareholders, subsidiaries or affiliates do not guarantee or are liable for the obligations, residual profits or losses of the Décimo Segundo Fideicomiso de Bonos de Préstamos Hipotecarios including the payment of mortgage loan bonds. According to the terms and conditions of the Trust, in case of financial loss, the bondholders may be affected in the payment of interest and principal.

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(7) Cash in Banks

As of December 31, 2018, the Trust held savings accounts at a local bank, with a balance of B/.434,171 (2017: B/.482,020) bearing interest from 0.25% to 0.75% (2017: 0.25% to 0.75) per annum on the average balance.

(8) Residential Mortgage Loans

The group of mortgages which comprised the Trust consists of 2,476 (2017: 2,625) residential mortgage loans, whose original disbursements amounted on B/.67,818,889 (2017: B/.71,676,679), which at December 31, 2018 had an outstanding principal balance of B/.50,472,870 (2017: B/.55,387,011). The residential mortgage loans that comprise the Trust's portfolio have maturities from April 22, 2019 to October 8, 2043.

As of December 31, 2018, residential mortgage loans are detailed as follows:

	<u>2018</u>	<u>2017</u>
Residential mortgage loans	50,472,870	55,387,011
Allowance for impairment loss	<u>(3,537)</u>	<u>(4,270)</u>
Loans, net	50,469,333	55,382,741
Accrued interest receivable	<u>56,421</u>	<u>57,898</u>
Loans at amortized cost	<u><u>50,525,754</u></u>	<u><u>55,440,639</u></u>

At December 31, 2018, mortgage loans under the law of preferred interests according the reference rates published by the Superintendence of Banks of Panama, bear interests ranging from 0.25% a 5.50% (2017: 0.25% a 5.50%) and the mortgage loans that are not under the law of preferred interests ranges from 5.75% al 8.25% (2017: 5.50% a 9.00%); however, the Trust has the option to adjust these rates.

(8) Residential Mortgage Loans, continued

The following table shows the reconciliation from the opening to the closing balance of the loss allowance for ECL related to the loan portfolio. Comparative amounts for 2018 represent the allowance account for credit losses and reflect the measurement basis under IAS 39.

	<u>2018</u>				
	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>		
	<u>12 month ECL</u>	<u>Lifetime ECL (not credit impaired / collectively assessed)</u>	<u>Lifetime ECL (credit impaired / individually assessed)</u>	<u>Total</u>	<u>2017</u>
Balance at January 1	760	1,320	881	2,961	4,270
- Transfer to Stage 1	1,987	(1,150)	(837)	0	0
- Transfer to Stage 2s	(264)	484	(220)	0	0
- Transfer to Stage 3	0	(1,745)	1,745	0	0
- Net remeasurement of loss allowance	(1,108)	1,974	896	1,762	
- Financial instruments that have been derecognized	(380)	(220)	(586)	(1,186)	0
Balance at December 31	995	663	1,879	3,537	4,270

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(9) Bonds Payable

As of December 31, 2018, the bonds payable amounted to B/.49,475,691 (2017: B/.55,454,828).

On July 29, 2014, the Trust issued two series of mortgage bonds for a total of B/.75,000,000: Series A mortgage bonds with a par value of B/.68,250,000, Series B mortgage bonds for B/.6,000,000 and Series C mortgage bonds for B/.750,000. These bonds were issued in nominative form and registered without coupons attached, in amounts of B/.1,000 or multiples of that amount. The maturity of the bonds are November 24, 2042 or the maturity of the last mortgage loan, whichever occurs first.

The interest rate established for mortgage bonds is as follows:

Series A Bonds: Series A bonds' interest rate is indexed to the reference rate published by the Superintendence of Banks of Panama less 1.6% annually, but in any case it is subject to a minimum interest rate of 0.642% annually (the "Series A's Interest Rate"). At December 31, 2018, the interest rate paid was 3.90% (2017: 3.65%).

Series B Bonds: Series B bonds bear interest on a rate indexed equal to the reference rate published by the Superintendence of Banks during the period plus 0.75%, but in any case it is subject to a minimum interest rate of 0% annually (the "Series B's Interest Rate"). At December 31, 2018, the interest rate paid was 6.25% (2017: 6.00%).

Series C Bonds: Series C bonds bear interest on a rate indexed equal to the reference rate published by the Superintendence of Banks during the period plus 4.0% annually, but in any case it is subject to a minimum interest rate of 0% annually (the "Series C's Interest Rate"). At December 31, 2018, the interest rate paid was 9.50% (2017: 9.25%).

The Series A bonds' principal and interest payment have priority over the principal and interest payments of Series B bonds, the Series B bonds' principal and interest payment have priority over the principal and interest payments of Series C bonds

As of December 31, 2018, the balance of Series A bonds payable is B/.42,725,691 (2017: B/.48,704,827), B/.6,000,000 (2017: B/.6,000,000) for Series B bonds and B/.750,000 (2017: B/.750,000) Series C bonds.

(10) Interest Payable

As of December 31, 2018, the bonds payable amounted to B/.213,171 (2017: B/.251,488).

The Trust kept interest payable on the Series A bonds for B/.138,858 (2017: B/.86,000), interest payable on Series B bonds for B/.57,292 (2017: B/.30,000) and interest payable on Series C bonds for B/.17,021 (2017: B/.17,344).

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(11) Preferred Interest on Mortgage Loans

According to current tax regulations in Panama, financial institutions that grant mortgage loans not exceeding B/.120,000 with preferred interest, receive an annual benefit of a tax credit through a resolution granted by the General Revenue Department of Panama. From July 2010 under the Law 8 of March 15, 2010 which supersedes Article 6 of Law 3 of 1985, the benefit of a tax credit for the first ten (10) years, is increased to the first fifteen (15) years for new loans, for an amount equal to the difference between the income that the lender would have received if there collected the market's interest rate in effect during that year, and the revenue actually received as interest in relation to each such preferred mortgage loans.

The Law 3 of May 1985 of the Republic of Panama, establishes that the tax credit could be used for the payment of national taxes, including the income tax. The tax credit under the Law 11 of September 1990, which extends the previous law, and the Law 28 of June 1995, establishes that the tax credit could be only for the payment of income tax. Whether the financial entity in any fiscal year could not use all of its tax credits, then could use the exceeding credit during the next three years, at its preference, or transfer it complete or in part to another taxpayer.

The Trust recorded preferred interest income on the residential mortgage loans for B/.1,557,106 (2017: B/.1,602,286).

Once this amount is recognized by the tax authority, a tax credit is recorded and could be used for income tax payments up to 100% of the tax debt, according to tax regulations in Panama. During the year ended on December 31, 2018, the Trust sold tax credits of the previous year for B/.2,085,984 (2017: B/.1,282,116), generating an income of B/.38,422 (2017: 20,692). At December 31, 2018, the tax credit to be recognized in account receivable in the statement of financial position, amounted to B/.1,127,270 (2017:1,604,251).

(12) Taxes

The Trust is subject to the general regime for the determination and payment of the income tax of the Republic of Panama according to Article 699 of the Tax Code, which establishes an income tax of 25% on the one that is greater among the following two calculations:

- the net taxable income calculated by the traditional method; or
- the net taxable income that results from applying to the total of taxable income, the four point sixty-seven percent (4.67%) (method known as the 'alternative calculation' or 'CAIR' for its acronym in Spanish).

The income tax returns of the companies incorporated in the Republic of Panama are subject to examination by the local tax authorities for the last three years, including the year ended December 31, 2018.

As of December 31, 2018 and 2017, the Trust did not generate taxable income, for that reason it did not incur expenses on income tax.

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(12) Taxes, continued

The Fiduciary will submit an application for non-application CAIR on the results of the period 2018, since the Trust is created so as not to generate profits or losses according to its structure. Once the application for non-application of CAIR is submitted, it will be in the process of approval by the tax authorities.

According to current tax law are not considered taxable gains or deductible losses from the sale of bonds for the purpose of income tax, dividend tax and complementary tax, as long as the securities have been issued by a person registered with the Superintendence of Market Securities. The interest paid to bondholders will be exempt from income tax as long as they are authorized by the Superintendence of Market Securities and to be placed in primary public offering through a stock exchange duly established and licensed to operate in the Republic of Panama.

(13) Transaction with the Fiduciary

The Trust has incurred in transactions in the ordinary course of business with its Fiduciary. At December 31, 2018, the following were the balances and aggregate results regarding these transactions:

	<u>2018</u>	<u>2017</u>
Bonds payable	<u>8,306,470</u>	<u>8,524,287</u>
Interest payable	<u>81,363</u>	<u>109,740</u>
Accounts payable	<u>2,362,378</u>	<u>1,821,660</u>
Interest expense on bonds	<u>535,038</u>	<u>497,840</u>
Commissions	<u>773,875</u>	<u>805,383</u>

(14) Fair Value of Financial Instruments

The fair value of financial assets and financial liabilities that are traded in active markets are based in quoted prices in this markets or quotes from market participants. For every other financial instrument, the Trust determine fair values using other valuation techniques.

For financial instruments that are traded infrequently and have little price information available, the fair value is less objective, and its determination requires the use of varying degrees of judgment dependent on liquidity, concentration, uncertainty of market factors, assumptions in the determination of prices and other risks affecting the specific instrument.

The Trust measures the fair value using the following levels of hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities to which the Trust may access at the measurement date.

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(14) Fair Value of Financial Instruments, continued

- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Other valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist and other valuation models. The assumptions and inputs used in valuation techniques include free reference rate risk, credit spreads and other assumptions used in estimating discount rates.

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

The fair value and carrying amount of financial assets and liabilities not measured at fair value are as follows:

	<u>Carrying</u> <u>amount</u>	<u>2018</u> <u>Fair</u> <u>value</u>	<u>Carrying</u> <u>amount</u>	<u>2017</u> <u>Fair</u> <u>value</u>
Financial assets:				
Loans, net	<u>50,469,333</u>	<u>53,926,002</u>	<u>55,382,741</u>	<u>59,107,432</u>
Financial liabilities:				
Bonds payable	<u>49,475,691</u>	<u>55,594,180</u>	<u>55,454,828</u>	<u>56,648,239</u>

As of December 31, 2018, these instruments are classified as level 3 if the fair value hierarchy, based on the inputs and valuation techniques used.

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(14) Fair Value of Financial Instruments, continued

The table below describes the valuation techniques and inputs data used in fair value measurements of financial instruments not measured at fair value classified in level 3:

Financial instruments	Valuation Techniques and Data Used Posts
Residential mortgage loans	The fair value of loans represents the discounted amount of estimated future cash flows to be received. Provided cash flows are discounted at current market rates to determine fair value.
Bonds payable	The fair value of mortgage loan bonds payable represents the discounted cash flow at current market rates.

(15) Changes in Accounting Policies

Except for the changes detailed below, the Trust has consistently applied the accounting policies established in Note 4 to all the periods presented in these financial statements.

IFRS 9 – Financial Instruments

The Trust has adopted IFRS 9 Financial Instruments issued in July 2014 with an initial application date of January 1, 2018. The requirements of IFRS 9 represent a significant change in IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes in the accounting of financial assets and in certain aspects of the accounting of financial liabilities.

The key changes in the Trust's accounting policies resulting from its adoption of IFRS 9 are summarized below:

Classification of financial assets and financial liabilities

IFRS 9 contains three main categories of classification for financial assets: measured at amortized cost (AC), fair value with changes in other comprehensive income (FVOCI), and fair value through profit or loss (FVTPL). The classification of IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing categories of IAS 39 from held-to-maturity, loans and accounts receivable and securities available for sale. Under IFRS 9, derivatives implicit in contracts where the host is a financial asset within the scope of the standard never diverge. In contrast, the complete hybrid instrument is evaluated for classification. See Note 4, for an explanation of how the Trust classifies its financial assets according to IFRS 9.

IFRS 9 retains to a large extent the requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all changes in the fair value of the liabilities designated under the fair value option were recognized in profit or loss, in accordance with IFRS 9, changes in fair value are generally presented as follows:

- the amount of the change in fair value attributable to changes in the credit risk of the liability is presented in other comprehensive income, and
- the remaining amount of change in fair value is presented in profit or loss. See Note 4, for an explanation of how the Trust classifies its financial liabilities according to IFRS 9.

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(15) Changes in Accounting Policies, continued

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The new impairment model also applies to certain loan commitments and financial guarantee contracts, but not to equity investments.

According to IFRS 9, credit losses are recognized before than according to IAS 39. See Note 4, for an explanation of how the Trust applies the impairment requirements of IFRS 9.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retroactively, except as described below.

- The comparative periods have not been restated. Differences in carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings and accumulated reserves as of January 1, 2018. Consequently, the information presented for 2017 does not reflect the requirements of IFRS 9 and, therefore, is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made based on the facts and circumstances that existed on the date of the initial application:
 - The determination of the business model within which a financial asset is maintained.

For more information and details about the changes and the implications resulting from the adoption of IFRS 9, see Note 16.

IFRS 15 – Revenue from Contracts with Customers

The Trust has adopted IFRS 15 *Revenue from Contracts with Customers* since January 1, 2018, the date of its entry into force.

According to the assessment carried out by the Trust on the requirements of IFRS 15, this standard has no impact on its accounting policies for revenue recognition, given that the income of the Trust is earned from financial instruments under the scope of IFRS 9.

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Notes to the Financial Statements

(16) Financial Assets and Financial Liabilities

Classification of financial assets and financial liabilities

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments:

<u>December 31, 2018</u>	<u>Amortized cost</u>	<u>Total carrying amount</u>
<u>Financial assets</u>		
Cash in Banks	434,171	434,171
Loans at amortized cost	50,525,754	50,525,754
Total financial assets	<u>50,959,925</u>	<u>50,959,925</u>
<u>Financial liabilities</u>		
Bonds payable at amortized cost	49,688,862	49,688,862
Total financial liabilities	<u>49,688,862</u>	<u>49,688,862</u>
 <u>December 31, 2017</u>	 <u>Amortized cost</u>	 <u>Loans and receivables</u>
<u>Financial assets</u>		<u>Carrying amount</u>
Cash in Banks	0	482,020
Loans at amortized cost	0	55,440,639
Total financial assets	<u>0</u>	<u>55,922,659</u>
<u>Total financial liabilities</u>		
Bonds payable at amortized cost	55,706,316	0
Total financial liabilities	<u>55,706,316</u>	<u>0</u>

Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Trust's financial assets and liabilities as at January 1, 2018.

	<u>Original classification under IAS 39</u>	<u>New classification under IFRS 9</u>	<u>Original carrying amount under IAS 39</u>	<u>New carrying amount under IFRS 9</u>
<u>Financial assets:</u>				
Cash in Banks	Loans and receivables	Amortized cost	482,020	482,020
Loans at amortized cost	Loans and receivables	Amortized cost	55,440,639	55,441,948
			<u>55,922,659</u>	<u>55,923,968</u>
<u>Financial liabilities:</u>				
Bonds payable at amortized cost	Amortized cost	Amortized cost	55,706,316	55,706,316
			<u>55,706,316</u>	<u>55,706,316</u>

The Trust's accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 4.

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(16) Financial Assets and Financial Liabilities, continued

The following table reconciles the carrying amount under IAS 39 to the carrying amounts under IFRS on transition to IFRS 9 on 1 January 2018

	IAS 39 carrying amount December 31, 2017	Reclassification	Remeasurement	IFRS 9 carrying amount January 1, 2018
Financial assets				
Amortized cost				
Cash in Banks:				
Opening balance	482,020	0	0	482,020
Closing balance	<u>482,020</u>	<u>0</u>	<u>0</u>	<u>482,020</u>
Loans:				
Opening balance	55,440,639	0	0	55,440,639
Remeasurement	0	0	1,309	1,309
Closing balance	<u>55,440,639</u>	<u>0</u>	<u>1,309</u>	<u>55,441,948</u>
Total amortized cost	<u>55,922,659</u>	<u>0</u>	<u>1,309</u>	<u>55,923,968</u>
	IAS 39 carrying amount December 31, 2017	Reclassification	Remeasurement	IFRS 9 carrying amount January 1, 2018
Financial liabilities				
Amortized cost				
Bonds payable				
Opening balance	55,706,316	0	0	55,706,316
Closing balance	<u>55,706,316</u>	<u>0</u>	<u>0</u>	<u>55,706,316</u>
Total financial liabilities	<u>55,706,316</u>	<u>0</u>	<u>0</u>	<u>55,706,316</u>

The following table analyzes the impact of the transition to IFRS 9 on equity. The impact related to the first time adoption of IFRS 9. There is no impact on other components of equity.

	Impact of adopting IFRS 9 at January 1, 2018
Adjustment on initial application of IFRS 9	
Closing balance under IAS 39 (December 31, 2017)	0
Recognition of ECL under IFRS 9	1,309
Opening balance under IFRS 9 (January 1, 2018)	<u>1,309</u>

The following table reconciles:

- the closing impairment allowance for financial assets under IAS 39 as at December 31, 2017; to
- the opening ECL allowance determined under IFRS 9 as at January 1, 2018.

	December 31, 2017 (IAS 39)	Reclassification	Reameasurement	January 1, 2018 IFRS 9
Loans and receivables under IAS 39 / financial assets at amortized cost under IFRS 9	4,270	0	(1,309)	2,961
Total	<u>4,270</u>	<u>0</u>	<u>(1,309)</u>	<u>2,961</u>