FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2009

FRONTENAC MORTGAGE INVESTMENT CORPORATION

DECEMBER 31, 2009

CONTENTS

Auditors' Report

Raymond Chabot Grant Thornton LLP
2505 St-Laurent Blvd.
Ottawa, Ontario K1H 1E4

Telephone: 613-236-2211
Fax: 613-236-6104
www.rcgt.com

To the Shareholders of
Frontenac Mortgage Investment Corporation

We have audited the statements of net assets and investment portfolio of Frontenac Mortgage Investment Corporation as at December 31, 2009 and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position and investment portfolio of the Company as at December 31, 2009, and the results of its operations, change in net assets and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2008 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 24, 2009 (except as to Note 11 dated on July 30, 2009).

Raymond Chabot Grant Thornton LLP

Chartered Accountants,
Licensed Public Accountants

Ottawa, Canada
March 24, 2010

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF NET ASSETS

AS AT DECEMBER 31, 2009

	2009	2008
ASSETS		
Cash	$ 206,651	$ 11,776
Temporary investments (Note 5)	50,239	53,294
Accrued interest receivable	158,497	125,573
Accounts receivable	66,030	-
Mortgages (Note 6)	28,083,274	23,017,150
Prepaid expenses	7,190	7,187
	28,571,881	23,214,980
LIABILITIES		
Bank line of credit (Note 7)	$ 265,000	$ 330,000
Accounts payable and accrued expenses	30,920	13,077
Prepaid mortgage payments	123,115	-
	419,035	343,077
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY	$ 28,152,846	$ 22,871,903
NET ASSETS PER SHARE	$ 30.00	$ 30.00

APPROVED ON BEHALF OF THE BOARD:

_______________________________ Director

_______________________________ Director

The accompanying notes are an integral part of these financial statements.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2009

	2009	2008
INTEREST INCOME	$ 2,464,219	$ 2,337,590
EXPENSES		
Administration fees (Note 9)	542,186	451,102
Audit fees	26,175	15,225
Director fees	19,774	21,329
General and operating expenses	195,424	167,327
Interest and bank charges	2,660	16,126
Legal fees	26,735	95,675
Realized losses on mortgages	2,057	71,301
Provision for mortgage losses	157,000	107,000
Trustee fees	-	61,501
	972,011	1,006,586
NET EARNINGS FROM OPERATIONS	$ 1,492,208	$ 1,331,004
WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING	857,591	731,321
NET EARNINGS PER SHARE	$ 1.74	$ 1.82

The accompanying notes are an integral part of these financial statements.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED DECEMBER 31, 2009

	2009	2008
NET ASSETS, beginning of year	$ 22,871,903	$ 19,966,602
Increase in net assets from operations	1,492,208	1,331,004
Share capital transactions		
Proceeds from issuance of shares	4,752,960	2,545,148
Reinvested distributions	1,492,208	1,331,004
Cost of shares redeemed	(964,225)	(970,851)
	5,280,943	2,905,301
Distributions to shareholders		
Dividends to shareholders	(1,492,208)	(1,331,004)
NET ASSETS, end of year (Note 10)	$ 28,152,846	$ 22,871,903

The accompanying notes are an integral part of these financial statements.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF CASH FLOW

FOR THE YEAR ENDED DECEMBER 31, 2009

	2009	2008
CASH FROM OPERATING ACTIVITIES		
Net earnings from operations	$ 1,492,208	$ 1,331,004
Items not requiring an outlay of cash:		
Provision for mortgage losses	157,000	107,000
Net changes in non-cash items:		
(Increase) in accrued interest receivable	(32,924)	(10,704)
(Increase) in accounts receivable	(66,030)	-
(Increase) in prepaid expenses	(3)	(2,237)
Increase (decrease) in accounts payable and accrued expenses	17,843	(8,167)
Increase in prepaid mortgage payments	123,115	-
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,691,209	1,416,896
FINANCING ACTIVITIES		
Proceeds from issuance of shares	4,752,960	2,545,148
Decrease in bank line of credit	(65,000)	(710,000)
Redemption of common shares	(964,225)	(970,851)
NET CASH PROVIDED BY FINANCING ACTIVITIES	3,723,735	864,297
INVESTING ACTIVITIES		
Net investment in temporary investments	3,055	(42,281)
Investment in mortgages	(17,586,833)	(13,909,679)
Repayment of mortgages	12,363,709	11,686,557
NET CASH USED IN INVESTING ACTIVITIES	(5,220,069)	(2,265,403)
NET INCREASE IN CASH	194,875	15,790
CASH, beginning of year	11,776	(4,014)
CASH, end of year	$ 206,651	$ 11,776

The accompanying notes are an integral part of these financial statements.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2009

	Par Value	Average Cost	Market Value
MONEY MARKET 0.18%			
RBC Premium Money Market Fund	$ 50,239	$ 50,239	$ 50,239

Money market investments earn a return of 0.89%.

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 99.75%	28,083,274	28,083,274	28,083,274
TOTAL INVESTMENTS 99.93%		$ 28,133,513	28,133,513
CASH AND OTHER NET ASSETS 1.01%			284,333
BANK LINE OF CREDIT (0.94)%			(265,000)
NET ASSETS (100%)			$ 28,152,846

DISTRIBUTION OF MORTGAGES

Mortgages are 72% residential and 28% commercial. All mortgages are pre-payable, uninsured conventional mortgages with terms to maturity ranging from 1 to 2 years.

Interest Rates	Number of mortgages	Amortized Cost	Current Value
8%	3	$ 505,452	$ 505,452
9%	9	3,371,445	3,371,445
10%	21	5,750,064	5,750,064
11%	34	5,277,796	5,277,796
12%	71	12,927,103	12,927,103
13%	4	251,414	251,414
	142	$ 28,083,274	$ 28,083,274

The accompanying notes form an integral part of these financial statements

1. DESCRIPTION OF THE BUSINESS

Frontenac Mortgage Investment Corporation (the "Company") was incorporated on October 26, 2004 pursuant to the *Canada Business Corporations Act*. The Company's objective is to generate income while preserving, for its beneficial shareholders, capital for re-investment. As a mortgage investment corporation, the Company expects to derive its earnings principally from the receipt of mortgage interest payments and of interest or interest-like distributions on the cash reserves of the Company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and with National Instrument 81-106 on continuous disclosure.

(a) Revenue recognition

Interest income on mortgages and other investment income are recognized on the accrual basis in the period earned. Interest is not accrued on mortgages that are identified as impaired.

(b) Allowance for mortgage losses

An allowance for mortgage losses is recorded against mortgages identified as impaired to reduce them to their estimated realizable amounts. Impairment is assessed on a mortgage by mortgage basis taking into account experience, credit quality, payment in arrears and specific problem situations. Estimated realizable amounts are determined by reference to mortgage collection experience and the estimated value of security underlying the mortgages after deducting costs of realization.

When the prospect of recovery of a mortgage is no longer considered realistic, it is written-off first against any provision established for mortgage losses and the remaining amount, if any, to expense.

(c) Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses for the year, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Actual amounts could differ from these estimates. Significant estimates include the allowance for mortgage losses and are subject to measurement uncertainty. Changes in estimates are recorded in the accounting period in which they are determined.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Income taxes

The Company is considered a mortgage investment corporation under the *Income Tax Act* (Canada). The company distributes all of its net income to its shareholders in the form of dividends in order not to be subject to income taxes.

(e) Net assets per share

Net assets per share is calculated by dividing the net assets by the total number of issued and outstanding common shares at the end of the year.

(f) Prepaid mortgage payments

Some mortgagors may prepay or may be required to prepay a portion of their periodic payments. These prepaid mortgage payments are applied against the related mortgage receivable balance in the period for which they relate.

(g) Financial instruments

The Company's financial instruments consist of cash, temporary investments, accrued interest receivable, accounts receivable, mortgages, bank line of credit, accounts payable and accrued expenses, and prepaid mortgage payments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying value, unless otherwise noted.

In accordance with Canadian GAAP, the Company is required to classify its financial assets as one of the following: held-to-maturity, loans and receivables, held-for-trading or available for sale. Financial liabilities must be classified as: held-for-trading or other liabilities. The Company has designated its financial assets and financial liabilities as follows:

(i) Financial assets:

Cash and temporary investments are classified as held-for-trading and recorded at fair value.

Accounts receivable, accrued interest receivable, and mortgages are classified as loans and receivables and recorded at amortized cost.

(ii) Financial liabilities:

Bank line of credit, accounts payable and accrued expenses, and prepaid mortgage payments are classified as other liabilities and recorded at amortized cost.

(h) Accounting changes

In March 2009, the Accounting Standards Board ("AcSB") of the CICA amended Handbook Section 3862, Financial Instruments - Disclosures. The amendments enhanced disclosure requirements regarding fair value measurements and liquidity risk. The Company has adopted these amendments for its year ended December 31, 2009. The enhanced disclosures are presented in Note 4.

3. CAPITAL STRUCTURE FINANCIAL POLICIES

The Company's definition of capital includes net assets and bank line of credit.

The Company's objective when managing its share capital is to generate income while preserving, for its beneficial shareholders, capital for re-investment. As a mortgage investment corporation, the Company expects to derive its earnings principally from the receipt of mortgage interest payments and of interest or interest-like distributions on the cash reserves of the Company.

3. CAPITAL STRUCTURE FINANCIAL POLICIES (Continued)

The Company achieves its investment objective by lending on the security of mortgages on real properties situated in Canada, primarily in Eastern Ontario. The mortgages transacted by the Company will not generally meet the underwriting criteria of conventional lenders and/or involve borrowers in rural areas generally not well serviced by major lenders. As a result, the Company's investments are expected to earn a higher rate of interest than what is generally obtainable through conventional mortgage lending activities.

In order to provide some liquidity to its shareholders, the Company is required to maintain 5% of its net assets in cash or near cash assets and such levels of cash reserves have been adequate to meet the needs of normal share redemption levels during the year. Management regularly monitors its available cash and credit line facility to ensure that the 5% cash reserve is maintained. For unusual circumstances, the Company has redemption policies in place to restrict the payout of share redemption at levels to match the normal repayment of the mortgages receivable.

The Company's capital management objectives and strategies are unchanged from prior years.

4. FINANCIAL INSTRUMENTS

In accordance with Canadian GAAP, the Company must classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making its fair value measurements. The following hierarchy has been used in determining and disclosing fair value of financial instruments:

Level 1: quoted prices in active markets for the same instrument (i.e. without modification or repackaging);

Level 2: quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data; and

Level 3: valuation techniques for which any significant input is not based on observable market data.

The Company's temporary investments are valued using Level 1 measures.

5. TEMPORARY INVESTMENTS

For the purpose of meeting short-term cash commitments, the Company maintains short-term investments in highly liquid money market securities earning a return of approximately 0.89% (2008 - 3.49%). The temporary investments are readily convertible to cash and are not subject to significant risk of change in value. Consequently, their fair value approximates their carrying amount.

6. MORTGAGES

There are 142 mortgages (2008 - 114) held which are a combination of mainly first and second mortgages secured by residential and commercial property.

	2009	2008
Mortgages	$ 28,465,274	$ 23,242,150
Allowance for mortgage losses	(382,000)	(225,000)
	$ 28,083,274	$ 23,017,150

To assess impairment, management has reviewed each mortgage taking into account experience, credit quality, payment in arrears, and specific problem situations. As at December 31, 2009, there are 15 mortgages totaling $2,806,712 (2008 - 6 mortgages totaling $1,086,642) that are past due and considered impaired by management. When the estimated realizable amounts for each of the impaired mortgages is greater than their carrying values, no allowance for mortgage loss is made.

6. MORTGAGES (Continued)

Credit risk

Credit risk arises from the possibility that mortgagors may experience financial difficulty and be unable to fulfil their mortgage commitments. The Company mitigates this risk by having well established lending policies in place that ensure mortgages are well secured and by limiting its exposure to any one mortgagor. There are no significant concentrations of credit risk as the average mortgage amount as at December 31, 2009 was $199,058 (2008 - $203,878) and the largest mortgage was $1,772,012 (2008 - $2,006,469).

Interest rate price risk

Interest rate price risk arises from the possibility that at the end of a mortgage's term it will be re-priced to a prevailing interest rate lower then the original one. This risk is mitigated by the fact that the Company is not as exposed to market mortgage rates because there is no specific market for mortgages of similar type, term and credit risk. This has allowed the Company to renew its mortgages at good rates.

Mortgages are issued with either 1 or 2 year terms, have fixed interest rates and can be paid in full without penalty. The weighted average interest rate of the mortgages as at December 31, 2009 was 10.84% (2008 - 11.12%).

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations and commitments as they fall due. The Company's approach is to ensure that it will have sufficient cash and credit facilities to meet its liabilities when due, under normal and stressed circumstances. As at December 31, 2009, the Company's liabilities and consisted of accounts payable and accrued expenses totaling $30,920 all of which are due within normal trade terms of generally 30 days. The Company maintains significant committed borrowing facilities from its bank for credit room at least equal to ten percent of net assets. In additions, the Company has policies in place that can restrict the total amount of share redemptions. Those restrictions permit share redemptions to be funded through the normal repayment of the mortgages receivable.

7. BANK LINE OF CREDIT

The Company has established a revolving line of credit with a limit of $3,000,000. It is secured by a General Security Agreement and a first ranking interest in the mortgages and is repayable on demand. The availability of funds may be cancelled or restricted by the bank at any time. The credit facility bears interest at bank prime rate of 2.25% (2008 - 3.50%) plus 1%.

Financial covenants require the Company to maintain a minimum levels for equity, debt to equity ratio, and percentage of residential mortgages. As at December 31, 2009 the Company was in compliance with the bank's financial covenants.

8. CAPITAL STOCK

Authorized capital:
The authorized capital consists of an unlimited number of voting, non-cumulative common shares.

Changes during the years:

	2009		2008	
	Number of shares issued	$	Number of shares issued	$
Balance, beginning of year	762,396	22,871,903	665,553	19,966,602
Issued	158,432	4,752,960	84,838	2,545,148
Issued through dividend reinvestment plan	49,740	1,492,208	44,367	1,331,004
Redeemed	(32,140)	(964,225)	(32,362)	(970,851)
Balance, end of year	938,428	28,152,846	762,396	22,871,903

Dividend reinvestment plan and direct share purchase plan
The dividends issued to shareholders are automatically reinvested in the Company by the direct purchase of shares at the current market price.

9. RELATED PARTIES

Pillar Financial Services Inc. ("Pillar") is the administrator for the Company. Its responsibilities include originating loan transactions, underwriting the mortgages, collecting mortgage payments, and the internal audit and accounting for the Company.

W.A. Robinson & Associates Ltd. ("W.A.") provides portfolio management advice and investment counsel and acts as share registrar and transfer agent for the Company.

The companies are related in that they share common management. Pillar and W.A. each charge an annual fee of 1% of the total asset value calculated on a monthly basis. Total fees paid to Pillar for the year ended December 31, 2009 were $264,481 (2008- $369,876) and the total fees paid to W.A. for the year ended December 31, 2009 were $277,705 (2008 - $81,226) under these contracts. These transactions are in the normal course of operations and are measured at the exchange amount which is the amount of consideration established and agreed to by the parties.

10. RECONCILIATION OF NET ASSETS TO NET ASSET VALUE

In accordance with the amendments issued by the Canadian securities regulatory authorities, a reconciliation is required of any difference between net assets, calculated in accordance with Canadian GAAP, and net asset value, calculated in accordance with the Corporation's fair value policies and procedures for unit pricing. As at December 31, 2009, there was no difference between the net assets and the net asset value. Due to their short-term nature, the fair value of the Corporation's mortgages was equal to their amortized cost under the effective interest rate method.

11. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the financial statements presentation adopted in the current year.