FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2010

FRONTENAC MORTGAGE INVESTMENT CORPORATION

DECEMBER 31, 2010

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Raymond Chabot Grant Thornton

Independent Auditor's Report

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To the Shareholders of
Frontenac Mortgage Investment Corporation

We have audited the accompanying financial statements of Frontenac Mortgage Investment Corporation, which comprise the statement of investment portfolio as at December 31, 2010, the statement of net assets as at December 31, 2010 and 2009 and the statements of operations, changes in net assets and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the statement of investment portfolio as at December 31, 2010, the financial position of Frontenac Mortgage Investment Corporation as at December 31, 2010 and 2009 and the results of its operations, changes in net assets and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Raymond Chabot Grant Thornton LLP

Chartered Accountants,
Licensed Public Accountants

Ottawa, Ontario
March 24, 2011

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF NET ASSETS

AS AT DECEMBER 31, 2010

	2010	2009
ASSETS		
Cash and cash equivalents	$ 1,279,227	$ 256,890
Accounts receivable	-	66,030
Mortgage investments (Note 6)	31,067,014	28,241,771
Prepaid expenses	8,517	7,190
	32,354,758	28,571,881
LIABILITIES		
Bank line of credit (Note 7)	$ 1,300,000	$ 265,000
Dividends payable	7,364	-
Accounts payable and accrued expenses	62,351	30,920
Prepaid mortgage payments	11,667	123,115
	1,381,382	419,035
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY	$ 30,973,376	$ 28,152,846
NET ASSETS PER SHARE	$ 30.00	$ 30.00

APPROVED ON BEHALF OF THE BOARD:

__*Colleen Allison* (signed)__________ Director

__*Margaret Kelk* (signed)__________ 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, 2010

	2010	2009
INTEREST INCOME	$ 2,851,989	$ 2,464,219
EXPENSES		
Administration fees (Note 9)	639,149	542,186
Audit fees	26,943	26,175
Director fees	40,567	19,774
General and operating expenses	212,508	184,924
Interest and bank charges	3,788	2,660
Legal fees	48,249	26,735
Custodian fees	10,500	10,500
Trustee account fees	88,904	-
	1,070,608	812,954
NET INVESTMENT INCOME	1,781,381	1,651,265
Realized losses on mortgage investments	(326,119)	(2,057)
Unrealized change in fair value of mortgage investments	15,000	(157,000)
INCREASE IN NET ASSETS FROM OPERATIONS	$ 1,470,262	$ 1,492,208
WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING	993,420	857,591
INCREASE IN NET ASSETS FROM OPERATIONS PER SHARE	$ 1.48	$ 1.74

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, 2010

	2010	2009
NET ASSETS, beginning of year	$ 28,152,846	$ 22,871,903
Increase in net assets from operations	1,470,262	1,492,208
Share capital transactions		
Proceeds from issuance of shares for cash	2,929,163	4,752,960
Reinvested dividends	1,425,783	1,492,208
Cost of shares redeemed	(1,534,416)	(964,225)
	2,820,530	5,280,943
Distributions to shareholders		
Dividends to shareholders	(1,470,262)	(1,492,208)
NET ASSETS, end of year	$ 30,973,376	$ 28,152,846

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, 2010

	2010	2009
CASH FROM OPERATING ACTIVITIES		
Net investment income	$ 1,781,381	$ 1,651,265
Net changes in non-cash working capital balances:		
Decrease (increase) in accounts receivable	66,030	(66,030)
(Increase) in prepaid expenses	(1,327)	(3)
Increase in dividends payable	7,364	-
Increase in accounts payable and accrued expenses	31,431	17,843
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,884,879	1,603,075
FINANCING ACTIVITIES		
Increase (decrease) in bank line of credit	1,035,000	(65,000)
Proceeds from issuance of shares for cash	2,929,163	4,752,960
Cash dividends	(44,478)	-
Redemption of common shares	(1,534,416)	(964,225)
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,385,269	3,723,735
INVESTING ACTIVITIES		
(Decrease) increase in prepaid mortgage payments	(111,448)	123,115
New mortgage investments	(23,871,668)	(17,586,833)
Repayment of mortgage investments	20,735,305	12,328,728
NET CASH USED IN INVESTING ACTIVITIES	(3,247,811)	(5,134,990)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,022,337	191,820
CASH AND CASH EQUIVALENTS, beginning of year	256,890	65,070
CASH AND CASH EQUIVALENTS, end of year	$ 1,279,227	$ 256,890

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

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2010

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 100.30%	31,434,014	31,067,014	31,067,014
TOTAL INVESTMENTS 100.30%		$ 31,067,014	31,067,014
CASH AND OTHER NET ASSETS 3.89%			1,206,362
BANK LINE OF CREDIT (4.20)%			(1,300,000)
NET ASSETS 100%			$ 30,973,376

DISTRIBUTION OF MORTGAGE INVESTMENTS

Mortgages are 77% residential and 23% 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	Fair Value
8%	6	$ 472,142	$ 472,142
9%	13	4,741,877	4,741,877
10%	41	10,695,040	10,695,040
11%	27	4,238,626	4,238,626
12%	63	10,783,735	10,783,735
13%	2	135,594	135,594
	152	$ 31,067,014	$ 31,067,014

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. CHANGE IN ACCOUNTING POLICY

In accordance with the Company's classification as an investment fund under National Instrument 81-106, the Company has amended its accounting policies to re-classify and record its mortgages at their fair value in accordance with Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 18 - "Investment Companies" ("AcG-18") and CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement". This change in accounting policy has been applied retroactively. Applying AcG-18 did not materially change the previous year's results.

3. 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) 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 fair value of the Company's mortgages and are subject to measurement uncertainty. Changes in estimates are recorded in the accounting period in which they are determined.

(c) Mortgage investments

Mortgage investments are stated at fair value in accordance with CICA AcG-18. Any unrealized changes in the fair value of an investment are recorded in the net earnings for the period. The fair value of mortgage investments is determined by discounting future cash flow at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk.

3. 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 most significant financial instruments consist of its mortgage investments. In accordance with AcG-18, mortgage investments are required to be recorded at fair value as defined in CICA Handbook Section 3855, "Financial Instruments - Recognition and Measurement". Mortgage investments are valued on the policies described in paragraph (c) above. The financial risks associated with the Company's mortgage investments and the Company's management of those risks are discussed in Note 6.

The Company's other financial instruments consist of cash and cash equivalents, accounts receivable, bank line of credit, accounts payable and accrued expenses, and dividends payable. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or currency 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 classified its financial assets and financial liabilities as follows:

(i) Financial assets:

Cash and cash equivalents are classified as held-for-trading and recorded at fair value.

Accounts receivable are classified as loans and receivables and recorded at amortized cost.

(ii) Financial liabilities:

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

4. 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.

4. 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 approximately 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. As at December 31, 2010 and 2009, the Company has maintained the 5% cash reserve. 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.

5. 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 and the mortgage investments are valued using Level 3 measures. Mortgage investments are valued using Level 3 measures as there are no quoted prices in an active market for the Company's mortgages. As explained in more detail in Note 6, management makes its determination of fair value for its mortgage investments based on its assessment of the current mortgage market for mortgages of same or similar terms.

6. MORTGAGE INVESTMENTS

There are 152 mortgages (2009 - 142) held which are a combination of mainly first and second mortgages secured by residential and commercial property.

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, 2010 was $205,532 (2009 - $199,058) and the largest mortgage was $2,014,800 (2009 - $1,772,012). As at December 31, 2010, there are 11 mortgages totaling $1,762,896 (2009 - 15 mortgages totaling $2,806,712) that considered are past due by management.

6. MORTGAGES (Continued)

Interest rate risk

Interest rate 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 consistent 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, 2010 was 10.82% (2009 - 10.84%).

A 50 basis point increase or decrease in interest rates, with all other variables held constant, will not effect an increase or decrease in net investment income as the Company's mortgage investments are issued at fixed interest rates.

Fair Values

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties under no compulsion to act. As there are no quoted prices in an active market for the Company's mortgages, management makes its determination of fair value based on its assessment of the current mortgage market for mortgages of same or similar terms. As the Company and its borrowers are unrelated third parties under no compulsion to act, the initial terms of the mortgage represents their fair value at the time of mortgage origination. When collection of principal on a particular mortgage investment is no longer reasonably assured, the fair value of the mortgage is reduced to reflect the estimated net realizable recovery from the collateral securing the loan.

The following table shows a reconciliation of the opening and closing balance of mortgage investments:

	2010	2009
Mortgage investments - beginning of year	$ 28,241,771	$ 23,142,723
Realized losses	(326,119)	(2,057)
Unrealized change in fair value	15,000	(157,000)
Net advances and repayments	3,136,362	5,258,105
Mortgage investments - end of year	31,067,014	28,241,771

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, 2010, the Company's liabilities consisted of accounts payable and accrued expenses totaling $62,351 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 addition, 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 3.00% (2009 - 2.25%) 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, 2010 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:

	2010		2009	
	Number of shares issued	$	Number of shares issued	$
Balance, beginning of year	938,428	28,152,846	762,396	22,871,903
Issued for cash	97,639	2,929,163	158,432	4,752,960
Issued through dividend reinvestment plan	47,526	1,425,783	49,740	1,492,208
Redeemed for cash	(51,147)	(1,534,416)	(32,140)	(964,225)
Balance, end of year	1,032,446	30,973,376	938,428	28,152,846

Dividend reinvestment plan and direct share purchase plan
Unless a shareholder elects to receive their dividends as cash, the dividends issued to shareholders are automatically reinvested in the Company by the direct purchase of shares at the current market price.

Redemptions
Shareholders may only redeem common shares once per year, on November 30, except in certain unusual circumstances. During the year the Company redeemed for cash 51,147 common shares at the price of $30.00 per share for total proceeds of $1,534,416. For the year ended December 31, 2009, 32,140 common shares were redeemed for cash at the price of $30.00 per share for total proceeds of $964,225.

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, 2010 were $305,695 (2009 - $264,481) and the total fees paid to W.A. for the year ended December 31, 2010 were $333,454 (2009 - $277,705) 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 Canadian securities legislation, a reconciliation is required of any difference between net assets, calculated in accordance with Canadian GAAP, and net asset value. As at December 31, 2010 and as at December 31, 2009, as the Company's net assets are presented at fair value and there was no difference between the net assets and the net asset value.

11. COMPARATIVE FIGURES

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