FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS
(UNAUDITED)

AS AT JUNE 30, 2012

<u>Notice Under National Instrument 81-106 (para 2.12):</u> The independent external auditor, Raymond Chabot Grant Thornton LLP, has not performed a review of these financial statements for the six months ended June 30, 2012 and 2011.

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FINANCIAL STATEMENTS
(UNAUDITED)
AS AT JUNE 30, 2012

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FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF NET ASSETS
(UNAUDITED)
AS AT JUNE 30, 2012

	June 30, 2012 $	December 31, 2011 $
ASSETS		
Cash and cash equivalents	13,942,614	1,254,128
Mortgage investments (Note 6)	47,553,194	44,925,909
Prepaid expenses	6,975	8,517
Investment in private company (Note 7)	100,000	-
	61,602,783	46,188,554
LIABILITIES		
Bank line of credit (Note 8)	1,720,000	-
Dividends payable	59,662	50,189
Accounts payable and accrued expenses	49,884	56,238
Prepaid mortgage payments	175,938	33,810
	2,005,484	140,237
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY	59,597,299	46,048,317
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
(UNAUDITED)

	Six months ended June 30, 2012 $	Six months ended June 30, 2011 $
INTEREST INCOME	2,214,621	1,707,617
EXPENSES		
Administration and management fees (Note 10)	584,189	356,302
Audit fees	21,582	16,231
Director fees	17,735	20,111
General and operating expenses	112,179	124,899
Interest on credit line	273	20,397
Legal fees	28,177	18,000
Trustee fees	34,063	29,087
	798,198	585,027
NET INVESTMENT INCOME	1,416,423	1,122,590
Realized losses on mortgages	(132,222)	(351,998)
Unrealized change in fair value of mortgages	123,000	265,000
INCREASE IN NET ASSETS FROM OPERATIONS	1,407,201	1,035,592
WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING	1,781,267	1,090,097
NET INCREASE IN NET ASSETS FROM OPERATIONS PER SHARE	$ 0.79	$ 0.95

The accompanying notes are an integral part of these financial statements

STATEMENT OF CHANGES IN NET ASSETS
(UNAUDITED)

	Six months ended June 30, 2012 $	Six months ended June 30, 2011 $
NET ASSETS, beginning of period	46,048,317	30,973,376
Increase in net assets from operations	1,407,201	1,035,592
Share capital transactions		
Proceeds from issuance of shares for cash	12,454,660	2,596,298
Reinvested distributions	1,094,322	981,732
Cost of shares redeemed	-	(33,114)
	13,548,982	3,544,916
Distributions to shareholders		
Dividends to shareholders	(1,407,201)	(1,035,592)
NET ASSETS, end of period	59,597,299	34,518,292

The accompanying notes are an integral part of these financial statements

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF CASH FLOW
(UNAUDITED)

	Six months ended June 30, 2012 $	Six months ended June 30, 2011 $
CASH FROM OPERATING ACTIVITIES		
Net earnings from operations	1,407,201	1,035,592
Items not requiring an outlay of cash:		
Unrealized change in fair value of mortgages	(123,000)	(265,000)
Realized losses on mortgages	132,222	351,998
Changes in non-cash balances:		
Decrease (increase) in prepaid expenses	1,542	3,008
Increase in dividends payable	9,473	4,172
(Decrease) in accounts payable and accrued expenses	(6,354)	(26,079)
(Decrease) in prepaid mortgage payments	142,128	(11,667)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,563,212	1,092,024
FINANCING ACTIVITIES		
Proceeds from issuance of shares for cash	12,454,660	2,596,298
Increase in bank line of credit	1,720,000	155,000
Redemption of common shares	-	(33,114)
Cash dividends	(312,879)	(53,860)
NET CASH PROVIDED BY FINANCING ACTIVITIES	13,861,781	2,664,324
INVESTING ACTIVITIES		
Investment in mortgages	(21,688,624)	(11,988,948)
Repayment of mortgages	19,052,117	7,949,186
Investment in private company	(100,000)	-
NET CASH USED IN INVESTING ACTIVITIES	(2,736,507)	(4,039,762)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	12,688,486	(283,414)
CASH AND CASH EQUIVALENTS, beginning of period	1,254,128	1,279,227
CASH AND CASH EQUIVALENTS, end of period	13,942,614	995,813

The accompanying notes are an integral part of these financial statements

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO
(UNAUDITED)
AS AT JUNE 30, 2012

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 79.79%	$ 47,646,194	$ 47,553,194	$ 47,553,194
INVESTMENT IN PRIVATE COMPANY			
10 common shares of Bruce Young's Salvage Inc.		100,000	100,000
TOTAL INVESTMENTS 79.96%		47,653,194	47,653,194
CASH AND OTHER NET ASSETS 22.93%			13,664,105
BANK LINE OF CREDIT (2.89)%			(1,720,000)
NET ASSETS (100%)			$ 59,597,299

DISTRIBUTION OF MORTGAGES

Mortgages are 81% residential and 19% commercial and vacant land. 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
6% or less	3	$ 769,750	$ 769,750
6.01-7.00%	7	2,906,071	2,906,071
7.01-8.00%	3	420,798	420,798
8.01-9.00%	17	4,023,209	4,023,209
9.01-10.00%	59	12,658,437	12,658,437
10.01-11.00%	45	11,796,128	11,796,128
11.01-12.00%	82	14,931,212	14,931,212
12.01-13.00%	1	47,589	47,589
	217	$ 47,553,194	$ 47,553,194

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. AMALGAMATION SUBSEQUENT TO PERIOD END

Immediately subsequent to period end, the Company amalgamated with Mortgage Investment Corporation of Eastern Ontario ("MICEO") to form a new company, Frontenac Mortgage Investment Corporation. Like the Company, MICEO is an Ontario-based mortgage investment corporation and is managed by a common manager, W.A. Robinson Asset Management Ltd. For accounting purposes, as the Company is larger than MICEO and placed more directors on the new board of directors, the Company is deemed to have acquired MICEO.

The aggregate purchase price was equal to the net assets of MICEO totalling $46,152,700. The acquisition was made in exchange for 1,538,423 common shares of the new amalgamated company valued at $30 per share.

The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition:

Assets:	-
Cash and cash equivalents	7,635,622
Mortgage investments	38,550,047
Prepaid expenses	10,269
Total assets acquired	46,195,938
	-
Liabilities:	-
Investor distributions payable	9,579
Accounts payable and accrued liabilities	17,875
Prepaid mortgage payments	15,784
Total liabilities assumed	43,238
Net assets acquired	46,152,700

The mortgage investment portfolio of MICEO is similar to that of the Company in average size, geographic location, terms, and interest rate. As at June 30, 2012, MICEO held 124 mortgages with a weighted average interest rate of 10.01%. The largest mortgage was $4,769,898 and the average outstanding balance was $310,888. As at June 30, 2012, there were 6 mortgages totaling $1,832,867 that were considered past due by management.

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 pre-changeover to International Financial Reporting Standards ("IFRS").

(a) Revenue recognition

Interest income on mortgage investments and other investment income are recognized on the accrual basis in the period earned. Interest is not accrued on mortgage investments 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 mortgage investments 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 Accounting Guideline 18 ("AcG-18"). Any unrealized changes in the fair value of an investment are recorded in the statement of operations for the period. The fair value of mortgage investments is determined by discounting the future cash flow at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk.

(d) Investment in private company

Investment in private company is stated at fair value in accordance with CICA Accounting Guideline 18 ("AcG-18"). Any unrealized changes in the fair value of an investment are recorded in the statement of operations for the period.

(e) 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.

(f) 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.

(g) 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.

(h) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Financial instruments (continued)

The Company's other financial instruments consist of cash and cash equivalents, investment in private company, 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 designated 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. Investment in private company is classified as available-for-sale.

(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.

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.

4. CAPITAL STRUCTURE FINANCIAL POLICIES (Continued)

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 June 30, 2012 and December 31, 2011, 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 cash and cash equivalents are valued using Level 1 measures and the mortgage investments and investment in private company are classified using Level 3 measures. Mortgage investments and investment in private company are valued using Level 3 measures as there are no quoted prices in an active market for the Company's mortgages or for the shares of the investment, which is a privately-held company. 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. As at June 30, 2012, the investment in private company has been measured at its acquistion cost value which has been determined to be its fair value based on the close timing between the period end and the actual acquisition date of the investment.

6. MORTGAGE INVESTMENTS

There are 217 mortgages (December 31, 2011 - 203) 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 fulfill 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 June 30, 2012 was $216,995 (December 31, 2011 - $219,215) and the largest mortgage was $2,611,471 (December 31, 2011 - $2,611,173). As at June 30, 2012, there are 8 mortgages totaling $2,235,170 (December 31, 2011 - 10 mortgages totaling $2,862,240) that are considered past due by management.

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 than 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 strategy has allowed the Company to renew its mortgages at consistent rates.

6. MORTGAGE INVESTMENTS (Continued)

Interest rate price risk (continued)

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 June 30, 2012 was 10.30% (December 31, 2011 - 10.80%).

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 quote prices in an active market for the Company's mortgage investments, 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 mortgage loan.

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

	Six months ended June 30, **2012**	Six months ended June 30, **2011**
Mortgage investments - beginning of period	$ 44,925,909	$ 31,067,014
Realized losses	(132,222)	(351,998)
Unrealized change in fair value	123,000	265,000
Net advances and repayments	2,636,507	4,039,762
Mortgage investments - end of period	47,553,194	35,019,778

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 June 30, 2012, the Company's liabilities consisted of accounts payable and accrued expenses totaling all $49,884 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. INVESTMENT IN PRIVATE COMPANY

On April 30, 2012, the Company acquired a 50% interest in Bruce Young's Salvage Inc. ("BYSI"), a Canadian-owned private company based in Nova Scotia, for cash consideration of $100,000. In addition to its investment in common shares, the Company has loaned BYSI $650,000 which is included in the Company's total mortgage investments. BYSI operates as a scrap metal salvage business and currently has a contract for salvage in the Caribbean.

In accordance with AcG-18, the Company's investment in BYSI is presented at fair value. Based on the proximity of the acquisition date to the period end and the minimal amount of operating activity in BYSI during that time, the fair value as at June 30, 2012 has been determined to be equal to its acquisition cost.

8. BANK LINE OF CREDIT

The Company has established a revolving line of credit with a limit of $4,500,000. 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% (December 31, 2011 - 3.00%) plus 1%.

Financial covenants require the Company to maintain a minimum level of equity, debt to equity ratio and percentage of residential mortgages. As at June 30, 2012 the Company was in compliance with the bank's financial covenants.

As part of the amalgamation discussed in Note 2, subsequent to year end, the existing $4.5 million credit line of the Company was combined with the existing $4.5 million credit line of MICEO. The new combined credit line of $9 million bears the same interest rate and other terms as described above.

9. CAPITAL STOCK

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

Changes during the periods:

	Six months ended June 30, 2012		Year ended December 31, 2011	
	Number of shares issued	$	Number of shares issued	$
Balance, beginning of period	1,534,944	46,048,317	1,032,446	30,973,376
Issued for cash	415,155	12,454,660	466,586	13,997,592
Issued through dividend reinvestment plan	36,477	1,094,322	72,351	2,170,541
Redeemed			(36,440)	(1,093,192)
Balance, end of period	1,986,576	59,597,299	1,534,943	46,048,317

Dividend reinvestment plan and direct share purchase plan
The dividends paid 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 period ended June 30, 2012, no shares were redeemed. For the year ended December 31, 2011, 36,440 common shares were redeemed for cash at the price of $30 per share for total proceeds of $1,093,192.

10. 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 to 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 six months ended June 30, 2012 were $274,267 (six months ended June 30, 2011 - $167,278) and the total fees paid to W.A. for the six months ended June 30, 2012 were $309,922 (six months ended June 30, 2011 - $189,024) 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.

11. 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 June 30, 2012 and as at December 31, 2011, as the Company's net assets are presented at fair value in accordance with Canadian GAAP for investment companies, there was no difference between the net assets and the net asset value.