

# **FRONTENAC MORTGAGE INVESTMENT CORPORATION**

## **FINANCIAL STATEMENTS**

**AS AT DECEMBER 31, 2012 AND 2011**

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

DECEMBER 31, 2012 AND 2011

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## **Independent Auditor's Report**

To the Shareholders of  
Frontenac Mortgage Investment Corporation

**Raymond Chabot Grant Thornton LLP**  
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We have audited the accompanying financial statements of Frontenac Mortgage Investment Corporation, which comprise the statement of investment portfolio as at December 31, 2012, the statements of net assets as at December 31, 2012 and 2011 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, 2012, the financial position of Frontenac Mortgage Investment Corporation as at December 31, 2012 and 2011 and the results of its operations, changes in its 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 27, 2013

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## STATEMENTS OF NET ASSETS

AS AT DECEMBER 31

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 66,279	\$ 1,254,128
Mortgage investments (Note 6)	105,712,355	44,925,909
Prepaid expenses	16,500	8,517
Investment in private company (Note 7)	587,155	-
Property held for sale under foreclosure (Note 8)	<u>424,256</u>	<u>-</u>
	<u>106,806,545</u>	<u>46,188,554</u>
<b>LIABILITIES</b>		
Bank line of credit (Note 9)	\$ 5,950,000	\$ -
Dividends payable	127,358	50,189
Accounts payable and accrued expenses	85,547	56,238
Deferred lender fee revenue	87,147	-
Prepaid mortgage payments	<u>705,518</u>	<u>33,810</u>
	<u>6,955,570</u>	<u>140,237</u>
<b>NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY</b>	<u>\$ 99,850,975</u>	<u>\$ 46,048,317</u>
<b>NUMBER OF SHARES ISSUED AND OUTSTANDING</b>	<u>3,328,364</u>	<u>1,534,943</u>
<b>NET ASSETS PER SHARE</b>	<u>\$ 30.00</u>	<u>\$ 30.00</u>

### APPROVED ON BEHALF OF THE BOARD:

Rosemarie Bowick (signed) Director

Colleen Allison (signed) Director

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

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## STATEMENTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31

	<u>2012</u>	<u>2011</u>
<b>INTEREST INCOME</b>	\$ <u>7,187,719</u>	\$ <u>3,771,220</u>
<b>EXPENSES</b>		
Management and administration fees (Note 11)	1,722,765	800,627
Audit fees	52,474	39,180
Director fees	68,391	36,417
General and operating expenses	308,336	239,863
Interest on bank line of credit	18,569	39,361
Legal fees	101,951	32,077
Custodian fees	11,300	11,300
Trustee account fees	<u>78,706</u>	<u>63,896</u>
	<u>2,362,492</u>	<u>1,262,721</u>
<b>NET INVESTMENT INCOME</b>	4,825,227	2,508,499
Realized losses on mortgage investments	(667,996)	(271,336)
Unrealized change in fair value of mortgage investments	384,000	151,000
Unrealized change in fair value of investment in private company	(277,000)	-
Unrealized change in fair value of property held for sale under foreclosure	<u>141,000</u>	<u>-</u>
<b>INCREASE IN NET ASSETS FROM OPERATIONS</b>	\$ <u>4,405,231</u>	\$ <u>2,388,163</u>
<b>WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING</b>	<u>2,669,837</u>	<u>1,224,699</u>
<b>INCREASE IN NET ASSETS FROM OPERATIONS PER SHARE</b>	\$ <u>1.65</u>	\$ <u>1.95</u>

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

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## STATEMENTS OF CHANGES IN NET ASSETS

### FOR THE YEAR ENDED DECEMBER 31

	<u>2012</u>	<u>2011</u>
NET ASSETS, beginning of year	\$ <u>46,048,317</u>	\$ <u>30,973,376</u>
<b>Increase in net assets from operations</b>	<u>4,405,231</u>	<u>2,388,163</u>
<b>Share capital transactions</b>		
Net assets acquired on amalgamation (Note 2)	46,152,700	
Proceeds from issuance of shares for cash	18,494,413	13,997,592
Reinvested dividends	3,325,297	2,170,541
Shares redeemed	<u>(14,169,752)</u>	<u>(1,093,192)</u>
	<u>53,802,658</u>	<u>15,074,941</u>
<b>Distributions to shareholders</b>		
Dividends to shareholders	<u>(4,405,231)</u>	<u>(2,388,163)</u>
NET ASSETS, end of year	\$ <u>99,850,975</u>	\$ <u>46,048,317</u>

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

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2012

	<u>2012</u>	<u>2011</u>
<b>CASH FROM OPERATING ACTIVITIES</b>		
Net investment income	\$ 4,825,227	\$ 2,508,499
<b>Net changes in non-cash working capital balances:</b>		
Decrease in prepaid expenses	2,286	-
Increase (decrease) in accounts payable and accrued expenses	11,434	(6,113)
Increase in deferred lender fee revenue	<u>87,147</u>	<u>-</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>4,926,094</u>	<u>2,502,386</u>
<b>FINANCING ACTIVITIES</b>		
Increase (decrease) in bank line of credit	5,950,000	(1,300,000)
Proceeds from issuance of common shares for cash	18,494,413	13,997,592
Cash dividends	(1,012,344)	(174,796)
Redemption of common shares	<u>(14,169,752)</u>	<u>(1,093,192)</u>
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<u>9,262,317</u>	<u>11,429,604</u>
<b>INVESTING ACTIVITIES</b>		
Increase in prepaid mortgage payments	655,924	22,143
Cash acquired on amalgamation (Note 2)	7,635,622	-
New mortgage investments	(66,865,882)	(36,574,028)
Repayment of mortgage investments	44,345,487	22,594,796
New investment in private company	(864,155)	-
New investment in property held for sale under foreclosure	<u>(283,256)</u>	<u>-</u>
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<u>(15,376,260)</u>	<u>(13,957,089)</u>
<b>NET (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(1,187,849)	(25,099)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>1,254,128</u>	<u>1,279,227</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 66,279</u>	<u>\$ 1,254,128</u>

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



# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2012

### INVESTMENT PORTFOLIO

		Principal Value	Amortized Cost	Fair Value
Private mortgages	105.87%	\$ 105,825,355	\$ 105,712,355	\$ 105,712,355
Investment in Bruce Young Salvage Inc.	0.59%		864,155	587,155
Property held for sale under foreclosure	0.42%		283,256	424,256
Cash & other net assets	(0.92)%			(922,791)
Bank line of credit	(5.96)%			(5,950,000)
Net assets	<u>100.00%</u>			<u>\$ 99,850,975</u>

### DISTRIBUTION OF MORTGAGE INVESTMENTS

Interest rate	Number of mortgages	Amortized cost	Fair value
5%	3	\$ 1,304,672	\$ 1,304,672
7%	20	4,995,169	4,995,169
8%	15	3,386,293	3,386,293
9%	39	12,885,722	12,885,722
10%	113	36,885,867	36,885,867
11%	61	17,485,898	17,485,898
12%	115	28,722,058	28,722,058
13%	<u>1</u>	<u>46,676</u>	<u>46,676</u>
	<u>367</u>	<u>\$105,712,355</u>	<u>\$105,712,355</u>

Mortgages are 76% residential and 20% commercial. All mortgages are pre-payable, uninsured conventional mortgages with terms to maturity ranging from 1 to 2 years.

The accompanying notes form an integral part of these financial statements

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2012

### 1. DESCRIPTION OF THE BUSINESS

Frontenac Mortgage Investment Corporation (the "Company") was incorporated on October 26, 2004 and continued under Articles of Amalgamation dated July 1, 2012 both 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

On July 1, 2012, the Company amalgamated with Mortgage Investment Corporation of Eastern Ontario ("MICEO"). Like the Company, MICEO is an Ontario-based mortgage investment corporation and is managed by a common manager, W.A. Robinson Asset Management Ltd. As both the Company and MICEO operate under the same investment objectives and investment strategy, combination of the two companies allowed management to streamline the operations of the two companies and is a reflection of management's strategy for future growth. For accounting purposes, as the Company has more shareholders and directors on the Board of the post-amalgamation company than MICEO, 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
<b>Total assets acquired</b>	<b>46,195,938</b>
Liabilities:	
Investor distributions payable	9,579
Accounts payable and accrued expenses	17,875
Prepaid mortgage payments	15,784
<b>Total liabilities assumed</b>	<b>43,238</b>
<b>Net assets acquired</b>	<b>46,152,700</b>

As at the date of amalgamation, the mortgage investment portfolio of MICEO was 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.

The operating results of the Company presented in these financial statements for the year ended December 31, 2012 do not include the operating results of MICEO prior to amalgamation on July 1, 2012. Had the two companies been combined for the entire year ended December 31, 2012, total revenues would have been \$9,249,614 and total increase in net assets from operations would have been \$5,784,908. For the period from amalgamation to the year end the operating results presented in these financial statements include the operating results of the combined entities; however, the increases in revenues and increase to net assets from operations that resulted from the amalgamation cannot be practically determined as, once amalgamated, the individual predecessor portfolios were not separately tracked in the Company's books and records.

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS

### FOR THE YEAR ENDED DECEMBER 31, 2012

#### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") included in Part V of the CICA Handbook - Pre-changeover Accounting Standards including Accounting Guideline 18 Investment Companies ("AcG-18") 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 and the reported amounts of revenue and expenses for the year. Actual amounts could differ from these estimates. Significant estimates include the fair value of the Company's mortgages and are subject to measurement uncertainty. Estimates and underlying assumptions are reviewed on an ongoing basis. 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 future cash flows 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 the investment are recorded in the statement of operations for the period. The fair value of investment in private company is determined by discounting future cash flows at an appropriate discount rate.

(e) Property held for sale under foreclosure

Property held for sale under foreclosure is stated at fair value in accordance with CICA Accounting Guideline 18 ("AcG-18"). Any unrealized changes in the fair value of the property held for sale under foreclosure are recorded in the statement of operations for the period. The carrying value of property held for sale under foreclosure is determined by its fair value net of selling expenses.

(f) 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.

(g) 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.

# FRONTENAC MORTGAGE INVESTMENT CORPORATION

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### FOR THE YEAR ENDED DECEMBER 31, 2012

#### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Deferred lender fee revenue

Some mortgagors may be required to pay a one time fee, referred to as a lender fee, upon initiation of their mortgage. These lender fees are recognized into revenue on a straight-line basis over the term of the related mortgages.

(i) 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.

(j) 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, 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.

(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.

(k) Accounting changes

In February 2009, the Accounting Standards Board of the CICA confirmed that Canadian GAAP for publically accountable enterprises will be converged with International Financial Reporting Standards ("IFRS") effective January 1, 2011. Implementation of IFRS has been deferred for investment companies that apply the provisions of AcG-18 to January 1, 2014. As the Corporation meets the definition of a publically accountable enterprise and is classified as an investment company, the Corporation will be adopting IFRS beginning on January 1, 2014. Management is in the process of assessing the impact of IFRS in detail on its financial reporting systems. Based on the existing IFRS and proposed amendments, management has presently determined that the change to IFRS will mainly result in changes to the financial statement presentation and additional disclosure.

**FRONTENAC MORTGAGE INVESTMENT CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**4. CAPITAL STRUCTURE AND FINANCIAL POLICIES**

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

The Company's objective when managing its 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.

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, 2012 and 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, investment in private company, and property held for sale under foreclosure are valued using Level 3 measures. Mortgage investments, investment in private company, and property held under foreclosure for re-sale are valued using Level 3 measures as there are no quoted prices in an active market for these investments. 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 explained in more detail in Note 7, management makes its determination of fair value of its investment in private company based on a discounted cash flow analysis of the private company's projected future cash flows. As explained in more detail in Note 8, management makes its determination of fair value of property held for sale under foreclosure based on its assessment of the net realizable value of the property taking into consideration appraisals by qualified appraisers and purchase offers received from unrelated third parties.

**FRONTENAC MORTGAGE INVESTMENT CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**6. MORTGAGE INVESTMENTS**

There are 367 mortgages (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 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, 2012 was \$281,886 (2011 - \$219,215) and the largest mortgage was \$5,223,136 (2011 - \$2,611,173). As at December 31, 2012, there are 12 mortgages totaling \$2,589,541 (2011 - 10 mortgages totaling \$2,862,240) that considered are 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 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 before maturity without penalty. The weighted average interest rate of the mortgages as at December 31, 2012 was 10.00% (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 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 fair value of mortgage investments:

	<b>2012</b>	<b>2011</b>
Mortgage investments - beginning of year	\$ 44,925,909	\$ 31,067,014
Realized losses	(667,996)	(271,336)
Unrealized change in fair value	384,000	151,000
Mortgages acquired on amalgamation	38,517,078	-
Net advances and repayments	<u>22,553,364</u>	<u>13,979,231</u>
Mortgage investments - end of year	<u>105,712,355</u>	<u>44,925,909</u>

**FRONTENAC MORTGAGE INVESTMENT CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**6. MORTGAGE INVESTMENTS (Continued)**

**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, 2012, the Company's financial obligations and commitments consisted of accounts payable and accrued expenses totaling \$85,547 and dividends payable totaling \$127,358 all of which are due within normal trade terms of generally 30 days. The Company also has a bank line of credit that is repayable on demand and had a balance outstanding of \$5,950,000 as at December 31, 2012.

To mitigate its liquidity risk, the Company maintains significant committed borrowing facilities from its bank for credit room at approximately 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. BYSI operates as a scrap metal salvage business and currently has a contract for salvage in the Caribbean.

The investment in BYSI consists of the following:

10 common shares, representing 50% of all the issued and outstanding common shares	100,000
Term loan bearing interest at 0% maturing April 2013	400,000
Operating loan bearing interest at 12%	<u>364,155</u>
Total investment at cost	864,155
Unrealized change in fair value of investment in private company	<u>(277,000)</u>
Fair value of investment as at December 31, 2012	<u><u>587,155</u></u>

The term loan and operating loan are secured by a general security agreement covering all assets of BYSI.

The Company's investment in BYSI is presented at fair value. The fair value of the investment, including the shares held and the outstanding loans, is determined by discounting future expected cash flows at an appropriate discount rate. As at December 31, 2012, the fair value was determined by discounting expected cash repayments from BYSI of \$175,000 per year over the next five years using a discount rate of 15%.

**8. PROPERTY HELD FOR SALE UNDER FORECLOSURE**

As at December 31, 2012, there is 1 property (2011 - nil) held for sale under foreclosure as follows:

Property held for sale under foreclosure - at cost	283,256
Unrealized change in fair value of property held for sale under foreclosure	<u>141,000</u>
Fair value	<u><u>424,256</u></u>

The fair value of the property held for sale under foreclosure was determined taking into consideration a recent appraisal of the property by a qualified appraiser based on an analysis of comparative sales and a recent legal and reasonable offer by an unrelated third party to purchase the property. In this case, the property is an uncompleted residential development and, as the appraisal received included many assumptions and estimates on completion costs, the purchase price offered by the unrelated third party, being the lower value, was used to determine the fair value of the property.

**FRONTENAC MORTGAGE INVESTMENT CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**9. BANK LINE OF CREDIT**

The Company has established a revolving line of credit with a major Canadian chartered bank and, upon amalgamation in July 2012, the limit of this line of credit was increased from \$4,500,000 to \$9,000,000 representing the combined limit of the predecessor corporations. The line of credit 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% (2011 - 3.00%) plus 1%.

Financial covenants require the Company to maintain a minimum levels for net assets, debt to net assets ratio, and percentage of residential mortgages. As at December 31, 2012 the Company was in compliance with the bank's financial covenants.

**10. CAPITAL STOCK**

**Authorized capital:**

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

**Changes during the year:**

	<b>2012</b>		<b>2011</b>	
	Number of shares issued	\$	Number of shares issued	\$
Balance, beginning of year	1,534,943	46,048,317	1,032,446	30,973,376
Issued on amalgamation	1,538,423	46,152,700		
Issued for cash	616,480	18,494,413	466,586	13,997,592
Issued through dividend reinvestment plan	110,843	3,325,297	72,351	2,170,541
Redeemed for cash	<u>(472,325)</u>	<u>(14,169,752)</u>	<u>(36,440)</u>	<u>(1,093,192)</u>
Balance, end of year	<u>3,328,364</u>	<u>99,850,975</u>	<u>1,534,943</u>	<u>46,048,317</u>

**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 472,325 common shares at the price of \$30.00 per share for total proceeds of \$14,169,752. For the year ended December 31, 2011, 36,440 common shares were redeemed for cash at the price of \$30.00 per share for total proceeds of \$1,093,192.

**11. 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, 2012 were \$809,871 (2011 - \$375,881) and the total fees paid to W.A. for the year ended December 31, 2012 were \$912,894 (2011 - \$424,746) 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.



**FRONTENAC MORTGAGE INVESTMENT CORPORATION**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**FOR THE YEAR ENDED DECEMBER 31, 2012**

**12. 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, 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.

**13. COMPARATIVE FIGURES**

The comparative figures presented in this financial statements for the year ended December 31, 2011 reflect the net assets and operating results for the Frontenac Mortgage Investment Corporation only and do not include the net assets and operating results for MICEO.