FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2008

FRONTENAC MORTGAGE INVESTMENT CORPORATION

DECEMBER 31, 2008

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David Seeds, CA, Professional Corporation

AUDITOR'S REPORT

To the Shareholders of:
Frontenac Mortgage Investment Corporation

I have audited the statements of net assets and Investment portfolio of Frontenac Mortgage Investment Corporation as at December 31, 2008 and the statements of operations, changes in net assets, and cash flow for the year then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the investment portfolio of the Company as at December 31, 2008, its financial position as at December 31, 2008, and the results of its operations, changes in net assets and cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.

Sharbot Lake, Ontario
March 24, 2009, except for Note 11 which
is as of July 30, 2009

David Seeds

David Seeds, CA, Professional Corporation
Authorized to practise public accounting by The
Institute of Chartered Accountants of Ontario

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FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF NET ASSETS

AS AT DECEMBER 31, 2008

	2008	2007
ASSETS		
Cash	$ 11,776	$ -
Temporary investments (Note 6)	53,294	11,013
Accrued interest receivable	125,573	114,869
Mortgages (Note 7)	23,017,150	20,901,028
Prepaid expenses	7,187	4,950
	23,214,980	21,031,860
LIABILITIES		
Bank indebtedness	$ -	$ 4,014
Bank line of credit (Note 8)	330,000	1,040,000
Accrued expenses	13,077	21,244
	343,077	1,065,258
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY	$ 22,871,903	$ 19,966,602
NET ASSETS PER SHARE	$ 30.00	$ 30.00

APPROVED ON BEHALF OF THE BOARD:

Colleen Allison Director

Margaret Kelk 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, 2008

	2008	2007
INTEREST INCOME	$ 2,337,590	$ 2,062,087
EXPENSES		
Administration fees (Note 10)	451,102	403,328
Audit fees	15,225	14,310
Director fees	21,329	16,900
General and operating expenses	167,327	89,714
Interest and bank charges	16,126	45,670
Legal fees	95,675	39,232
Realized losses on mortgages	71,301	86,465
Provision for mortgage losses	107,000	(39,186)
Trustee fees	61,501	59,683
	1,006,586	716,116
NET EARNINGS FROM OPERATIONS	$ 1,331,004	$ 1,345,971
NET EARNINGS PER SHARE	$ 1.82	$ 2.11

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, 2008

	2008	(See Note 2) 2007
NET ASSETS, beginning of year	$ 19,966,602	$ 17,772,832
Increase in net assets from operations	1,331,004	1,345,971
Share capital transactions		
Proceeds from issuance of shares	2,545,148	1,742,460
Reinvested distributions	1,331,004	1,345,971
Cost of shares redeemed	(970,851)	(894,661)
	2,905,301	2,193,770
Distributions to shareholders		
Dividends to shareholders	(1,331,004)	(1,345,971)
NET ASSETS, end of year (Note 11)	$ 22,871,903	$ 19,966,602

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, 2008

	2008	(See Note 2) 2007
CASH FROM OPERATING ACTIVITIES		
Net investment income	$ 1,331,004	$ 1,345,971
Items not requiring an outlay of cash:		
Provision for mortgage losses	107,000	(39,186)
Changes in non-cash balances:		
Increase (decrease) in accrued interest receivable	(10,705)	26,759
Decrease in prepaid expenses	(2,237)	-
Increase (decrease) in accrued expenses	(8,167)	6,110
Dividends	(1,331,004)	(1,345,970)
NET CASH PROVIDED BY OPERATING ACTIVITIES	85,891	(6,316)
FINANCING ACTIVITIES		
Proceeds from issuance of shares	3,876,153	3,088,430
Increase (decrease) in Bank line of credit	(710,000)	1,040,000
Redemption of common shares	(970,851)	(894,661)
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,195,302	3,233,769
INVESTING ACTIVITIES		
Investment in temporary investments	(42,281)	7,534
Investment in mortgages (net of repayments)	(2,223,122)	(3,559,116)
NET CASH USED IN INVESTING ACTIVITIES	(2,265,403)	(3,551,582)
NET INCREASE (DECREASE) IN CASH	15,790	(324,129)
CASH, beginning of year	(4,014)	320,115
CASH, end of year	$ 11,776	$ (4,014)

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

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2008

	Par Value	Average Cost	Market Value
MONEY MARKET 0.23%			
RBC Premium Money Market Fund	$ 53,294	$ 53,294	$ 53,294

Money market investments earn a return of 3.49%.

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 100.64%	23,017,150	23,017,150	23,017,150
TOTAL INVESTMENTS 100.87%		$ 23,070,444	23,070,444
CASH AND OTHER NET ASSETS 0.57%			131,459
BANK LINE OF CREDIT (1.44)%			(330,000)
NET ASSETS (100%)			$ 22,871,903

DISTRIBUTION OF MORTGAGES

Mortgages are 67% residential and 33% 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
7-8%	3	$ 501,876	$ 501,876
8-9%	5	484,264	484,264
9-10%	10	2,004,470	2,004,470
10-11%	29	6,462,944	6,462,944
11-12%	63	13,471,656	13,471,656
12-13%	4	91,940	91,940
	114	$ 23,017,150	$ 23,017,150

NOTES TO THE 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

During the year, Canadian Generally Accepted Accounting Principles ("GAAP") for financial instruments, CICA accounting standard 3855 "Financial Instruments - Recognition and Measurement" were amended and these changes affect the accounting treatment of the Company's mortgages receivable. Under these revised rules effective July 1, 2008, the company may redesignate its mortgages receivable as loans and receivables as the Company has the intention and the ability to hold these mortgages receivables for the foreseeable future or until maturity.

As loans and receivables, the Company accounts for its mortgage receivables at their amortized cost less any provision for losses on impaired or defaulted mortgages.

This change has been applied effective July 1, 2008. In accordance with the revised GAAP, this policy change has not been applied retroactively - however, for 2007, the fair value of the mortgages receivable had been determined to be equal to their amortized cost.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles 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) Mortgages receivable

As explained in Note 2, mortgages receivable are stated at their amortized cost less any provision for losses on mortgages that are identified as impaired or in default.

(c) 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.

(d) Use of estimates

The preparation of financial statements 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 uncertainty. Changes in estimates are recorded in the accounting period in which they are determined.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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 in order not to be subject to income taxes.

4. CAPITAL STRUCTURE FINANCIAL POLICIES

The Company's definition of capital includes net assets, bank debt, cash and temporary investments, and mortgages receivable.

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.

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. 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

The Company's financial instruments consist of cash, temporary investments, accrued interest receivable, mortgages, bank line of credit and accrued expenses. 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.

6. TEMPORARY INVESTMENTS

For the purpose of meeting short-term cash commitments, the Company maintains short-term investments in highly liquid money market securities earnings a return of approximately 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.

7. MORTGAGES

There are 114 mortgages (2007 - 116) held which are a combination of mainly first and second mortgages secured by residential and commercial property.

	2008	2007
Mortgages	$ 23,242,150	$ 21,019,028
Allowance for mortgage losses	(225,000)	(118,000)
	$ 23,017,150	$ 20,901,028

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, 2008, there are 6 mortgages totaling $1,086,642 that are 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.

7. 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, 2008 was $203,878 (2007 - $181,239) and the largest mortgage was $2,006,469 (2007 - $1,536,606).

Fair Values

The fair value of mortgages receivable is considered to be the amortized cost, net of allowance for credit losses, using the effective interest rate method.

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, 2008 was 11.12% (2007 - 11.20%).

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. 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.

8. 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. The credit facility bears interest at prime 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 December 31, 2008 the Company was in compliance with the bank's financial covenants.

9. CAPITAL STOCK

Authorized capital:

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

Changes during the year:

	Number of shares issued	Amount
Balance, December 31, 2007	665,553	$ 19,966,602
Issued	84,838	2,545,148
Issued through dividend reinvestment plan	44,367	1,331,004
Redeemed	(32,362)	(970,851)
Balance, December 31, 2008	762,396	$ 22,871,903

9. CAPITAL STOCK (Continued)

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.

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 and acts as share registrar and transfer agent for the Company.

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, 2008 were $369,876 and the total fees paid to W.A. for the year ended December 31, 2008 were $81,226 under these contracts.

11. 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, 2008, 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.