

FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS (UNAUDITED)

AS AT JUNE 30, 2010

Notice Under National Instrument 81-106 (para 2.12): 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, 2010 and 2009.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS AS AT JUNE 30, 2010

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FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF NET ASSETS (UNAUDITED) AS AT JUNE 30, 2010

	June 30, 2010 \$	December 31, 2009 \$
ASSETS		
Cash	430,882	206,651
Temporary investments (Note 6)	1,776,047	50,239
Accrued interest receivable	148,875	158,497
Accounts receivable	-	66,030
Mortgages (Note 7)	28,086,256	28,083,274
Prepaid expenses	61,366	7,190
	<hr/>	<hr/>
	30,503,426	28,571,881
LIABILITIES		
Bank line of credit (Note 8)	\$ -	\$ 265,000
Accounts payable and accrued expenses	18,931	30,920
Prepaid mortgage payments	57,234	123,115
	<hr/>	<hr/>
	76,165	-
	<hr/>	<hr/>
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY	30,427,261	28,152,846
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NET ASSETS PER SHARE (Note 11)	30.00	30.00
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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, 2010 \$	Six months ended June 30, 2009 \$
INTEREST INCOME	1,389,390	1,184,077
EXPENSES		
Administration and management fees (Note 10)	307,018	249,214
Audit fees	10,197	\$ 6,600
Director fees	20,192	9,574
General and operating expenses	104,337	112,520
Interest on credit line	753	1,675
Legal fees	18,089	25,701
Realized losses on mortgages	211,699	1,055
Unrealized change in fair value of mortgages	(83,000)	20,000
	589,285	426,339
NET EARNINGS FROM OPERATIONS	800,105	757,738
WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING	963,982	823,628
NET EARNINGS PER SHARE	\$ 0.83	\$ 0.92

The accompanying notes are an integral part of these financial statements

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF CHANGES IN NET ASSETS (UNAUDITED)

	Six months ended June 30, 2010 \$	Six months ended June 30, 2009 \$
NET ASSETS , beginning of period	28,152,846	22,871,903
Increase in net assets from operations	800,105	757,738
Share capital transactions		
Proceeds from issuance of shares	1,502,880	2,962,050
Reinvested distributions	771,535	757,738
	2,274,415	3,719,788
Distributions to shareholders		
Dividends to shareholders	(800,105)	(757,738)
NET ASSETS , end of period	30,427,261	26,591,691

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, 2010 \$	Six months ended June 30, 2009 \$
CASH FROM OPERATING ACTIVITIES		
Net earnings from operations	800,105	757,738
Items not requiring an outlay of cash:		
Unrealized change in fair value of mortgages	(83,000)	\$ 20,000
Realized losses on mortgages	211,699	1,055
Changes in non-cash balances:		
Decrease in accrued interest receivable	9,622	779
Decrease in accounts receivable	66,030	-
(Increase) in prepaid expenses	(54,176)	(13,881)
(Decrease) increase in accounts payable and accrued expenses	(11,989)	22,521
(Decrease) in prepaid mortgage payments	(65,881)	-
NET CASH PROVIDED BY OPERATING ACTIVITIES	872,410	788,212
FINANCING ACTIVITIES		
Proceeds from issuance of shares	1,502,880	2,962,050
(Decrease) in bank line of credit	(265,000)	(330,000)
Cash dividends	(28,570)	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	1,209,310	2,632,050
INVESTING ACTIVITIES		
Net investment in temporary investments	(1,725,808)	(1,075,075)
Investment in mortgages	(9,574,303)	(6,487,658)
Repayment of mortgages	9,442,622	4,184,022
NET CASH USED IN INVESTING ACTIVITIES	(1,857,489)	(3,378,711)
NET INCREASE (DECREASE) IN CASH	224,231	41,551
CASH, beginning of period	206,651	11,776
CASH, end of period	430,882	53,327

The accompanying notes are an integral part of these financial statements

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO (UNAUDITED) AS AT JUNE 30, 2010

	Par Value	Average Cost	Market Value
MONEY MARKET 5.84%			
RBC Premium Money Market Fund	\$ <u>1,776,047</u>	\$ <u>1,776,047</u>	\$ <u>1,776,047</u>

Money market investments earn an annualized return of 0.18%.

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 92.31%	<u>28,086,256</u>	<u>28,086,256</u>	<u>28,086,256</u>
TOTAL INVESTMENTS 98.14%		\$ <u>29,862,303</u>	29,862,303
CASH AND OTHER NET ASSETS 1.86%			564,958
NET ASSETS (100%)			\$ <u>30,427,261</u>

DISTRIBUTION OF MORTGAGES

	Interest Rates	Number of mortgages	Amortized Cost	Current Value
Mortgages are 69% residential and 31% commercial. All mortgages are pre-payable, uninsured conventional mortgages with terms to maturity ranging from 1 to 2 years.	8% or less	4	\$ 276,738	\$ 276,738
	8.01-9.00%	7	3,190,680	3,190,680
	9.01-10.00%	23	5,016,162	5,016,162
	10.01-11.00%	44	8,579,721	8,579,721
	11.01-12.00%	65	10,885,839	10,885,839
	12.01-13.00%	<u>2</u>	<u>137,116</u>	<u>137,116</u>
		<u>145</u>	\$ <u>28,086,256</u>	\$ <u>28,086,256</u>

FRONTENAC MORTGAGE INVESTMENT CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2010

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 estimated fair value in accordance with Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 18 - "Investment Companies" ("AG-18") and CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement". This change in accounting policy has been applied retroactively. As explained in more detail in Note 7, due to the short-term nature of the Company's mortgages, the estimated fair value of the Company's mortgages is approximately equal to amortized cost and all other financial instruments' fair value approximates their carrying value. Therefore, there was no impact resulting from this change in accounting policy on the comparative figures presented in these financial statements. The figure presented in the comparative figures as provision for mortgage losses has been reclassified as unrealized change in fair value of mortgages.

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) 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) Mortgages

Mortgages are stated at estimated fair value in accordance with CICA AG-18. Any unrealized changes in the fair value of a mortgage are recorded in the net earnings for the period. The estimated fair value of mortgages 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.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2010

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

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

(i) Financial assets:

Cash and temporary investments are classified as held-for-trading and recorded at fair value. Accounts receivable and accrued interest 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 prepaid mortgage payments 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.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2010

4. CAPITAL STRUCTURE FINANCIAL POLICIES (Continued)

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

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

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 mortgages are classified using Level 3 measures.

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 an annualized return of approximately 0.18% (year ended December 31, 2009 - 0.89%). 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 145 mortgages (December 31, 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 June 30, 2010 was \$194,420 (December 31, 2009 - \$199,058) and the largest mortgage was \$1,840,161 (December 31, 2009 - \$1,772,012).

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 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 June 30, 2010 was 10.80% (December 31, 2009 - 10.84%).

FRONTENAC MORTGAGE INVESTMENT CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2010

7. MORTGAGES (Continued)

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 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. The fair values of performing mortgages have been estimated to be equal to their carrying values due to the fact that they are short-term in nature and borrowers may repay the mortgage at any time without penalty or bonus. 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 mortgages:

	As at January 1, 2010	Realized fair value gain (loss)	Unrealized fair value gain (loss)	Net advances and repayments	As at June 30, 2010
Financial asset:					
Mortgages	28,083,274	(211,699)	83,000	9,574,303	28,086,256

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, 2010, the Company's liabilities consisted of accounts payable and accrued expenses totaling all \$18,931 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.

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 and is repayable on demand. The availability of funds may be cancelled or restricted by the bank at any time. The credit facility bears interest at bank prime rate of 2.50% (December 31, 2009 - 2.25%) 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, 2010 the Company was in compliance with the bank's financial covenants.

FRONTENAC MORTGAGE INVESTMENT CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2010

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, 2010		Year ended December 31, 2009	
	Number of shares issued	\$	Number of shares issued	\$
Balance, beginning of period	938,428	28,152,846	762,396	22,871,903
Issued	49,144	1,474,310	158,432	4,752,959
Issued through dividend reinvestment plan	26,670	800,105	49,740	1,492,209
Redeemed			(32,140)	(964,225)
Balance, end of period	1,014,242	30,427,261	938,428	28,152,846

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.

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, 2010 were \$149,765 (six months ended June 30, 2009 - \$121,568) and the total fees paid to W.A. for the six months ended June 30, 2010 were \$157,253 (six months ended June 30, 2009 - \$127,646) 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 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 June 30, 2010, 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.