FRONTENAC MORTGAGE INVESTMENT CORPORATION

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Canadian Dollars)

FRONTENAC MORTGAGE INVESTMENT CORPORATION

YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Canadian Dollars)

CONTENTS

Independent Auditor's Report

To the Shareholders of Frontenac Mortgage Investment Corporation:

Opinion

We have audited the financial statements of Frontenac Mortgage Investment Corporation (the "Company"), which comprise the statements of financial position as at December 31, 2018 and December 31, 2017, and the statements of comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and December 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audits in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audits of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the Management Report of Fund Performance.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audits of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audits or otherwise appears to be materially misstated. We obtained the Management Report of Fund Performance prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, 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.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audits and significant audit findings, including any significant deficiencies in internal control that we identify during our audits.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Shawn Mincoff.

MNP LLP

Ottawa, Ontario — Chartered Professional Accountants

March 15, 2019 — Licensed Public Accountants

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENTS OF FINANCIAL POSITION

(In Canadian Dollars)

	As at December 31, 2018 $	As at December 31, 2017 $
ASSETS		
Cash and cash equivalents	45,324	-
Due from administrator in trust (Note 5)	120,053	574,788
Accrued interest receivable	11,194,987	10,251,803
Mortgage investments (Note 6)	180,967,671	189,980,578
Prepaid expenses	16,200	16,200
	192,344,235	200,823,369
LIABILITIES		
Bank indebtedness	-	79,627
Bank line of credit (Note 7)	13,880,000	16,580,000
Dividends payable	321,444	428,662
Accounts payable and accrued liabilities	186,717	192,852
Prepaid mortgage payments	168,609	316,111
	14,556,770	17,597,252
NET ASSETS REPRESENTING SHAREHOLDERS' EQUITY (Note 8)	177,787,465	183,226,117
NUMBER OF SHARES ISSUED AND OUTSTANDING (Note 8)	5,926,249	6,141,401
NET ASSETS PER SHARE	30.00	29.84

APPROVED ON BEHALF OF THE BOARD:

__________________________ Director

__________________________ Director

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

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In Canadian Dollars)

	Year ended December 31, 2018 $	Year ended December 31, 2017 $
INTEREST INCOME	18,134,892	16,178,501
EXPENSES		
Management and administration fees (Note 9)	4,608,592	4,229,612
Audit fees	96,565	69,905
Director fees	122,264	102,772
General and operating expenses	339,330	485,329
Interest on bank line of credit	707,639	54,372
Legal fees	168,260	55,604
Custodian fees	21,069	16,812
Provision for mortgage impairment losses (Note 6)	738,184	2,817,427
	6,801,903	7,831,833
NET INVESTMENT INCOME	11,332,989	8,346,668
NET INCOME AND COMPREHENSIVE INCOME	11,332,989	8,346,668
BASIC AND DILUTED WEIGHTED AVERAGE NUMBER OF SHARES ISSUED AND OUTSTANDING	6,627,479	6,572,180
BASIC AND DILUTED EARNINGS PER SHARE	$ 1.71	$ 1.27

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

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In Canadian Dollars)

	Year ended December 31, 2018 $	Year ended December 31, 2017 $
NET ASSETS, beginning of year	183,226,117	191,904,019
Net income from operations	11,332,989	8,346,668
Share capital transactions		
Proceeds from issuance of shares for cash	22,998,073	5,614,809
Reinvested dividends	5,631,065	5,182,391
Shares redeemed	(35,192,790)	(18,459,102)
	(6,563,652)	(7,661,902)
Distributions to shareholders		
Dividends to shareholders	(10,207,989)	(9,362,668)
NET ASSETS, end of year	177,787,465	183,226,117
Dividends per share	1.54	1.43

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

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENTS OF CASH FLOW

(In Canadian Dollars)

	Year ended December 31, 2018 $	Year ended December 31, 2017 $
CASH FROM OPERATING ACTIVITIES		
Net income	11,332,989	8,346,668
Items not requiring an outlay of cash:		
Provision for mortgage impairment losses	738,184	2,817,427
Net changes in non-cash operating items:		
Decrease in due from administrator in trust	454,735	659,416
(Increase) in accrued interest receivable	(943,184)	(2,515,466)
Decrease in prepaid expenses	-	12,784
Increase (decrease) in accounts payable and accrued expenses	(6,135)	99,986
NET CASH PROVIDED BY OPERATING ACTIVITIES	11,576,589	9,420,815
FINANCING ACTIVITIES		
Increase (decrease) in bank line of credit	(2,700,000)	16,580,000
Proceeds from issuance of common shares for cash	22,998,073	5,614,809
Cash dividends	(4,684,142)	(4,142,228)
Redemption of common shares	(35,192,790)	(18,459,102)
NET CASH USED IN FINANCING ACTIVITIES	(19,578,859)	(406,521)
INVESTING ACTIVITIES		
Decrease in prepaid mortgage payments	(147,502)	(105,451)
Mortgage investments	(90,805,545)	(99,180,264)
Repayment of mortgage investments	99,080,268	82,165,592
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	8,127,221	(17,120,123)
NET INCREASE IN CASH AND CASH EQUIVALENTS (BANK INDEBTEDNESS)	124,951	(8,105,829)
CASH AND CASH EQUIVALENTS (BANK INDEBTEDNESS), beginning of year	(79,627)	8,026,202
CASH AND CASH EQUIVALENTS, end of year	45,324	(79,627)

Additional information:

Interest received	17,191,708	13,663,035
Interest paid	707,639	54,372

FRONTENAC MORTGAGE INVESTMENT CORPORATION

STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2018

INVESTMENT PORTFOLIO

		Principal Value	Amortized Cost	Fair Value
Private mortgages	101.79%	$ 184,063,359	$ 180,967,671	$ 180,967,671
Cash & other net assets	6.02%			10,699,794
Bank line of credit	(7.81)%			(13,880,000)
Net assets	100.00%			$ 177,787,465

DISTRIBUTION OF MORTGAGE INVESTMENTS

Interest rate	Number of mortgages	Amortized cost	Fair value
5%	3	$ 3,320,636	$ 3,320,636
6%	1	7,528,456	7,528,456
7%	13	3,284,932	3,284,932
8%	64	27,206,945	27,206,945
9%	179	43,784,895	43,784,895
10%	247	70,028,886	70,028,886
11%	35	9,218,458	9,218,458
12%	35	16,594,463	16,594,463
	577	$180,967,671	$180,967,671

Mortgages are 91.05% residential and 8.95% commercial and vacant land. All mortgages are uninsured conventional mortgages and substantially all mortgages are pre-payable, at the option of the borrower, with terms to maturity ranging from 1 to 2 years.

The accompanying notes form an integral part of these financial statements

1. DESCRIPTION AND ORGANIZATION OF THE BUSINESS

Frontenac Mortgage Investment Corporation (the "Company") was incorporated on October 26, 2004 pursuant to the *Canada Business Corporations Act* and operates as a Canadian mortgage investment corporation as defined under the *Income Tax Act* of Canada. The registered head office of the Company is 14216 Road 38, Sharbot Lake, Ontario, K0H 2P0. W.A. Robinson Asset Management Ltd. is the Company's manager (the "Manager").

2. BASIS OF PRESENTATION

(a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and with National Instrument 81-106 Investment Funds Continuous Disclosure ("NI 81-106").

These financial statements were approved for issue by the Board of Directors on March 8, 2019.

(b) Change in Accounting Policy

Effective January 1, 2018 the Company adopted IFRS 9 Financial Instruments (“IFRS 9”) which replaced IAS 39 - Financial Instruments: Recognition and Measurement, which was the previous financial instrument accounting guidance. IFRS 9 addresses classification and measurement of financial assets and liabilities, as well as impairment of financial assets.

IFRS 9 was applied on a modified retrospective basis. As permitted, prior period comparative financial statements were not restated. They are reported under IAS 39 and are therefore not comparable to the information presented for 2018. The IAS 39 accounting policies for financial instruments that were applied prior to January 1, 2018 are included in Note 3(d).

The adoption of IFRS 9 on January 1, 2018 resulted in changes in accounting policies for mortgages receivable which became effective January 1, 2018. It was opted for that any measurement difference in the carrying amounts on January 1, 2018 would be recognized through an adjustment to retained earnings on that date. As at January 1, 2018 management’s statistical analysis indicated that there was an immaterial difference and therefore no adjustment was required to be made to the allowance due primarily to the short-term duration of the financial assets held.

Financial liabilities continue to be initially recognized at fair value net of transaction costs and are subsequently measured at amortized cost (see Note 3(k)(ii)). Other financial assets have been and continue to be recognized consistent with the requirements of IFRS 9 (see Note (3)(k)(i)).

(c) Basis of measurement

These financial statements have been prepared on the historical cost basis, except for financial instruments classified as fair value through profit or loss, which are measured at fair value.

(d) Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the functional currency of the Company.

2. BASIS OF PRESENTATION (Continued)

(e) Use of estimates and judgements

The preparation of financial statements in accordance with IFRS requires management to make assumptions and estimates and judgements 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.

In making estimates and judgements, the Manager relies on external information and observable conditions where possible supplemented by internal analysis as required. Those estimates and judgements have been applied in a manner consistent with the prior period and there are no known trends, commitments, events, or certainties that are believed to materially affect the methodology or assumptions utilized in making those estimates in these financial statements. Actual amounts could differ from these estimates. Changes in estimates are recorded in the accounting period in which they are determined. Significant estimates used in determining the recorded amount for assets and liabilities in the financial statements are as follows:

(i) Mortgage investments:

The Company is required to make an assessment as to whether the credit risk of a mortgage has changed significantly since initial recognition and is also required to determine the impairment of mortgage investments. The Company considers a number of factors when assessing if there has been a significant increase in credit risk. Mortgages with payments over 30 days in arrears are immediately flagged as potentially being in Stage 2. Other factors that the Company considers when confirming if there has been a significant increase in credit risk include changes in the financial condition of the borrower, responsiveness of the borrower, and other borrower or property specific information that may be available. Mortgage investments are considered to be impaired only if objective evidence indicates that one or more events have occurred after its initial recognition that have a negative effect on the estimated future cash flows of that asset. The estimation of future cash flows includes assumptions about local real estate market conditions, market interest rates, availability and terms of financing, underlying value of the security and various other factors. These assumptions are limited by the availability of reliable comparative market data, economic uncertainty and the uncertainty of future events. Accordingly, by their nature, estimates of impairment are subjective and may not necessarily be comparable to the actual outcome. Should the underlying assumptions change, the estimated future cash flows could vary.

The Company has incorporated forward looking information through the use of an Autoregressive Distributed Lag (“ARDL”) model. ARDL models allow the Company to forecast various statistics and assess the material impact, or lack thereof, of certain information on its performance. Information was selected for inclusion in the model based on evidence that it materially explains the likelihood of mortgage impairment as well as operating statistics specific to the Company’s mortgage portfolio which proxy the lending environment in the Company’s target market. Specifically, the Company included information on borrower credit score, loan to value ratio, debt servicing ratio, borrower age, portfolio net cash position, current portfolio impairment levels, and current portfolio net return. National statistics and macroeconomic forecasts were not included as they are not statistically significant indicators of future performance due to the geographically restricted and relatively small size of the Company’s lending business.

IFRS 9 uses an expected credit loss (“ECL”) model to determine the provision for credit losses.

2. BASIS OF PRESENTATION (Continued)

(e) Use of estimates and judgements (Continued)

The ECL allowances are calculated through three probability-weighted forward-looking scenarios including base, optimistic, and pessimistic, that measures the expected cash shortfalls on the financial assets related to default events either (i) over the next 12 months or (ii) over the expected life based on the maximum contractual period over which the Company is exposed to credit risk. The expected life of certain revolving credit facilities is based on the period over which the Company is exposed to credit risk and where the credit losses would not be mitigated by management actions. The three scenarios are updated at each reporting date, and the probability weights and the associated scenarios are determined through a management review process that involves significant judgement and review by the Company's Finance and Risk management groups.

Upon initial recognition of financial assets, the Company recognizes a 12-month ECL allowance which represents the portion of lifetime ECL that result from default events that are possible within the next 12 months (Stage 1). If there has been a Significant Increase in Credit Risk ("SICR"), the Company then recognizes a lifetime ECL allowance resulting from possible default events over the expected life of the financial asset (Stage 2). The SICR is determined through changes in the lifetime probability of default ("PD") since initial recognition of the financial assets, using a combination of borrower specific and account specific attributes with a presumption that credit risk has increased significantly when contractual payments are more than 30 days past due. This assessment considers all reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions that impact the Company's credit risk assessment. Criteria for assessing SICR are defined at a portfolio level and vary based on the risk of default at the origination of the portfolio. If credit quality subsequently improves such that the increase in credit risk since initial recognition is no longer significant, the loss allowances will revert back to be measured based on a 12-month ECL, and the financial asset will transfer from Stage 2 back to Stage 1. Stages 1 and 2 comprise all non-impaired financial assets.

Management developed a modeling of the Stage 2 estimate which requires a reassessment of the overall credit risk resulting from a SICR. The model developed for SICR assumes a complete degradation in credit quality as proxied by the borrower's Beacon Score. This enters into a logistic regression to estimate lifetime probability of default based on this new assumption. The lifetime probability of default estimate then enters into the Survival Analysis as a parameter to allow probability of default to be estimated over the remaining term to maturity.

In addition, management exercises expert credit judgements in assessing exposures that have experienced a SICR and in determining the amount of ECL allowances required at each reporting date by considering reasonable and supportable information that are not already included in the quantitative models. Expert credit judgements are performed by considering emergence of economic, environmental or political events, as well as expected changes to parameters, models or data that are not currently incorporated. Significant judgements made by management may impact the amount of ECL allowances recognized. ECL is calculated as the product of PD, loss given default ("LGD"), and exposure at default ("EAD"), and is calculated over the remaining expected life of the financial asset and discounted to the reporting date at the respective effective interest rate. PD measures the estimated likelihood of default over a given time period. PD estimates are updated for each scenario at each reporting date and is based on current information. LGD provides the estimate of loss when default occurs at a given time, and is determined based on historical write-off events, recovery payments, borrower specific attributes and direct costs. The estimate is updated at each reporting date for each scenario based on current information. EAD estimates the exposure at the future default date.

2. BASIS OF PRESENTATION (Continued)

(e) Use of estimates and judgements (Continued)

Financial assets with objective evidence of impairment as a result of loss events that have a negative impact on the estimated future cash flows are considered to be impaired requiring the recognition of lifetime ECL allowances. (Stage 3). Deterioration in credit quality is considered an objective evidence of impairment and includes observable data that comes to the attention of the Company, such as significant financial difficulty of the borrower. The Company defines default as when there is identification of objective evidence of impairment (which could, for example, be delinquency of 90 days or more). A financial asset is no longer considered impaired when past due amounts have been recovered, and the objective evidence of impairment is no longer present.

Financial assets are written off, either partially or in full against the related allowances for credit losses when the Company believes there are no reasonable expected future recoveries through payments or the sale of the related security. Any recoveries of amounts previously written off are credited against provision for credit losses in the statements of income and comprehensive income.

Loan Modification

The Company defines loan modification as changes to the original contractual terms of the financial asset that represents a fundamental change to the contract or changes that may have a significant impact on the contractual cash flow of the asset. The Company derecognizes the original asset when the modification results in significant change or expiry in the original cash flows; a new asset is recognized based on the new contractual terms. The new asset is assessed for staging and SICR to determine the corresponding ECL measurement required at the date of modification. If the Company determines the modifications do not result in derecognition, then the asset will retain its original staging and SICR assessments."

(ii) Fair value measurements:

In accordance with IFRS, 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 properties held for sale under foreclosure 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 10, management makes its determination of fair value of mortgages by discounting future cash flows at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk.

These assumptions are limited by the availability of reliable comparative market data, economic uncertainty and the uncertainty of future events. Accordingly, by their nature, measurements of fair value are subjective and may not necessarily be comparable to the actual outcome. Should the underlying assumptions change, the estimates could vary.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue recognition

Interest income on mortgage investments and other investment income are recognized on a time proportionate basis using the effective interest rate method. Interest is calculated on the gross carrying amount for each mortgage receivable in Stage 1 and Stage 2 and interest is not accrued on the mortgage receivable identified as being in Stage 3.

(b) Cash and cash equivalents

The Company considers highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value to be cash equivalents. Cash equivalents are initially recognized at their fair value plus any attributable transaction costs. Any changes in the fair value of the cash equivalents are recorded in the statement of income and comprehensive income for the period.

(c) Mortgage investments

Mortgages receivable are a financial asset and are recognized initially at fair value and are subsequently carried at amortized cost using the effective interest method. The Company's business model is to hold mortgages receivable to collect cash flows that represent solely payments of principal and interest. Mortgages receivable are assessed for impairment at the end of each reporting period in accordance with IFRS 9 as outlined below and are presented net of provisions for mortgages losses on the statement of financial position.

IFRS 9 uses an ECL model to determine the provision for credit losses. The ECL model is forward looking and results in a provision for mortgage losses being recorded on the financial statements regardless if there has been a loss event. ECLs are the difference between the present value of all contractual cash flows that are due under the original terms of the contract and the present value of all cash flows expected to be received.

The ECL model uses a three-stage impairment approach based on changes in the credit risk of the financial asset since initial recognition. The three stages are as follows: Stage 1 – financial assets that have not experienced a significant increase in credit risk since initial recognition. Stage 2 – financial assets that have experienced a significant increase in credit risk between initial recognition and the reporting date. Stage 3 – financial assets for which there is objective evidence of impairment at the reporting date. The Company considers a number of factors (see 2e i) when assessing if there has been a significant increase in credit risk.

The ECL model requires the recognition of credit losses equal to 12-month ECLs for Stage 1 financial assets and ECLs for the remaining life of the financial assets (lifetime expected credit losses) for financial assets classified as Stage 2 and 3. The lifetime expected credit losses represent the expected loss in value due to possible defaults events over the life of the financial instrument weighted by the likelihood of a loss. Three factors are primarily used to measure ECLs: probability of default, loss given default and exposure at default . These factors are used to estimate the ECLs for mortgages receivable classified at Stage 1. When mortgages receivable are considered to have experienced a significant increase in credit risk (Stage 2) or are considered to be impaired (Stage 3), each loan category is assessed and the ECL estimated (on an individual basis for those mortgages in Stage 3). A loan is considered impaired only if objective evidence indicates that one or more events have occurred after its initial recognition that have a negative effect on the estimated future cash flows of the loan.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Mortgage investments (continued)

When a subsequent event causes the amount of an impairment to decrease, the decrease in impairment loss is reversed through profit or loss

(d) Financial instruments - IAS 39 accounting policy applied prior to January 1, 2018

Financial assets and liabilities

The Company's most significant financial asset consists of its mortgage investments. Mortgage investments are classified as loans and receivables.

The Company's other financial assets consist of cash and cash equivalents, due from administrator in trust, and accrued interest receivable. The Company's financial liabilities consist of bank line of credit, dividends payable, and accounts payable and accrued liabilites. The fair value of these financial instruments approximate their carrying value, unless otherwise noted.

The Company classifies its financial assets as one of the following: loans and receivables or fair value through profit or loss ("FVTPL"). Financial liabilities are classified as: held-for-trading or financial liabilities at amortized cost. The Company has designated its financial assets and financial liabilities as follows:

(i) Financial Assets

Cash and cash equivalents are classified as FVTPL. Due from administrator in trust, accrued interest receivable, and mortgage investments are classified as loans and receivables and recorded at amortized cost.

(ii) Financial liabilites:

Bank line of credit, dividends payable, and accounts payable and and accrued expenses are classified as financial liabilites at amortized cost.

Mortgage investments - impairment measurement

Mortgage investments are financial instruments and are classified as loans and receivables. These investments are recognized initially at fair value plus any attributable transaction costs. Subsequent to initial recognition, the mortgage investments are measured at amortized costs using the effective interest rate method, less any impairment losses. The mortgage investments are assessed on each reporting period date to determine whether there is objective evidence of impairment. A financial asset is considered impaired only if objective evidence indicates that one or more events have occurred after its inital recognition that have a negative effect on the estimated future cash flows of the asset.

An impairment loss in respect of specific mortgage investments is calculated as the difference between its carrying amount including accrued interest and the present value of the estimated future cash flows discounted at the investment's original effective interest rate. Losses are recognized in profit and loss and reflected in an allowance account against the mortgage investments. When a subsequent event causes the amount of an impairment to decrease, the decrease in impairment loss is reversed through profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Properties held for sale under foreclosure

When the Company obtains legal title of the underlying security of an impaired mortgage investment through foreclosure, the carrying value of the mortgage investment, which comprises of the outstanding principal amount, costs incurred, accrued interest, and a provision for mortgage impairment loss, if any, is reclassified from mortgage investments to foreclosed properties held for sale. The intention of the Company is to sell foreclosed properties as soon as possible in a commercially responsible manner. At each reporting date, foreclosed properties held for sale are measured at fair value. 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 properties held for sale under foreclosure is determined by its estimated fair value net of selling expenses taking into consideration independent appraisals, assessement of market conditions, and other various factors.

(f) Income taxes

The Company is considered a mortgage investment corporation under the *Income Tax Act* (Canada). As such, the Company is entitled to deduct from its taxable income dividends paid to shareholders during the year or within 90 days of the end of the year to the extent that such dividends were not deducted previously. The Company intends to maintain its status as a mortgage investment corporation and intends to distribute sufficient dividends in the year and in future years to ensure the Company is not subject to income taxes. Accordingly, for financial statement reporting purposes, the tax deductibility of the Company's dividends results in the Company effectively being exempt from taxation and no provision for current or deferred income taxes is required.

(g) 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 netted against the related mortgages and recognized into revenue using the effective interest method.

(h) 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.

(i) Net assets

Net assets consists of issued and outstanding common shares of the Company and is classified as equity.

(j) 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.

(k) Financial assets and liabilities

The Company's most significant financial asset consists of its mortgage investments. Mortgage investments are classified as measured at amortized cost. 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)

(k) Financial assets and liabilities (continued)

The Company's other financial assets consist of cash and cash equivalents, due from administrator in trust, and accrued interest receivable. The Company's financial liabilities consist of bank line of credit, dividends payable, and accounts payable and accrued liabilities. 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.

The Company classifies its financial assets as one of the following: measured at amortized cost or fair value through profit or loss ("FVTPL") or fair value through other comprehensive income ("FOCI"). Financial liabilities are classified as: FVTPL or financial liabilities at amortized cost. The Company has designated its financial assets and financial liabilities as follows:

(i) Financial assets:

Cash and cash equivalents are classified as FVTPL. Due from administrator in trust, accrued interest receivable, and mortgage investments are classified as measured at amortized cost.

(ii) Financial liabilities:

Bank indebtedness is classified as FVTPL. Bank line of credit, dividends payable, and accounts payable and accrued expenses are classified as financial liabilities at amortized cost.

(l) Accounting pronouncements

At the date of authorization of these financial statements, certain new standards, and amendments to existing standards have been published by the International Accounting Standards Board ("IASB"). Information on those expected to be relevant to the Company's financial statements is provided below.

Management anticipates that all relevant pronouncements will be adopted in the Company's accounting policies for the first period beginning after the effective date of the pronouncement. New standards, interpretations, and amendments not either adopted or listed below are not expected to have a material impact on the Company's financial statements.

- IFRS 16 - Leases ("IFRS 16")

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement contains a Lease, SIC- 15 Operating Leases - Incentives and SIC - 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. It eliminates the distinction between operating and finance leases from the perspective of the lessee. All contracts that meet the definition of a lease will be recorded in the condensed interim financial statements with a "right of use" asset and a corresponding liability. The asset is subsequently accounted for as a property, plant and equipment or investment property and the liability is unwound using the interest rate inherent in the lease. The accounting requirements from the perspective of the lessor remain largely in line with previous IAS 17 requirements. The effective date for IFRS 16 is January 1, 2019. The Company is currently assessing the impact of IFRS 16 to its financial statements. Based on a preliminary assessment of the standard the Company does not expect this standard to have a significant impact on its financial statements.

(In Canadian Dollars)

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 targets to maintain a cash reserve (consisting of cash, near cash investments, and the Company's approved credit line) of approximately 5% of its net 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 sufficient cash reserves are maintained to meet shareholder redemption requests. As at December 31, 2018 and 2017, 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. DUE FROM ADMINISTRATOR IN TRUST

As part of the mortgage underwriting and adminsitration services provided to the Company, Pillar Financial Services Inc. (the "Administrator") collects repayments, both regular periodic repayments and repayments of outstanding balances in full, from borrowers through the Administrator's electronic payments collection system. These repayments are electronically deposited into a trust account of the Administrator. Funds are deposited from the Administrator's trust account into the Company's bank account within a few business days once the funds have been confirmed cleared from the borrower.

6. MORTGAGE INVESTMENTS

There are 577 mortgages (December 31, 2017 - 638) held which are a combination of mainly first and second mortgages secured by residential, commercial property, and property under development. Mortgage investments consist of the following:

	As at December 31, 2018	**As at December 31, 2017**
	$	$
Mortgages	184,063,359	193,480,773
Allowance for impairment losses	(3,095,688)	(3,500,195)
	180,967,671	189,980,578

(In Canadian Dollars)

6. MORTGAGE INVESTMENTS (Continued)

Broken down by mortgage investments and allowance for credit losses as follows:

Gross investments at amortized cost **As at December 31, 2018**

	Stage 1	Stage 2	Stage 3	Total
	$	$	$	$
Commercial	3,304,349	363,261	537,996	4,205,606
Residential	72,303,060	1,358,354	3,615,332	77,276,746
Residential construction	44,686,344	56,815	813,584	45,556,743
Residential developments	28,697,105		16,142,873	44,839,978
Vacant land	10,995,689	255,318	933,278	12,184,286
	159,986,548	2,033,748	22,043,064	184,063,359

Allowance for credit losses on loans **As at December 31, 2018**

	Stage 1	Stage 2	Stage 3	Total
	$	$	$	$
Commercial	1,577	6,788	41,437	49,802
Residential	82,794	23,816	280,379	386,989
Residential construction	53,267	10,629	4,206	68,102
Residential developments	17,239		2,403,589	2,420,828
Vacant land	16,494	7,045	146,428	169,967
	171,371	48,277	2,876,039	3,095,688

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, 2018, there are 27 mortgages totaling $22,043,064 (December 31, 2017 - 24 mortgages totaling $7,930,370) that are past due and 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.

(In Canadian Dollars)

6. MORTGAGE INVESTMENTS (Continued)

The fair value of collateral held against impaired mortgages at December 31, 2018 was approximately $29,443,500 (December 31, 2017 - $9,524,000).

The following table presents a continuity of the provision for impairment losses:

	2018 $	2017 $
Balance - beginning of year	3,500,195	1,754,000
Deduct: realized losses for year	(1,142,691)	(1,071,232)
Add: provision for credit losses for year	738,184	2,817,427
Balance - end of year	3,095,688	3,500,195

Principal repayments based on contractual maturity dates are as follows:

	$
2019	172,330,000
2020	8,637,000
Thereafter	671
Total	180,967,671

Substantially all of the 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, 2018 was 9.10% (December 31, 2017 - 9.05%).

Mortgages past due but not impaired are as follows:

	2018 $	2017 $
1 to 30 days	2,794,179	2,658,036
31 - 90 days	1,224,841	525,474
over 90 days	808,907	5,871,121
over 90 days	4,827,927	9,054,631

Credit risk

Credit risk Is the risk of financial loss resulting from the failure of a counterparty, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from our mortgage lending activities. Fluctuations in real estate values may reduce the net realizable value of the collateral property to the Company. These risks may result in defaults and credit losses, which may result in a loss of earnings. Credit losses occur when a counterparty fails to meet its obligations to the Company and the value realized on the sale of the underlying security deteriorates below the carrying amount of the exposure. 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. This would include ensuring, at origination, that the value of the mortgage never exceeds 80% of the appraised value of the property. Due to the short term duration of the financial assets held, the quality of the collateral tends to be impacted more so by specific factors relating to the borrower, such as their ability to maintain the property, as opposed to market fluctuations. The maximum exposure to credit risk at December 31, 2018 is the carrying values of its mortgage investments, including accrued interest receivable, which total $192,162,658 (December 31, 2017 - $200,232,381). The Company has recourse under these investments in the event of default by the borrower, in which case, the Company would have a claim against the underlying security.

6. MORTGAGE INVESTMENTS (Continued)

Credit risk (Continued)

When it is determined that there is a shortfall resulting after the sale of the property held as collateral, the Company will instruct legal counsel to pursue the mortgagor and or, if applicable, the guarantor, provided there is reasonable assurance of recovery. Likewise, in some cases further collection action is taken against other parties involved in the mortgage transaction when it is reasonable to assume they may have been negligent in fulfilling their responsibilities. In all cases, the shortfall is written off immediately and any recoveries included into income when received.

There are no significant concentrations of credit risk as the average mortgage amount as at December 31, 2018 was $319,001 (December 31, 2017 - $304,013) and the largest mortgage was $13,432,040 (December 31, 2017 - $13,271,049).

Fair values

The fair value of the mortgage investments approximates its carrying value as substantially all of the loans are short-term in nature and repayable in full at any time at the option of the borrower.

Fair value is the price that would be received to sell an assets or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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. For subsequent reporting periods, as there are no quoted prices in an active market for the Company's mortgages, management makes its determination of fair value by discounting future cash flows at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk. The discounted cash flow analysis performed assumes that all mortgages will be held until maturity and not paid out early by the borrower and at a weighted average interest rate for loans advanced within three months of the period end. Typically, the fair value of the Company's mortgage investments approximate their carrying amounts given the amounts consist of short-term loans that are repayable at the option of the borrower at any time without significant penalties.

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, 2018, the Company's financial obligations and commitments consisted of accounts payable and accrued liabilities totaling $186,717 (December 31, 2017 - $192,852) and dividends payable totaling $321,444 (December 31, 2017 - $428,662). Accounts payable and accrued liabilities along with dividends payable are all 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 $13,880,000 as at December 31, 2018 (December 31, 2017 - $16,580,000).

To mitigate its liquidity risk, the Company targets to maintain significant committed borrowing facilities from its bank for credit room within a range between 10% to 15% of net assets. As at December 31, 2018, the Company's committed borrowing facilities represented approximately 15% of net assets (December 31, 2017 - 15% of net assets). In addition, the Company has policies in place that can restrict the total amount of share redemptions. Those restrictions permit share redemptions to be funded through the normal repayment of the mortgages receivable.

7. BANK LINE OF CREDIT

The Company has established a revolving line of credit with a major Canadian chartered bank with a limit of an amount equal to 15% of net assets of the Company subject to a maximum limit of $29,000,000. 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 3.95% (December 31, 2017 - 3.20%) plus 1%.

Financial covenants require the Company to maintain a minimum level for net assets, debt to net assets ratio, and percentage of residential mortgages. The Company was in compliance with all such covenants as at December 31, 2018 and as at December 31, 2017.

(In Canadian Dollars)

8. CAPITAL STOCK

The beneficial interests of the Company are represented by a single class of shares, designated as common shares, which are unlimited in number and without par value. Each share carries a single vote at any meeting of shareholders and carries the right to participate pro rata in any dividends.

Changes during the year to issued and outstanding shares of the Company:

	Year ended December 31, 2018		**Year ended December 31, 2017**	
	Number of shares issued	$	Number of shares issued	$
Balance, beginning of year	6,141,401	183,226,117	6,396,798	191,904,019
Issued for cash	769,862	22,998,073	187,160	5,614,809
Issued through dividend reinvestment plan	188,184	5,631,065	172,746	5,182,391
Redeemed for cash	(1,173,198)	(35,192,790)	(615,303)	(18,459,102)
Undistributed net earnings/(excess distributions)		1,125,000		(1,016,000)
Balance, end of year	5,926,249	177,787,465	6,141,401	183,226,117

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 1,173,198 common shares of which 1,151,842 were redeemed at $30.00 per share and the balance were redeemed at the price in effect at the time which ranged from $29.84 to $29.95 per share for total proceeds of $35,192,790. For the year ended December 31, 2017, 615,303 common shares were redeemed for cash at the price of $30.00 per share for total proceeds of $18,459,102.

The Company had no potentially dilutive instruments as at December 31, 2018 or December 31, 2017.

9. RELATED PARTIES

Pillar Financial Services Inc. ("Pillar") is the administrator for the Company. Its responsibilities include originating loan transactions, underwriting the mortgages, collecting mortgage payments, and the internal audit and accounting for the Company.

W.A. Robinson Asset Management Ltd. (the "Manager") 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 the Manager 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, 2018 were $2,163,630 (2017 - $1,985,420) and the total fees paid to the Manager for the year ended December 31, 2018 including applicable sales taxes were $2,444,962 (2017 - $2,244,192) 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.

(In Canadian Dollars)

10. FAIR VALUE MEASUREMENTS

The following table shows the carrying amounts and fair values of assets and liabilities:

As at December 31, 2018	**Carrying Value Basis**	**Carrying Value**	**Fair Value**
ASSETS:		$	$
Cash and equivalents	Fair value through profit & loss	45,324	45,324
Due from administrator in trust	Measured at amortized cost	120,053	120,053
Accrued interest receivable	Measured at amortized cost	11,194,987	11,194,987
Mortgage investments	Measured at amortized cost	180,967,671	180,967,671
LIABILITIES:			
Bank line of credit	Financial liabilities - amortized cost	13,880,000	13,880,000
Dividends payable	Financial liabilities - amortized cost	321,444	321,444
Accounts payable and accrued liabilities	Financial liabilities - amortized cost	186,717	186,717
Prepaid mortgage payments	Financial liabilities - amortized cost	168,609	168,609

As at December 31, 2017	**Carrying Value Basis**	**Carrying Value**	**Fair Value**
ASSETS:		$	$
Cash and equivalents	Fair value through profit & loss	-	-
Due from administrator in trust	Loans and receivables - amortized cost	574,788	574,788
Accrued interest receivable	Loans and receivables - amortized cost	10,251,803	10,251,803
Mortgage investments	Loans and receivables - amortized cost	189,980,578	189,980,578
Properties held for sale under foreclosure	Fair value through profit & loss	-	-
LIABILITIES:			
Bank indebtedness	Fair value through profit & loss	79,627	79,627
Bank line of credit	Other liabilities - amortized cost	16,580,000	16,580,000
Dividends payable	Other liabilities - amortized cost	428,662	428,662
Accounts payable and accrued liabilities	Other liabilities - amortized cost	192,852	192,852
Prepaid mortgage payments	Other liabilities - amortized cost	316,111	316,111

The valuation techniques and the inputs used for the Company's financial instruments are as follows:

(a) Mortgage Investments

There are no quoted prices in an active market for the Company's mortgages. Management makes its determination of fair value by discounting future cash flows at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk. The discounted cash flow analysis performed assumes that all mortgages will be held until maturity and not paid out early by the borrower and at a weighted average interest rate for loans advanced within three months of the period end. 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. Generally, the fair value of the mortgage investments approximate their carrying values given their short-term nature and the option of borrowers to repay at any time. Accordingly, the fair value of the mortgage investments is based on level 3 inputs.

10. FAIR VALUE MEASUREMENTS (Continued)

(b) Other financial assets and liabilities

The fair values of due from administrator in trust, accrued interest receivable, bank line of credit, bank indebtedness, dividends payable, accounts payable and accrued liabilities, and prepaid mortgage payments approximate their carrying amounts due to their short-term maturities.

11. KEY MANAGEMENT PERSONNEL COMPENSATION

The Company paid directors fees totaling $122,264 (2017 - $102,772) to the members of the Board of Directors and Independent Review Committee for their services to the Company. The compensation to the senior management of the Manager is paid through the management fees paid to the Manager (Note 9).