

**MORTGAGE INVESTMENT CORPORATION OF EASTERN
ONTARIO**

FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2010

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

DECEMBER 31, 2010

CONTENTS

	<u>Page</u>
AUDITOR'S REPORT	1
FINANCIAL STATEMENTS	
Balance Sheet	3
Statement of Income and Retained Earnings	4
Statement of Cash Flows	5
Statement of Investment Portfolio	6
Notes to Financial Statements	7-12



Independent Auditor's Report

To the Shareholders of
Mortgage Investment Corporation of Eastern Ontario

Raymond Chabot Grant Thornton LLP
2505 St-Laurent Blvd.
Ottawa, Ontario K1H 1E4

Telephone: 613-236-2211
Fax: 613-236-6104
www.rcgt.com

We have audited the accompanying financial statements of Mortgage Investment Corporation of Eastern Ontario, which comprise the balance sheet and statement of investment portfolio as at December 31, 2010 and the statements of income and retained earnings and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the balance sheet and statement of investment portfolio of Mortgage Investment Corporation of Eastern Ontario as at December 31, 2010 and the results of its operations, changes in retained earnings and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Raymond Chabot Grant Thornton LLP

Chartered Accountants,
Licensed Public Accountants

Ottawa, Ontario
April 15, 2011

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

BALANCE SHEET

AS AT DECEMBER 31, 2010

	2010	2009
	\$	\$
ASSETS		
Cash and cash equivalents	1,661,709	638,229
Loans receivable (Note 6)	17,095	22,213
Mortgage investments (Note 7)	42,155,406	36,048,335
Prepaid expenses	2,159	2,272
Incorporation	517	517
	<hr/>	<hr/>
	43,836,886	36,711,566
LIABILITIES		
Bank line of credit (Note 8)	85,000	975,000
Dividends payable	11,759	-
Accounts payable and accrued expenses	63,877	48,466
Prepaid mortgage payments	335,550	290,057
Advances received on share subscriptions (Note 9)	216,842	300,000
	<hr/>	<hr/>
	713,028	1,613,523
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 10)	43,123,858	35,098,043
	<hr/>	<hr/>
	43,836,886	36,711,566
	<hr/>	<hr/>

APPROVED ON BEHALF OF THE BOARD:

_____ Director

_____ Director

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

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

STATEMENT OF INCOME AND RETAINED EARNINGS

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
	\$	\$
INTEREST INCOME	3,836,323	3,031,904
EXPENSES		
Administration fees (Note 11)	859,943	646,310
Audit fees	13,656	11,925
Director fees	40,684	21,500
General and operating expenses	272,771	210,456
Interest and bank charges	4,600	11,705
Legal fees	8,010	15,376
	1,199,664	917,272
NET INVESTMENT INCOME	2,636,659	2,114,632
Realized losses on mortgage investments	407,057	160,615
Unrealized loss in fair value of mortgage investments	173,000	195,000
NET INCOME	2,056,602	1,759,017
DIVIDENDS		
Cash dividends	(15,084)	-
Dividends paid under share re-investment plan	(2,041,518)	(1,759,017)
	(2,056,602)	(1,759,017)
RETAINED EARNINGS - BEGINNING OF YEAR	-	-
RETAINED EARNINGS - END OF YEAR	-	-

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

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
	\$	\$
CASH FROM OPERATING ACTIVITIES		
Net investment income	2,636,659	\$ 2,114,632
Net changes in non-cash working capital balances:		
Prepaid expenses	113	(6)
Dividends payable	11,759	-
Accounts payable and accrued expenses	15,411	(6,136)
Advances received on share subscriptions	(83,158)	(100,000)
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,580,784	2,008,490
FINANCING ACTIVITIES		
Increase (decrease) in bank line of credit	(890,000)	975,000
Proceeds from issuance of shares	10,574,949	7,734,237
Cash dividends	(15,084)	-
Redemption of common shares	(4,590,652)	(3,227,027)
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,079,213	5,482,210
INVESTING		
Increase in prepaid mortgage payments	45,493	290,057
New mortgage investments	(30,278,362)	(27,653,336)
Repayment of mortgage investments	23,591,233	19,432,704
Repayment of loans receivable	5,119	2,284
NET CASH USED IN INVESTING ACTIVITIES	(6,636,517)	(7,928,291)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,023,480	(437,591)
CASH AND CASH EQUIVALENTS, beginning of year	638,229	1,075,820
CASH AND CASH EQUIVALENTS, end of year	1,661,709	638,229

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

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

STATEMENT OF INVESTMENT PORTFOLIO

AS AT DECEMBER 31, 2010

	Principal Value	Amortized Cost	Fair Value
MORTGAGES 97.75%	<u>42,613,406</u>	<u>42,155,406</u>	<u>42,155,406</u>
TOTAL INVESTMENTS 97.75%		\$ <u>42,155,406</u>	42,155,406
CASH AND OTHER NET ASSETS 2.44%			1,053,452
BANK LINE OF CREDIT (0.20)%			<u>(85,000)</u>
NET ASSETS REPRESENTED BY SHAREHOLDERS' EQUITY (100%)			\$ <u>43,123,858</u>

DISTRIBUTION OF MORTGAGE INVESTMENTS

	Interest Rates	Number of mortgages	Amortized Cost	Fair Value
Mortgages are 77% residential and 23% commercial. All mortgages are pre-payable, uninsured conventional mortgages with terms to maturity ranging from 1 to 2 years.	8%	6	\$ 935,633	\$ 935,633
	9%	21	6,658,887	6,658,887
	10%	45	15,575,344	15,575,344
	11%	36	4,986,570	4,986,570
	12%	69	13,933,424	13,933,424
	13%	<u>2</u>	<u>65,548</u>	<u>65,548</u>
		<u>179</u>	\$ <u>42,155,406</u>	\$ <u>42,155,406</u>

The accompanying notes form an integral part of these financial statements

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2010

1. DESCRIPTION OF THE BUSINESS

Mortgage Investment Corporation of Eastern Ontario (the "Company") is a Mortgage Investment Corporation as defined by the *Income Tax Act* (Canada). 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 company, the Company has amended its accounting policies to re-classify and record its mortgages at their fair value in accordance with Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 18 - "Investment Companies" ("AcG-18") and CICA Handbook Section 3855 - "Financial Instruments - Recognition and Measurement". This change in accounting policy has been applied retroactively to 2009. Applying AcG-18 did not materially change the previous year's results.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

(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) Mortgage investments

Mortgage investments are stated at fair value in accordance with CICA AcG-18. Any unrealized changes in the fair value of an investment are recorded in the net earnings for the period. The fair value of mortgage investments is determined by discounting future cash flows at the Company's prevailing rate of return on new mortgages of similar type, term, and credit risk.

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

NOTES TO THE FINANCIAL STATEMENTS (Continued)

FOR THE YEAR ENDED DECEMBER 31, 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 most significant financial instruments consist of its mortgage investments. In accordance with AcG-18, mortgage investments are required to be recorded at fair value as defined in CICA Handbook Section 3855, Financial Instruments - Recognition and Measurement. Mortgage investments are valued on the policies described in paragraph (c) above. The financial risks associated with the Company's mortgage investments and the Company's management of those risks are discussed in Note 7.

The Company's other financial instruments consist of cash and cash equivalents, loans receivable, bank line of credit, accounts payable and accrued expenses, dividends payable, and advances received on share subscriptions. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or currency risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying value, unless otherwise noted.

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

(i) Financial assets:

Cash is classified as held-for-trading and recorded at fair value.

Loans receivable are classified as loans and receivables and recorded at amortized cost.

(ii) Financial liabilities:

Bank line of credit, accounts payable and accrued expenses, dividends payable and advances received on share subscriptions 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.

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

NOTES TO THE FINANCIAL STATEMENTS (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2010

4. CAPITAL STRUCTURE FINANCIAL POLICIES (Continued)

The Company achieves its investment objective by lending on the security of mortgages on real properties situated in Canada, primarily in Eastern Ontario. The mortgages transacted by the Company will not generally meet the underwriting criteria of conventional lenders and/or involve borrowers in rural areas generally not well serviced by major lenders. As a result, the Company's investments are expected to earn a higher rate of interest than what is generally obtainable through conventional mortgage lending activities.

In order to provide some liquidity to its shareholders, the Company is required to maintain approximately 5% of its net assets in cash or near cash assets and such levels of cash reserves have been adequate to meet the needs of normal share redemption levels during the year. Management regularly monitors its available cash and credit line facility to ensure that the 5% cash reserve is maintained. As at December 31, 2010, the Company has maintained the 5% cash reserve. For unusual circumstances, the Company has redemption policies in place to restrict the payout of share redemption at levels to match the normal repayment of the mortgages receivable.

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

5. FINANCIAL INSTRUMENTS

In accordance with Canadian GAAP, the Company must classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making its fair value measurements. The following hierarchy has been used in determining and disclosing fair value of financial instruments:

Level 1: quoted prices in active markets for the same instrument (i.e. without modification or repackaging);

Level 2: quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data; and

Level 3: valuation techniques for which any significant input is not based on observable market data.

Mortgage investments are valued using Level 3 measures as there are no quoted prices in an active market for the Company's mortgages. As explained in more detail in Note 7, management makes its determination of fair value for its mortgage investments based on its assessment of the current mortgage market for mortgages of same or similar terms.

6. LOANS RECEIVABLE

There are two loans held which are due on demand, require blended monthly payments of principal and interest and are secured by promissory notes.

7. MORTGAGE INVESTMENTS

There are 179 mortgages (2009 - 167) held which are a combination of mainly first and second mortgages secured by residential and commercial property.

Credit risk

Credit risk arises from the possibility that mortgagors may experience financial difficulty and be unable to fulfil their mortgage commitments. The Company mitigates this risk by having well established lending policies in place that ensure mortgages are well secured and by limiting its exposure to any one mortgagor. There are no significant concentrations of credit risk as the average mortgage amount as at December 31, 2010 was \$234,288 (2009 - \$196,422) and the largest mortgage was \$3,501,081 (2009 - \$2,227,718). As at December 31, 2010, there are 10 mortgages totaling \$2,651,370 (2009 - 12 mortgages totaling \$2,971,316) that considered are past due by management.

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO
NOTES TO THE FINANCIAL STATEMENTS (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2010

7. MORTGAGES (Continued)

Interest rate risk

Interest rate risk arises from the possibility that at the end of a mortgage's term it will be re-priced to a prevailing interest rate lower than the original one. This risk is mitigated by the fact that the Company is not as exposed to market mortgage rates because there is no specific market for mortgages of similar type, term and credit risk. This has allowed the Company to renew its mortgages at consistent rates.

Mortgages are issued with either 1 or 2 year terms, have fixed interest rates and can be paid in full without penalty. The weighted average interest rate of the mortgages as at December 31, 2010 was 10.70% (2009 - 11.00%).

A 50 basis point increase or decrease in interest rates, with all other variables held constant, will not effect an increase or decrease in net investment income as the Company's mortgage investments are issued at fixed interest rates.

Fair Values

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties under no compulsion to act. As there are no quoted prices in an active market for the Company's mortgages, management makes its determination of fair value based on its assessment of the current mortgage market for mortgages of same or similar terms. As the Company and its borrowers are unrelated third parties under no compulsion to act, the initial terms of the mortgage represents their fair value at the time of mortgage origination. When collection of principal on a particular mortgage investment is no longer reasonably assured, the fair value of the mortgage is reduced to reflect the estimated net realizable recovery from the collateral securing the loan.

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

	2010	2009
	\$	\$
Mortgage investments - beginning of year	36,048,335	28,183,318
Realized losses	(407,057)	(160,615)
Unrealized change in fair value	(173,000)	(195,000)
Net advances and repayments	6,687,128	8,220,632
Mortgage investments - end of year	<u>42,155,406</u>	<u>36,048,335</u>

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, 2010, the Company's liabilities consisted of accounts payable and accrued expenses totaling \$63,877 all 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.

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

NOTES TO THE FINANCIAL STATEMENTS (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2010

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 3.00% (2009 - 2.25%) plus 1%.

Financial covenants require the Company to maintain a minimum levels for equity, debt to equity ratio, and percentage of residential mortgages. As at December 31, 2010 the Company was in compliance with the bank's financial covenants.

9. ADVANCES ON SHARE SUBSCRIPTIONS

The Company processes new common share issuances on the first of the month only. Promissory notes bear interest at an annual rate equal to bank prime rate and are issued for any funds received by the Company at other times of a month on account of share subscriptions. These promissory notes together with any interest calculated on a per diem basis are converted to common shares of the Company on the first day of the next month.

10. CAPITAL STOCK

Authorized capital:

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

Changes during the years:

	2010		2009	
	Number of shares issued	\$	Number of shares issued	\$
Balance, beginning of year	3,509,806	35,098,043	2,883,182	28,831,816
Issued for cash	1,057,495	10,574,949	773,425	7,734,237
Issued through dividend reinvestment plan	204,152	2,041,518	175,902	1,759,017
Redeemed for cash	<u>(459,065)</u>	<u>(4,590,652)</u>	<u>(322,703)</u>	<u>(3,227,027)</u>
Balance, end of year	<u>4,312,388</u>	<u>43,123,858</u>	<u>3,509,806</u>	<u>35,098,043</u>

Dividend reinvestment plan and direct share purchase plan

Unless a shareholder elects to receive their dividends as cash, the dividends issued to shareholders are automatically reinvested in the Company by the direct purchase of shares at \$10.00 per share.

Redemptions

During the year the Company redeemed for cash 459,065 common shares at the price of \$10.00 per share for total proceeds of \$4,590,652. For the year ended December 31, 2009, 322,703 common shares were redeemed for cash at the price of \$10.00 per share for total proceeds of \$3,227,027.

11. RELATED PARTIES

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

W.A. Robinson & Associates Ltd. ("W.A.") provides portfolio management advice and investment counsel and acts as share registrar and transfer agent for the Company.

MORTGAGE INVESTMENT CORPORATION OF EASTERN ONTARIO

NOTES TO THE FINANCIAL STATEMENTS (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2010

11. RELATED PARTIES (Continued)

The companies are related in that they share common management. Pillar and W.A. each charge an annual fee of 1% of the total asset value calculated on a monthly basis. Total fees paid to Pillar for the year ended December 31, 2010 were \$411,091 (2009 - \$316,128) and the total fees paid to W.A. for the year ended December 31, 2010 were \$448,852 (2009 - \$330,182) 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.

12. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.