

Consolidated Financial Statements

First National Financial Income Fund

December 31, 2009 and 2008

AUDITORS' REPORT

To the Unitholders of
First National Financial Income Fund

We have audited the consolidated balance sheets of **First National Financial Income Fund** as at December 31, 2009 and 2008 and the consolidated statements of income and unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada,
March 9, 2010.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

First National Financial Income Fund

CONSOLIDATED BALANCE SHEETS

[in thousands of dollars]

As at December 31

	2009	2008
	\$	\$
ASSETS		
Distributions receivable	2,219	2,314
Investment in First National Financial LP <i>[note 4]</i>	117,077	110,361
	119,296	112,675
LIABILITIES AND EQUITY		
Liabilities		
Distributions payable	2,219	2,314
Accounts payable and accrued liabilities	37	37
Future income taxes <i>[note 6]</i>	13,750	10,300
Total liabilities	16,006	12,651
Equity		
Unitholders' equity	103,290	100,024
	119,296	112,675

See accompanying notes

Approved by the Trustees:

Trustee
John Brough

Trustee
Robert Mitchell

First National Financial Income Fund

CONSOLIDATED STATEMENTS OF INCOME AND UNITHOLDERS' EQUITY

[in thousands of dollars, except per unit amounts]

Years ended December 31

	2009	2008
	\$	\$
REVENUE		
Equity income from investment in First National Financial LP	25,103	13,422
EXPENSES		
Provision for future income taxes <i>[note 6]</i>	3,450	1,600
Net income for the year	21,653	11,822
Unitholders' equity, beginning of year	100,024	94,015
Issued pursuant to Distribution Reinvestment Plan <i>[note 3]</i>	—	11,031
Distributions <i>[note 5]</i>	(18,387)	(16,844)
Unitholders' equity, end of year	103,290	100,024
Average number of Units outstanding during the year	12,681,113	12,307,954
Earnings per Unit <i>[note 8]</i>		
Basic	\$1.71	\$0.96

See accompanying notes

First National Financial Income Fund

CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Years ended December 31

	2009	2008
	\$	\$
OPERATING ACTIVITIES		
Net income for the year	21,653	11,822
Add (deduct) items not involving cash		
Provision for future income taxes	3,450	1,600
Equity income from investment in First National Financial LP	(25,103)	(13,422)
Distributions received from First National Financial LP	18,482	16,467
Cash provided by operating activities	18,482	16,467
INVESTING ACTIVITIES		
Investment in First National Financial LP	—	(11,031)
Cash used in investing activities	—	(11,031)
FINANCING ACTIVITIES		
Issuance of Fund Units	—	11,031
Distributions paid	(18,482)	(16,467)
Cash used in financing activities	(18,482)	(5,436)
Net change in cash during the year and cash equivalents, end of year	—	—

See accompanying notes

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except per unit amounts]

December 31, 2009 and 2008

1. ORGANIZATION AND BUSINESS OF THE FUND

First National Financial Income Fund [the "Fund"] is an unincorporated, open-ended trust established under the laws of the Province of Ontario on April 19, 2006, pursuant to a Declaration of Trust. The Fund was established to acquire and hold, through a newly constituted wholly-owned trust, First National Financial Operating Trust [the "Trust"], investments in the outstanding limited partnership units of First National Financial LP ["FNFLP"]. Pursuant to an underwriting agreement dated June 6, 2006 and initial public offering and over-allotment option in June 2006, the Fund sold 11,800,000 units of the Fund ["Fund Units", "Units" or "Unit"], at a price of \$10.00 per Unit for proceeds totalling \$118,000. The proceeds of the offering, net of underwriters' fees of \$7,080, were used to partially fund the indirect acquisition [through the Trust] by the Fund of a 19.97% interest in FNFLP, through the issuance of 11,800,000 Class A LP Units by FNFLP.

Concurrent with the initial public offering and as part of the acquisition agreement between the Fund, FNFLP and First National Financial Corporation ["FNFC" or the "predecessor"], on June 15, 2006, FNFLP purchased all of FNFC's assets and assumed its liabilities, except for future income tax liabilities. Part of the consideration for this purchase was the issuance of 48,486,316 exchangeable Class B LP Units. The exchangeable Class B LP Units retained by FNFC are exchangeable on a one-for-one basis for Units of the Fund at any time at the option of FNFC. FNFLP is managed by First National Financial GP Corporation, the general partner, which holds a 0.01% interest in FNFLP. The Fund initially owned 19.97% of the shares of First National Financial GP Corporation and FNFC wholly owned the remaining 80.03%. The ownership of the general partner will change pro rata as the exchangeable Class B LP Units are exchanged for Units in the Fund. Pursuant to the Distribution Reinvestment Plan ["DRIP"] initiated in April 2008, another 881,113 Class A LP Units were issued. Accordingly, as at December 31, 2009, the Fund indirectly holds a 21.15% [2008 - 21.15%] interest in FNFLP and FNFC holds a 78.85% [2008 - 78.85%] controlling interest in FNFLP.

The Class A LP Unitholders and the exchangeable Class B LP Unitholders of FNFLP are entitled to one vote for each Unit held at all meetings of holders of the LP Units and have economic rights that are equivalent in all material respects, except that exchangeable Class B LP Units are exchangeable, directly or indirectly, on a one-for-one basis [subject to customary anti-dilution provisions] for Fund Units at the option of the holder at any time. Additionally, exchangeable Class B LP Units have special voting rights that entitle the holder to receive notice of, attend and vote at all meetings of Unitholders of the Fund.

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except per unit amounts]

December 31, 2009 and 2008

The Fund effectively commenced operations through its indirect investment in FNFLP on June 15, 2006. The excess of the Fund's cost of its investments in Units of FNFLP over the carrying value of the underlying net assets has been assigned to goodwill and finite life intangible assets. Income reported by the Fund commenced on the acquisition date.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Income taxes

Accounting for income taxes is reflected in these consolidated financial statements on the assumption that the Fund will qualify as a "mutual fund trust" as defined in the Income Tax Act (Canada) [the "Tax Act"], including its establishment and maintenance as a trust for the benefit of Canadian residents. Consequently, these consolidated financial statements do not reflect any provision for current income taxes as the Fund intends to distribute to its Unitholders substantially all of its taxable income and the Fund intends to comply with the provisions of the Tax Act that permit, amongst other items, the deduction of distributions to Unitholders from the Fund's taxable income.

The Fund accounts for income taxes in accordance with the liability method. Under this method, future income tax assets and liabilities are determined based on temporary differences between the carrying amounts and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect on future income taxes of a change in tax rates is recognized in income in the period that includes the date of substantive enactment. A valuation allowance is established, if necessary, to reduce future income tax assets to the amount that is more likely than not to be realized.

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except per unit amounts]

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Investments in FNFLP and First National Financial GP Corporation

The Fund accounts for its investments in FNFLP and First National Financial GP Corporation using the equity method. Under this method, the cost of the investment is increased by the Fund's proportionate share of FNFLP's earnings and reduced by any distribution paid to the Fund by FNFLP and amortization of the portion of the purchase price discrepancy, consisting of intangible assets.

The excess of the Fund's cost of its investment in Units over the carrying value of the underlying net assets has been allocated notionally to FNFLP's servicing rights, broker and borrower relationships and goodwill. The excess related to servicing rights is being amortized over the average term of the related mortgages and the excess related to broker and borrower relationships over the estimated useful term of 5 and 10 years of the relationships. The goodwill component of the purchase price discrepancy is not amortized. The value of the investments is tested annually for impairment.

3. FUND UNITS

The Fund may issue an unlimited number of Units for consideration and on the terms and conditions as determined by the Fund's trustees. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distribution from the Fund. All Fund Units are of the same class and have equal rights and privileges.

Under the terms of the Exchange, Voting and Registration Rights Agreement dated June 15, 2006, the exchangeable Class B LP Units held by FNFC are exchangeable for Fund Units on a one-for-one basis. After exercise of the over-allotment options, the Fund has reserved 47,286,316 Units for the exchange of the exchangeable Class B LP Units.

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Fund Units are redeemable at any time on demand by the Unitholder. The redemption price per Unit is equal to the lesser of:

- 90% of the weighted average trading price per Unit during the last 10 days on the principal exchange on which the Units are listed; or
- An amount equal to:
 - the closing price of the Units on the date on which the Units were tendered for redemption on the principal stock exchange on which the Units are listed, if there was a trade on the specified date and the applicable market or exchange provides a closing price; or
 - the average of the highest and lowest prices of the Units on the date on which the Units were tendered for redemption on the principal stock exchange on which the Units are listed, if there was trading on the date on which the Units were tendered for redemption and the exchange or other market provides only the highest and lowest trade prices of the Units traded on a particular day; or
 - the average of the last bid and ask prices quoted in respect of the Units on the principal stock exchange on which the Units are listed if there was no trading on the date on which the Units were tendered for redemption.

The Fund's optional DRIP allowed eligible Canadian Unitholders to elect to have their cash distributions from the Fund automatically reinvested in additional Units. Unitholders who participated in the DRIP received a further bonus distribution of Units equal in value to 5% of each distribution that was reinvested. During 2008, the Company issued 881,113 Units pursuant to this plan and invested the proceeds of \$11,031 in increased investment in FNFLP. No units under the DRIP were issued in 2009.

The following Units are issued and outstanding:

	2009		2008	
	Number of Units #	Amount \$	Number of Units #	Amount \$
Balance of Units outstanding, January 1	12,681,113	120,171	11,800,000	109,140
Units issued pursuant to the DRIP	—	—	881,113	11,031
Balance of Units outstanding, December 31	12,681,113	120,171	12,681,113	120,171

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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4. INVESTMENT IN FIRST NATIONAL FINANCIAL LP

Investment in First National Financial LP consists of the following:

	2009	2008
	\$	\$
Units outstanding	123,671	111,640
Investment pursuant to DRIP	—	12,031
Equity accounting adjustments		
Made prior to beginning of year	(13,310)	(9,888)
Equity earnings of First National Financial LP for the year	34,571	22,333
Amortization of purchase price discrepancy	(9,468)	(8,911)
Distributions received in the year	(18,387)	(16,844)
	<u>117,077</u>	<u>110,361</u>

5. DISTRIBUTIONS TO UNITHOLDERS

The Fund is entirely dependent on distributions from FNFLP to make its own distributions. The Fund pays monthly distributions to its Unitholders of record on the last business day of each month approximately 15 days after the end of each month. The table below outlines the cumulative distributions to the Unitholders:

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except per unit amounts]

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	Per Unit	Amount
	\$	\$
Distributions paid		
2008 regular distribution	0.11250	1,427
2008 special distribution	0.07000	887
January 2009	0.11250	1,427
February 2009	0.11250	1,427
March 2009	0.11250	1,426
April 2009	0.11250	1,427
May 2009	0.11250	1,427
June 2009	0.11250	1,426
July 2009	0.11250	1,427
August 2009	0.11250	1,426
September 2009	0.12500	1,585
October 2009	0.12500	1,585
November 2009	0.12500	1,585
		18,482
Distributions payable		
December 2009 regular distribution	0.12500	1,585
2009 special distribution	0.05000	634
		20,701

6. INCOME TAXES

In June 2007, the Government of Canada enacted new legislation imposing additional income taxes upon publicly traded income trusts, including the Fund, effective January 1, 2011. Prior to June 2007, the Trust estimated the future income taxes on certain temporary differences between amounts recorded on its consolidated balance sheets for book and tax purposes at a nil effective tax rate. Under the legislation and general federal and provincial corporate rate reductions, the Trust now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be 28.25% for 2011, 26.25% for 2012, 25.50% for 2013 and 25.0% for 2014. Temporary differences reversing before 2011 will still give rise to nil future income taxes.

First National Financial Income Fund

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The change in future tax rates has had two consequences for the Fund's consolidated financial statements: [i] the Fund has provided for a future income tax liability on the anticipated net book value and tax carrying cost difference as at January 1, 2011 related to the servicing rights and broker and borrower relationships listed in note 2, and [ii] the Fund has accounted for temporary tax differences implicit in its investment in FNFLP.

On the first issue, because there is a difference between the accounting carrying value of these intangible assets and their underlying tax carrying value, Canadian generally accepted accounting principles require a future income tax liability to be accrued. This was accrued on the initial public offering based on tax rates for income trusts, which at that time was a rate of nil. With new rates being enacted in 2009, the effective tax rate was changed to 28.25% for 2011, 26.25% for 2012, 25.50% for 2013 and 25.0% for 2014. Based on these new tax rates, the Fund accrued a future income tax liability of \$8,600 as at December 31, 2009 [2008 - \$9,200]. This liability will, in all likelihood, remain at this amount until January 1, 2011, when it will be drawn down every quarter as the Fund continues to amortize the related intangible assets until 2016.

In June 2007, based on the assets and liabilities of FNFLP, the Fund began estimating its portion of the amount of the temporary differences which were previously not subject to tax and has estimated the periods in which these differences will reverse. The Fund estimates that as at December 31, 2009, FNFLP has a net taxable temporary difference pertaining to the Fund which will reverse after January 1, 2011, such that an accrual of \$5,150 of future income taxes is required at year end. The temporary differences relate principally to the difference of net tax carrying values of the securitization receivable, servicing liability, purchased mortgage servicing rights and intangible assets recorded in the financial statements of FNFLP over the net book value of those assets.

While the Fund believes it will be subject to additional tax under the new legislation, the estimated effective tax rate on temporary difference reversals after 2011 may change in future periods. As the legislation is new, future technical interpretations of the legislation could occur and could materially affect management's estimate of the future income tax liability.

The amount and timing of reversals of temporary differences will also depend on the Fund's future operating results, acquisitions and dispositions of assets and liabilities, and distribution policy. A significant change in any of the preceding assumptions could materially affect the Fund's estimate of the net future income tax liability.

The calculation of taxable income of the Fund is based on estimates and the interpretations of tax legislation. In the event that the tax authorities take a different view, the balances of future income taxes could change and the change could be significant.

First National Financial Income Fund

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7. GUARANTEE

The Fund's wholly-owned subsidiary, First National Financial Operating Trust, has provided guarantees to and subordinated its rights to receive payments from FNFLP in respect of FNFLP's bank credit facility that had an outstanding amount at December 31, 2009 of \$240,704 [2008 - \$320,100] and an authorized limit of \$378,330 [2008 - \$378,330]. No fee is charged for this guarantee.

On February 12, 2010, FNFLP elected to cancel \$78,000 of its line of credit commitment, reducing the revolving line of credit to \$300,330.

8. EARNINGS PER UNIT

Earnings per Unit are calculated using net income for the year divided by the equivalent number of Fund Units outstanding during the year.