MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis of financial condition and results of operations is prepared as of March 9, 2010. This discussion should be read in conjunction with the audited consolidated financial statements of First National Financial Income Fund (the "Fund") and First National Financial LP ("FNFLP") as at and for the year (the "period") ended December 31, 2009 (as applicable) and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Fund and FNFLP for the year ended December 31, 2008. The audited consolidated financial statements of the Fund and FNFLP have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

The Fund earns income from its 21.15% interest in FNFLP. The Fund accounts for its investment in FNFLP using the equity method and therefore does not consolidate the results of operations of FNFLP. As a result, financial statements with accompanying notes thereon have been presented for both the Fund and FNFLP. In addition, the following management's discussion and analysis ("MD&A") presents a discussion of the financial condition and results of operations for both the Fund and FNFLP.

This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These "non-GAAP measures" such as "EBITDA", "Distributable Cash", and "Distributable Cash per Unit" should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with GAAP as an indicator of performance or as a measure of liquidity and cash flow. Non-GAAP measures do not have standard meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers.

The Fund is entirely dependent upon the operations and financial condition of FNFLP. The earnings and cash flows of FNFLP are affected by certain risks. For a description of those risks, please refer to the "Risk and Uncertainties Affecting the Business" section.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Fund and FNFLP is available in the Fund's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

GENERAL DESCRIPTION OF THE FUND AND FIRST NATIONAL FINANCIAL LP

Pursuant to an underwriting agreement dated June 6, 2006, and initial public offering ("IPO"), the Fund sold 10,600,000 units of the Fund ("Fund Units", "Units", or "Unit"), at a price of $10.00 per Unit for proceeds totalling $106,000,000. The proceeds of the offering were used to partially fund the indirect acquisition (through the Fund's wholly-owned subsidiary, First National Financial Operating Trust) by the Fund of a 17.94% interest in FNFLP. In turn, FNFLP purchased the net business assets of First National Financial Corporation ("FNFC"), as predecessor to FNFLP. Subsequently, with the issue of Units pursuant to an over-allotment option and its Distribution Reinvestment Plan ("DRIP"), the Fund now indirectly holds a 21.15% interest in FNFLP and FNFC holds a 78.85% controlling interest in FNFLP.

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 FNFLP. Each unitholder participates pro rata in any distribution from the Fund. Income tax obligations related to the distributions of the Fund are the obligations of the unitholders. The Fund effectively commenced operations through its indirect investment in FNFLP on June 15, 2006, and the income reported by the Fund commenced on that date.

Selected Quarterly Information

Quarterly Results of First National Financial Income Fund

(in $000s, except for per unit amounts)

	Revenue	Net Income for the period	Net Income per Unit	Total Assets
2009				
Fourth Quarter	$7,100	$6,950	$0.55	$119,296
Third Quarter	$7,092	$5,192	$0.41	$116,961
Second Quarter	$6,413	$5,463	$0.43	$114,138
First Quarter	$4,498	$4,048	$0.32	$112,005
2008				
Fourth Quarter	$1,560	$1,210	$0.09	$112,675
Third Quarter	$4,617	$4,117	$0.33	$115,716
Second Quarter	$3,946	$3,696	$0.30	$113,286
First Quarter	$3,299	$2,799	$0.24	$102,592

Investments

At December 31, 2009, the Fund had an investment in 12,681,113 units (21.15%) of First National Financial LP at a cost of $122,670,434. Under Canadian GAAP, the Fund is required to account for this investment using the equity method. During the year ended December 31, 2009, the Fund's earnings from FNFLP were $34.6 million, amortization of identifiable assets inherent in the investment was $9.5 million and the carrying value of this investment at December 31, 2009 was $117.1 million.

Distributions

The initial public offering described above closed on June 15, 2006, and beginning on this date, the Fund began making monthly distributions at the rate of $0.07917 per unit on or around the 15th of each month. Subsequently, the Fund increased the monthly distribution each year: to $0.10417 per unit in 2007, $0.1125 per unit in 2008, and $0.125 per unit, beginning with the distribution paid on October 15, 2009. The Fund also announced special distributions in December of the last three years. In 2009 the amount was $0.05, in 2008, the amount was $0.07 per unit and in 2007 the amount was $0.06 per unit. For the year, the Fund's distributions of approximately $18.4 million were equivalent to the distributions that the Fund received from FNFLP. The current monthly distribution rate represents an annualized distribution rate of $1.50 per unit, a 58% increase from the distribution rate contemplated at the time of the IPO. The following table shows the payout ratio based on the Fund's pro rata share of distributable cash earned by FNFLP.

For the year ended December 31, 2009, the payout ratio was 113%. Despite strong earnings, distributable cash was adversely affected by working capital requirements, particularly increased liquidity required to support the Alt-A program. The requirements totalled approximately $1.9 million at the Fund level at year end, accounting for a use of $0.15/Unit of distributable cash. The Alt-A support requirements peaked in the third quarter of 2009. In the fourth quarter, the Fund received more cash than it invested in working capital, such that the payout ratio was 84% for the quarter. These ratios were also affected by the large portion of the Company's income related to gains on securitization revenue. These gains provide only insignificant amounts of cash in the period of recognition; however the Company is still liable for the full cost of origination which is entirely cash based. The ratio of distributions to net income at the FNFLP level, which management believes is an important ratio, was 53% for the year.

Statement of Distributable Cash

(in $000s, except where noted)	For the quarter ended		For the year ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
First National Financial LP				
Distributable Cash of First National Financial LP (1)	30,252	18,795	76,907	81,818
First National Financial Income Fund				
Weighted Average Share of Distributable Cash from First National Financial LP (1)	6,399	3,975	16,266	16,991
Distributable Cash per Unit ($/Unit) (1)	0.50	0.31	1.28	1.37
Distributions Declared	5,390	5,168	18,388	16,844
Distributions Declared per Unit ($/Unit)	0.42	0.41	1.45	1.36
Payout Ratio	84%	132%	113%	99%

(1) Distributable cash and distributable cash per unit are non-GAAP measures generally used by Canadian open-ended trusts as an indicator of financial performance. They are considered key measures as they demonstrate the cash available for distributions to unit holders. See FNFLP section in this MD&A for their determination.

Income Taxes

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is only taxed on any amount of taxable income not distributed to unitholders. The Fund intends to distribute substantially all of its taxable income to its unitholders and also intends to comply with the provisions of the Income Tax Act (Canada) that permit, among other items, the deduction of distributions to unitholders from the Fund's income for tax purposes.

As described in the Fund's financial statements and the "Income Tax Matters" section later in this analysis, on June 22, 2007, the government enacted previously announced legislation that will have the effect of imposing additional income taxes on the Fund commencing January 1, 2011. Accordingly, the Fund's financial statements have been affected in two ways: (1) a future tax liability has been accrued based upon the net book value of the intangible assets inherent in the carrying value of the Fund's investment in FNFLP; and (2) a future tax liability has been accrued related to differences between the net book value of assets and liabilities in FNFLP and their tax cost base.

Accrued Future Tax Liability on Intangible Assets

The first issue relates to the intangible assets described in Note 2 to the financial statements. Due to a difference between the accounting carrying value of these assets and their underlying tax carrying value, GAAP requires that a future tax liability be accrued. This was effectively accrued at the time of the IPO based on the then current effective tax rate for income trusts, which was a rate of Nil. Under the new laws enacted on June 22, 2007, together with the general tax changes announced subsequently, the effective tax rate for the Fund as at January 1, 2011 was changed to approximately 29%. Based on this new rate, the Fund accrued a future tax liability related to these assets of $8.5 million in June 2007. Commencing in the second quarter of 2008, the difference between the accounting carrying value of these assets and their underlying tax carrying value increased pursuant to increased investment in FNFLP made through the DRIP. As such, the Fund has accrued an additional future tax liability of $1.05 million. In 2009 the Fund recorded a credit to the provision for future taxes as enacted changes in federal and provincial tax rates reduced this tax liability by $0.6 million. The combined liability of $8.6 million is expected to be drawn down beginning on January 1, 2011, as the Fund continues to amortize the related intangible assets until 2016. This future tax liability is an accounting convention and has no effect on the distributable cash of the Fund.

Accrued Future Tax Liability on Investment in FNFLP

Similar to the discussion above, there can also be differences in accounting and tax carrying values of certain assets and liabilities in FNFLP. Because there is no tax levied at the partnership level, these differences are temporary and require tax allocation accounting at the Fund level. In the reporting periods ended prior to June 22, 2007, these differences had been accounted for using a tax rate of Nil. As the new rules have been enacted, the Fund has accounted for these differences with the applicable higher tax rates. As at December 31, 2009, these differences were such that the Fund recorded a future tax liability of $5.15 million. This tax liability represents the Fund's estimated pro rata share of tax liabilities that FNFLP will incur in the periods subsequent to December 31, 2010 and is based on timing differences related to the period from June 15, 2006 (the IPO date) to December 31, 2009. Up until June 22, 2007, the Fund had been applying tax rates to temporary differences in FNFLP at a Nil tax rate. This was based on the assumption that the Fund would make sufficient tax deductible cash distributions to unitholders such that the Fund's taxable income would be Nil for the foreseeable future. The new legislation enacted on June 22, 2007, imposes a tax on certain income distributed to unitholders such that income taxes may become payable in the future. For the year ended December 31, 2009, the Fund recorded a provision for future taxes on these differences of $4.4 million.

The Fund has estimated both of these future income tax accruals based on its best estimates of the results of operations, current tax legislation and future cash distributions, assuming no material change to the Fund's current organizational structure. The Fund's estimate of future income taxes will vary as the Fund's assumptions vary in accordance with the factors above, and such variations may be material. Until 2011, the new legislation does not directly affect the Fund's distributable cash and as such, does not affect the Fund's financial condition.

Outstanding Securities of the Fund

At December 31, 2009 and March 9, 2010, the Fund had 12,681,113 units outstanding.

FNFC holds 47,286,316 exchangeable Class B LP units of FNFLP, each of which is exchangeable into one Fund Unit at no cost at any time at the option of FNFC, and each of which carries a Special Voting Right that entitles the holder to receive notice of, attend and vote at all meetings of unitholders of the Fund.

Critical Accounting Estimates

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and revenues and expenses during the reporting period. Management reviews these estimates on an ongoing basis, including those related to securitization accounting and future income taxes. Changes in facts and circumstances may result in revised estimates and actual results may differ from these estimates.

Business Risks

The Fund is entirely dependent upon the operations and financial condition of FNFLP. The earnings and cash flows of FNFLP are affected by certain risks. For a description of those risks, please refer to the "Risk and Uncertainties Affecting the Business" section in the First National Financial LP portion of this analysis.

Guarantee

The Fund's wholly-owned subsidiary, First National Financial Operating Trust, has provided guarantees to and subordinated their rights to receive payments from FNFLP in respect of FNFLP's $378 million bank credit facility.

FIRST NATIONAL FINANCIAL LP

Basis of Presentation

The financial statements of First National Financial LP ("FNFLP" or the "Company") are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). FNFLP is considered to be a continuation of FNFC's business following the continuity of interest method of accounting. Under this method of accounting, FNFLP's acquisition of the FNFC business is recorded at the net book value of FNFC's business assets and liabilities on June 14, 2006 and the equity of FNFLP represents the equity of the FNFC business at that date.

Executive Summary

In 2009, the Company achieved record profitability: capitalizing on strong mortgage origination while optimizing the use of its diverse funding sources. More specifically, the year featured sustained growth in mortgages under administration, revenue and net income. The demand for prime insured mortgages was strong and wide spreads were earned on much of the Company's origination. This allowed the Company to earn higher profits on its most creditworthy products and increase origination volumes of multi-unit residential mortgages. Single-family residential origination volumes rebounded from a slow start in the first quarter of the year such that year over year volumes were similar to those experienced in 2008.

2009 Results Summary

- During the year, the Company increased the annual distribution rate by 11% from $1.35 per unit to $1.50 per unit based on growing profits and increasing cash flow from operations.
- Mortgages under administration grew to $47.8 billion at December 31, 2009 from $40.6 billion at December 31, 2008, an increase of 18%; the growth from September 30, 2009, when mortgages under administration were $45.9 billion was 17% on an annualized basis.
- After a slow start to 2009, the Canadian single-family real estate market showed its strength with three strong quarters to end the year. Total mortgage originations for the Company declined by 1% from $11.9 billion in 2008 to $11.8 billion for 2009. Excluding $225 million of Alt-A originations in 2008, mortgage origination increased by 1% from 2008 to 2009.
- Revenue for the year ended December 31, 2009 increased by 16% year-over-year, as larger gains on securitization were earned by the Company driven by wide mortgage spreads and more liquidity in the credit markets.
- Net income increased by 51% for the year ended December 31, 2009 compared to 2008. This increase resulted from higher volumes and margins experienced in both the single-family and multi-unit residential origination departments, particularly from gains on securitization related to the Company's single-family NHA-MBS program;.
- EBITDA increased by 51% for the year ended December 31, 2009 compared to last year. This increase was due to the same factors cited above for net income.

Subsequent to year end the Company's business model was validated as DBRS assigned an issuer rating of BBB with a Stable trend. DBRS indicated that this rating reflects the Company's status as Canada's largest non-bank mortgage originator and servicer, its strong asset quality, as well as its servicing capabilities.

Selected Quarterly Information for Results of FNFLP

	Revenue	Net Income for the period	Net Income ($/Unit)	Total Assets
2009				
Fourth Quarter	$88,280	$44,768	0.75	$1,067,690
Third Quarter	$96,161	$44,730	0.75	$1,122,651
Second Quarter	$91,570	$41,519	0.69	$919,300
First Quarter	$65,705	$32,466	0.54	$905,774
2008				
Fourth Quarter	$59,488	$17,743	0.29	$737,065
Third Quarter	$91,266	$33,649	0.56	$857,273
Second Quarter	$76,893	$30,098	0.51	$1,001,600
First Quarter	$66,312	$26,531	0.45	$663,594

First National's quarterly revenue can be divided into two categories, (1) seasonally affected revenues and (2) those which are steadily earned throughout its fiscal year. Mortgage servicing income, mortgage investment income interest, and, generally, residual securitization income accrue to the Company each quarter and will reflect the trend of the changing portfolio of mortgages under administration. Alternatively, origination (including placement and securitization) activities are more seasonal in nature. This is particularly true for single-family residential origination for which volumes follow the purchasing patterns of single-family home buyers: origination activity is generally slower in the first quarter of each year, increases in the second quarter, peaks in the third quarter and gradually retreats in the last quarter of the year. Single-family origination has the effect of 'smoothing out' net income fluctuations because the large amount of revenue generated from this category does not generally result in significant income due to the high percentage of related brokerage fees.

Both the seasonal and income smoothing trends are apparent in the information presented above except the fourth quarter of 2008. In this quarter, the Company took charges against revenue related to unrealized fair value adjustments on the Company's securitization assets. If these adjustments are added back, revenue and net income for these quarters would have been in line with seasonal expectations and a growing business. In 2009, a steady mortgage origination market benefited from more reliable capital markets as First National was able to earn higher margins on both single-family and multi-unit residential origination, creating record net income.

Total assets fluctuated between $663 million and $1.1 billion over the past eight quarters due primarily to movements between the periods in the amount of securities purchased under resale agreements which are used for hedging purposes.

Selected Annual Financial Information for the Company's fiscal year ended

($000s, except per unit amounts)

	December 31, 2009	December 31, 2008	December 31, 2007
For the Period			
Income Statement Highlights			
Revenue	341,716	293,959	238,971
Brokerage fees	(98,677)	(105,757)	(102,886)
Other operating expenses	(77,807)	(78,526)	(61,999)
EBITDA[(1)]	165,232	109,675	74,086
Amortization of capital assets	(1,749)	(1,654)	(1,242)
Provision for income taxes	—	—	—
Net Income	163,483	108,021	72,844
Distributions declared	86,953	81,233	71,497
Per Unit Highlights			
Net Income per unit	2.73	1.81	1.23
Distributions declared per unit	1.45	1.36	1.21
At Period End			
Balance Sheet Highlights			
Total assets	1,067,690	737,065	460,336
Total long-term financial liabilities	—	—	—

Notes:

(1) EBITDA is not a recognized earnings measure under GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA should not be construed as an alternative to net income or loss determined in accordance with GAAP as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

Vision and Strategy

The Company provides mortgage financing solutions to virtually the entire mortgage market in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is the leading non-bank mortgage lender in the industry. Growth has been achieved while maintaining a relatively conservative risk profile. The Company intends to continue leveraging these strengths to lead the "non-bank" mortgage lending industry in Canada, while appropriately managing risk.

The Company's strategy is built on four cornerstones: Providing a full range of mortgage solutions; growing assets under administration; employing leading-edge technology to lower costs and rationalize business processes; and maintaining a conservative risk profile. An important consequence of the Company's strategy is its direct relationship with the mortgage borrower. Although the Company places most of its originations with third parties, FNFLP is perceived by all of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

Key Performance Drivers

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of higher margin mortgages;
- Lowering the costs of operations through the innovation of systems and technology; and
- Employing innovative securitization transactions to minimize funding costs.

Growth in Portfolio of Mortgages Under Administration

Management considers the growth in mortgages under administration ("MUA") to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through mortgage servicing portfolios purchased from third parties. Mortgage originations not only drive placement and securitization revenues, but perhaps more importantly, longer term values such as servicing fees, mortgage administration fees, renewal opportunities and growth in customer base for marketing initiatives. As at December 31, 2009, mortgages under administration totalled $47.8 billion, up from $40.6 billion at December 31, 2008, a rate of increase of 18%. This compares to $45.9 billion at September 30, 2009, representing a quarter-over-quarter increase of 4% and an annualized increase of 17%.

Growth in Origination of Higher Margin Mortgages

The Company's main focus has always been on the prime single-family mortgage market. Prior to the credit issues which have affected the market in the last three years, these mortgages had tight spreads such that the Company's strategy was to sell these mortgages on commitment to institutional investors and retain the servicing. This strategy changed with the challenges in the credit environment and the Company was able to take a larger portion of the spread for itself. Liquidity and credit concerns increased the cost of funding for most, if not all, of the Company's competitors, particularly the five large Canadian banks. Given the increased costs, mortgage rates did not fall in step with Government of Canada bond yields, such that spreads on prime single family mortgages have been at historically wide margins since mid 2007. In the spring of 2007, such spreads for discounted five-year mortgage rates were approximately 1.25 percentage points. For 2009, comparable spreads began the year as high as 3.00 percentage points; however in the first quarter of 2009 mortgage spreads began narrowing as competition among lenders began to lower mortgage rates. Each quarter throughout the year brought more tightening such that by year end, spreads were back to pre-crisis historical norms. The Company also took advantage of wider spreads on floating rate single-family mortgages in 2009. Historically such mortgages were priced at a discount to prime (a discount that reached a high of 0.90 percentage points in 2007). In 2009, these mortgages began the year priced at prime plus 0.80 percentage points as liquidity issues affected the large banks funding costs. As the liquidity issues were resolved, pricing gradually narrowed during the year such that by year end these mortgages were being originated at slight discounts to prime. Although these spreads have tightened during the year, the bid from the NHA-MBS market for this product tightened as well. The Company chose to securitize much of this origination as it was able to earn a higher return than on an institutional placement. In 2009, the Company originated for securitization, approximately $2 billion of floating rate single family mortgages to take advantage of these wider spreads.

Lowering Costs of Operations through Innovation of Systems and Technology

The Company has always used technology to provide for efficient and effective operations. This is particularly true for its MERLIN underwriting system, Canada's only web-based real-time broker information system. By creating a paperless, 24/7 available commitment management platform for mortgage brokers, the Company is now ranked among the top three lenders by market share in the broker channel. This has translated into increased single-family origination volumes and higher closing ratios (the percentage of mortgage commitments the Company issues that actually become closed mortgages). Despite a sometimes volatile year, the Company was able to maintain its single-family origination volumes, which were $8.5 billion for the year ended December 31, 2009. This represents a decrease of 3% from $8.8 billion originated in 2008 which included $225 million of Alt-A product.

Employing Innovative Securitization Transactions to Minimize Funding Costs

Uncertainty in the Asset-Backed Commercial Paper ("ABCP") Market

As described in the MD&A in prior periods, ABCP funded by third-party sponsored ABCP conduits became frozen in August 2007 due to liquidity and credit concerns. Similar issues have affected bank-sponsored ABCP conduits. The Company has continued to fund a portion of its assets (approximately $1.5 billion of the $47.8 billion of MUA as at December 31, 2009) with bank-sponsored ABCP. Although bank-sponsored ABCP has continued to trade in the marketplace, its cost has varied greatly in the past two years due to uncertainty surrounding both the quality of the underlying assets and the bank's ability to support the paper's continued liquidity. During 2008, ABCP spreads were volatile, trading at spreads ranging between 0.10 percentage points and 1.10 percentage points in excess of historical levels. The Company considers historical levels to be when ABCP traded at the same rates as bankers' acceptances rates ("BA"). In the fourth quarter of 2008, the global credit crisis worsened: the Bank of Canada dropped overnight lending rates dramatically; the cost of funds for the large Canadian banks increased significantly, and fears of recession grew. Together, these events negatively affected potential ABCP investors, resulting in spreads that increased to approximately 1.10 percentage points in excess of BA as at December 31, 2008. In the first half of 2009, spreads began tightening as the credit markets stabilized, such that by December 31, 2009, 30 day AAA rated ABCP traded at rates comparable to BA.

The Company is required to mark-to-market its securitization receivables at the end of each reporting period. A significant portion of those receivables are calculated using assumptions about the cost of funding arranged through the ABCP market. At the end of 2008, the Company had approximately $1.7 billion of mortgages under administration funded with ABCP, including all of its Alt-A mortgages. The Company's exposure to ABCP at December 31, 2009 has decreased to $1.4 billion. As described above, advertised ABCP spreads narrowed during the course of the year. Although the banks' trading desks indicate that the spot rate for AAA rated ABCP was the same as BA rates at the end of the year, the costs passed through to the Company from the bank-sponsored conduits have averaged approximately 0.25 percentage points for the six-month period ended December 31, 2009. Management believes that there is still some uncertainty in this market which may lead to further fluctuations in pricing and considers its best estimate of fair value to be represented by its actual ABCP costs. The Company has changed its assumption such that its models assume that ABCP will trade at 0.25 percentage points over BA. Accordingly, in the year, the Company has recorded an unrealized gain of $16.4 million with respect to the changing fair value of the Company's securitization receivables involving ABCP.

Approval as both an Issuer of NHA-MBS and Seller to the Canada Mortgage Bond Program

The Company has been involved in the issuance of National Housing Act-Mortgage Backed Securities ("NHA-MBS") since 1995. This program has been very successful, with over $4 billion of NHA-MBS issued. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA-MBS and as a seller into the Canada Mortgage Bond ("CMB") program, one of the first non-OSFI regulated companies in Canada to be so approved. Issuer status will provide the Company with another funding source that it will be able to access independently. Perhaps more importantly, seller status for the CMB will give the Company direct access to the CMB. This status has also allowed the Company to participate in the federal government's NHA-MBS reverse auction and has provided the Company with an additional, albeit temporary, source of liquidity. In addition, the demand for high quality fixed income and floating rate investments increased significantly in the year. This demand allowed the Company to issue $1.7 billion of NHA-MBS pools consisting of single-family floating rate mortgages directly through the NHA-MBS market during the year.

Canada Mortgage Bond (CMB) Program

The CMB program is an initiative introduced by CMHC whereby the Canada Housing Trust ("CHT") issues securities to investors in the form of semi-annual interest-yielding five-year bonds. The proceeds of these bonds are used to buy NHA-MBS. In previous years, the Company entered into an agreement with a Canadian bank which allowed the Company to indirectly sell a portion of the Company's residential mortgage origination into several CMB issuances. Subsequently, pursuant to the Company's approval as a seller into the CMB, the Company was able to make direct sales into the program. Because of the similarities to a traditional Government of Canada bond (both have five year unamortizing terms with a government guarantee), the CMB trades in the capital markets at a modest premium to the yields on Government of Canada bonds. The Company's ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because these funding structures do not amortize, the Company can fund future mortgages through this channel as the original mortgages amortize or pay out. The Company also enjoys significant demand for mortgages from investment dealers who sell directly into the CMB. Because of the effectiveness of the CMB, there have been requests from approved CMB sellers for larger issuances. CHT has indicated that it will not unduly increase the size of its issuances, and has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is also subject to these limitations.

Key Performance Indicators

The principal indicators used to measure the FNFLP's performance are:

- Earnings before income taxes, depreciation and amortization ("EBITDA") ; and
- Distributable cash.

EBITDA is not a recognized measure under GAAP. However, management believes that EBITDA is a useful measure that provides investors with an indication of cash available for distribution prior to capital expenditures. EBITDA should not be construed as an alternative to net income determined in accordance with GAAP or to cash flows from operating, investing and financing activities. FNFLP's method of calculating EBITDA may differ from other issuers and, accordingly, EBITDA may not be comparable to measures used by other issuers.

	Quarter ended		Year ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
For the Period	($ 000's)			
Revenue	88,280	59,488	341,716	293,959
Net income	44,768	17,743	163,483	108,021
EBITDA [(1)]	45,247	18,201	165,232	109,675
At Period end				
Total assets	1,067,690	737,065	1,067,690	737,065
Mortgages under administration	47,793,045	40,596,013	47,793,045	40,596,013

Note:

(1) This non-GAAP measure adjusts income before income taxes by adding back expenses for amortization of capital assets.

Distributable cash is not a defined term under GAAP. Management believes that net cash generated by FNFLP prior to distribution is an important measure for investors to monitor. Management cautions investors that due to the Company's nature as a mortgage seller and securitizer, there will be significant variations in this measure from quarter to quarter as the Company collects and invests cash from mortgage transactions. Distributable cash is determined by the Company as cash provided from operating activities increased/decreased by the change in mortgages accumulated for sale in the period and reduced by capital expenditures. Mortgages accumulated for sale consist primarily of mortgage loans that the Company funds on behalf of institutional investors. Normally a few days after funding, the Company aggregates all mortgages "warehoused" to date for each investor and receives a cash settlement. As the majority of mortgages are advanced in the last few days of a month, there are large amounts of cash invested at quarter ends by the Company that are typically received in the first week of the subsequent quarter. The Company's credit facility provides full financing for the majority of these mortgage loans. Accordingly, management believes the measure of distributable cash is only meaningful if the change in mortgages accumulated for sale between reporting periods is accounted for.

Determination of distributable cash

	Quarter ended		Year ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
For the Period	($ 000's)			
Cash provided by (used in) operating activities	(91,838)	(35,263)	(83,549)	(79,797)
Add (deduct):				
Cash change in mortgages accumulated for sale between periods	122,302	54,292	161,966	162,526
Less:				
Capital expenditures	(212)	(234)	(1,510)	(911)
Distributable cash [(1)]	30,252	18,795	76,907	81,818

Note:

(1) This non-GAAP measure adjusts cash provided by (used in) operating activities by accounting for changes between periods in mortgages accumulated for sale and deducting maintenance capital expenditures.

Revenues and Funding Sources

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. The majority of mortgages originated are funded by either placement with institutional investors or sale to securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provides the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2009, origination volume decreased from $11.9 billion to $11.8 billion or 1% from the prior year.

Placement Fees, Gain on Securitization, and Gain on Deferred Placement Fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor or sold to a securitization conduit. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "Placement fees". Prior to 2009, the present value of additional amounts (excess spread) expected to be received over the remaining life of the mortgages sold (net of servicing and other costs) was included with "Gain on securitization". The excess spread on a mortgage is the difference between the interest rate on the mortgage and the yield earned by the investor after accounting for all anticipated prepayment provisions, servicing obligations and other costs. For Alt-A and small conventional multi-unit residential and commercial mortgages, the excess spread also includes assumptions for credit losses.

Beginning in the first quarter of 2009, the Company changed the presentation of such gains, dividing the revenue into two components. Going forward the Company separates this revenue into "Gain on deferred placement fees" and "Gain on securitization". This distinction acknowledges the nature of the future payments being received. At the time of the IPO, these future payments represented primarily the present value of future payments from direct securitization by the Company where the Company was the principal risk taker. This included securitizations through ABCP, NHA-MBS, and the CMB program. At that time, the Company also entered into transactions with institutional investors in which placement fees were received over time instead of just at the time of the mortgage sale. In these cases the Company applied the same accounting methodology as it had with the direct securitization transactions; future expected cash flows were discounted to present and a gain on securitization was recorded. While arguably a different type of revenue, the Company determined it was insignificant to disclose separately from regular "gain on securitization" revenue. As described in previous discussions, the Company began to enter into more placement transactions that attracted larger deferred placement fees starting in the third quarter of 2007. During 2008, a significant portion of the Company's direct securitization business ceased, particularly with the discontinuance of the uninsured Alt-A program. Accordingly, deferred gains related to placement activity became a larger and larger component of the "gain on securitization" revenue line. The Company believes that such revenue is better described as "Gain on deferred placement fees" as the Company is not directly securitizing these mortgages but placing them with institutional investors. It has used this new presentation for its revenue beginning in the first quarter of 2009, reclassifying comparative figures on the same basis.

Upon the recognition of a "Gain on securitization," the Company establishes a "Securitization receivable" which is amortized as spread income is received by the Company. In addition, the Company is also required to establish a "servicing liability," which represents the future cost of servicing the securitized

mortgages. As spread income is received by the Company, both the securitization receivable and the servicing liability are amortized accordingly. Residual securitization income consists of two components: (a) the difference between the spread received over time and the spread income assumed in the Company's derivation of securitization receivable at the time of sale; and b) the amortization of the servicing liability. The excess is attributable to better than expected cash flows being earned by the securitization compared to those anticipated when gain on sale assumptions regarding prepayments, cost of funds, and credit losses were originally forecasted. All mortgages securitized through the Company's ABCP programs or directly sold as NHA-MBS or CMB produce "Gain on securitization" revenue. Of the Company's $11.8 billion of originations for the year ended December 31, 2009, $451 million was originated for ABCP conduits and other securitization vehicles, and $2.1 billion for direct sale to the NHA-MBS market, both generating "Gain on securitization" revenue.

For all institutional placements and most mortgages securitized through the NHA-MBS program, the Company earns "Placement fees." Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. Of the Company's $11.8 billion of originations for the year ended December 31, 2009, $6.5 billion was placed with institutional investors and $2.8 billion was originated for institutional investors involved in the issuance of NHA-MBS. In addition, under certain circumstances, additional revenue from institutional placements and NHA-MBS may be recognized as "Gain on deferred placement fees" as described above. Upon the recognition of a "Gain on deferred placement fee", the Company establishes a "Deferred placement fee receivable" which is amortized as income is received by the Company with similar accounting as described in the previous paragraph for a "securitization receivable."

In the past several years, the Company has experienced significant growth in mortgages funded through its securitization programs and deferred placement fee activities. As a result, revenues from "Gain on securitization" and "Gain on deferred placement fees" have increased accordingly. Since cash flows received from these assets are received over the life of the mortgages involved, and the revenue is recognized upon securitization, there will be a timing difference between the recognition of revenue and the receipt of cash. The financial effect of the timing difference between the recognition of revenue and the receipt of cash is effectively equal to the sum of "Gains on securitization" and "Gains on deferred placement fees" less the "Amortization of securitization and deferred placement fees receivable" (net of "Amortization of servicing liability") for any given period. For the year ended December 31, 2009, the volume of mortgages funded through NHA-MBS and institutional placements that earn either "Gain on securitization" or "Gain on deferred placement fees" revenue increased. This timing difference required working capital funding of approximately $79.3 million for the year ended December 31, 2009 ($36.6 million for the year ended December 31, 2008). To the extent that gains on securitization and deferred placement fees do not increase for a number of years, the effects of the timing difference would be neutralized as new securitization and deferred placement receivables would be offset by collections of existing receivables.

Mortgage Servicing and Administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including: borrower's property tax escrow, reserve escrows, and mortgage payments. As acknowledged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable

interest rates on these funds with the chartered bank that maintains the deposit account, which has resulted in significant interest revenue.

In addition to the interest income earned on securitization and deferred placement fees receivables, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale, mortgage and loan investments and purchased mortgage servicing rights.

Results of Operations

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

	Quarter ended		Year ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Mortgage Originations By Asset Class	($ millions)			
Single-family residential	2,018	1,910	8,468	8,757
Multi-unit residential and commercial	841	869	3,319	3,129
Total originations	2,859	2,779	11,787	11,886
Funding of Mortgage Originations by Source				
Institutional investors	1,101	1,935	6,519	8,875
NHA-MBS	1,799	570	4,817	1,739
Securitization and internal resources (1)	(41)	274	451	1,272
Total	2,859	2,779	11,787	11,886
Mortgages Under Administration				
Single-family residential	31,880	26,333	31,880	26,333
Multi-unit residential and commercial	15,913	14,263	15,913	14,263
Total	47,793	40,596	47,793	40,596

Note:

(1) The negative amount of $41 million in the fourth quarter of 2009 results from $103 million of mortgages securitized in the first and second quarters of 2009 with an institutional investor. In the fourth quarter of 2009 this transaction was repackaged in the form of a First National issued MBS.

The Company experienced strong origination volumes given the economic environment. Total mortgage origination volumes decreased in 2009 by just 1% to $11.8 billion from $11.9 billion in 2008. This decrease reflects a 3% decrease in single-family origination figures between the periods and a 6% increase in the multi-unit residential and commercial segment. Although single-family volumes are lower than the levels experienced in 2008, these volumes are above those expected by management coming in to the year. Management believes the single-family origination has remained strong as a result of three factors: historically low mortgage interest rates, the return of consumer confidence in the economy, and the Company's strong position in the mortgage broker market. For the commercial segment, the Company continued its strong performance in the multi-unit business as its pricing remained the most competitive in the market. Origination for the NHA-MBS program increased from $1.7 billion in 2008 to $2.8 billion in 2009. Institutional placements, however, decreased from 2008 as the demand for uninsured commercial product fell off.

Canadian capital markets, that began the year in turmoil, improved steadily throughout the year as economic indicators turned more positive. Despite the improvement, the Bank of Canada's monetary policy remained accommodative. For the Company, these conditions had primarily favourable outcomes. As an originator of primarily prime CMHC insured mortgages, the Company continued to see demand

for mortgages and funding costs for 30-day paper were reduced significantly. However mortgage spreads that began narrowing in the first quarter of 2009 continued to do so as mortgage rates fell despite rising bond yields. The large spreads that existed at the end of 2008 have gradually tightened such that by the end of 2009, prime mortgage spreads were close to the levels seen prior to the credit crisis which began in 2007. The tightening is a result of increased liquidity in the economy that saw the five big Canadian banks start to compete for mortgage products by reducing their offered mortgage rates. Increased bond yields have also meant some adverse changes in the value of the Company's securitization receivable, deferred placement fees receivable and mortgage and loan investments, as the time value of money has increased somewhat. The commercial segment of the Company continued to benefit from wider spreads on its prime origination due to lessened competition.

At the same time, the Company profited from a stabilizing ABCP market. At December 31, 2008, the Company had adjusted the fair value of its retained interests in ABCP conduits to assume the highest grade of ABCP would trade at a spread of 1.10 percentage points in excess of BA. However, by the beginning of March 2009, posted ABCP rates began coming down such that by December 31, 2009 quoted ABCP spreads were comparable to BA rates. While the Company welcomed the decrease, management is concerned that as fast as these spreads have come in, they could widen suddenly in the future. Additionally, the cost of funds currently being experienced by the Company is approximately 0.25 percentage points in excess of BA. Accordingly, the Company revised its assumption for ABCP costs such that its models assume 30-day ABCP will trade at 0.25 percentage points higher than BA in its calculation of the fair value of its securitization receivable. This has resulted in an unrealized fair value gain of $16.4 million recorded in 2009. Many of First National's securitization programs use BAs to fund Prime-indexed mortgages. Similar to the ABCP issue, the Company has a risk that the spread between these rates changes adversely for the Company. The Company updated its securitization models to assume this spread would revert to historical norms in the first quarter of 2009. The result was an unrealized loss of $10.9 million recorded in 2009.

Total revenues for the year ended December 31, 2009, compared to 2008 increased by 16% from $294 million to $342 million. This increase resulted primarily from higher amounts of mortgages originated for the Company's securitization programs which generated higher revenue on wider margins

Placement Fees

Comparing the year ended December 31, 2009, to the year ended December 31, 2008, placement fee revenue decreased by 15% to $123.9 million from $145.9 million. This was largely due to the change in the Company's strategy with respect to single-family floating rate mortgages. In 2008, these mortgages were originated for institutional placement. For much of 2009, the Company chose to fund these mortgages through securitization transactions. As a result, the volume of residential origination for institutional placement decreased by 22%. The Company also saw increased origination through its multi-unit residential NHA-MBS program, which had volumes of $2.8 billion for the year due to its continued competitive position. This compares to $1.7 billion in 2008. Together with mortgages for institutional investors, origination volumes which drive placement fees decreased by 15% from 2008 to 2009.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue increased 28% to $51.8 million from $40.4 million. The increase was due primarily to increased volumes of multi-unit residential mortgages originated for the Company's MBS program. These volumes grew by 58% and the wide margins realized in 2008 continued to be earned by the Company. From the program, the Company recognized both a placement fee (described above) and ongoing interest-only strips on these mortgages. The Company has valued these strips at $35.3 million, which is reflected in gains on deferred placement fees revenue. In 2008, the Company recorded $19.2 million in revenue from this program. These gains were offset with lower gains

on deferred placement fees from mortgages sold to institutional investors for the CMB program. As previously described, the Company sells a portion of its residential origination volume to institutional investors. In some cases, the Company earns additional revenue over the term of the sold mortgages based on those investors' current funding rates. The Company benefited from the increased mortgage spreads resulting from the turmoil in the credit markets beginning in August 2007. Although spreads in 2009 were greater than historical levels, such spreads decreased throughout the year as markets normalized. As such, the Company recorded reduced gains on deferred placement fees of $3.7 million for 2009, compared to 2008.

Gains on Securitization

Gains on securitization revenue increased 106% to $55.4 million from $26.9 million. The increase was due to the Company's decision to sell pools of insured floating rate mortgages to the NHA-MBS market. With the CMB and the federal government auction providing significant liquidity to the market combined with the very low interest rates on 30-day money market securities, institutional investors came to the market looking for alternative investment opportunities. During the year, the Company originated $2.1 billion (and pooled $1.7 billion) of single-family mortgages for inclusion in NHA-MBS pools. Due to historically high spreads currently being offered on these mortgages relative to funding costs, the Company was able to execute securitizations at very favourable terms. For all of 2009, the Company recognized $57.0 million in gains on securitization for such transactions. In 2008, the Company recorded only $11 million related to the securitization of such floating rate mortgages, primarily for replacement assets in the Company's existing CMB programs. ABCP was used mainly in 2008 to support the Alt-A and small commercial loan programs. These securitizations which produced no revenue in 2009, earned the Company about $11 million of gains on securitization in 2008. Offsetting the 2009 gains was a downward adjustment of $4.3 million related to gains on securitization on the Alt-A program recorded in previous periods. Although the program is slowly winding down, the Company began experiencing higher rates of loss severity than estimated on defaults in the program. In the third quarter of 2009, the Company increased its assumption for credit losses for the Alt-A program from 0.35% annually to 0.70% in its models.

Mortgage Servicing Income

Mortgage servicing income increased 3% to $64.4 million from $62.3 million. This was primarily due to the growth in the portfolio of mortgages under administration offset by smaller returns on monies held in trust. The mortgage administration portfolio grew by 18% year-over-year. The residential component grew by 21% and should have a larger impact on servicing revenue than the commercial component (the price per unit is much higher on residential than that on the commercial portfolio). In aggregate, revenue associated with mortgage administration activities, increased by 20%. This growth was offset by a decrease in the interest earned on funds held in trust. These funds are administered by the Company and include borrowers' property tax escrow. In the year, this income did not grow at the same rate as the mortgage portfolio, decreasing to $1.3 million for 2009 from $9.6 million in 2008. The reduction was the result of the significant decrease in short-term interest rates offset by the normal growth of the amount of funds held in trust. At December 31, 2009, the amount of funds held in trust was $435 million compared to $334 million at December 31, 2008, and the average 30-day CDOR, which is a benchmark for short-term interest rates decreased from 3.19% in 2008 to 0.56% for 2009.

Mortgage Investment Income

Mortgage investment income increased 6% to $23.4 million from $22.1 million. The change is a combination of offsetting factors, including: an increase in the amount of securitization and deferred placement fees receivables, higher bond yields than in the comparative year (which affect the interest earned on these receivables), falling prime lending rates (which affect gross revenues on mortgage and loan investments), and increased amounts of mortgages accumulated for sale and mortgage and loan investments held during the year.

Residual Securitization Income

Residual securitization income increased 154% to $22.9 million from $9.0 million. The recurring source of this revenue is the amortization of the servicing liability, which represents the servicing portion of the spread received from past securitization transactions. The other source is any excess of cash flows received above the expected cash flows assumed in the Company's calculation of the securitization and deferred placement fee receivables. The increase in 2009 is a result of the conservatism inherent in the Company's securitization models. The Company has tried to use realistic values for spread, prepayment and credit losses assumptions in these models. Faced with a choice, the Company tends to use conservative assumptions to record its gain on securitization revenue. If actual receipts in a period exceed the Company's assumed cash flows for that same period, the amount is recognized as residual securitization income in the period. This conservatism is demonstrated by the Company's assumption on the spread between prime and 30-day BA rates. This spread has remained historically wide since the fourth quarter of 2008; however, as disclosed previously in this MD&A, the Company assumed that this spread would narrow by 0.25 percentage points as at April 1, 2009. Because this spread did not narrow as predicted, the Company received approximately $6 million of spread in excess of what it had assumed in the models which determine the value of the Company's securitization receivables.

Realized and Unrealized Gains (Losses) on Financial Instruments

For First National, this line item typically consists of two components: (1) gains and losses related to holding term assets derived using discounted cash flow methodology, and (2) those related to the Company's economic hedging activities. The term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to price the Company's assets, including the Company's investment in securitization and deferred placement fees receivable, cash collateral and subordinate notes held by securitization trusts, as well as swap derivatives). The Company does not attempt to hedge these assets and accordingly will experience potentially significant unrealized gains and losses as credit spreads change and bond yields fluctuate.

Bond yields began the year at comparatively low absolute levels due to the financial crisis experienced at the end of 2008. During 2009, yields rose rapidly in the second quarter as recessionary pressures subsided, then remained choppy for the remainder of the year. Generally, five-year Government of Canada bond yields increased from approximately 2% at the beginning of the year to 2.6% by year-end. The impact of these changing bond yields on the fair market values of the Company's assets held during 2009 was a loss of $5.7 million recorded in unrealized losses on financial instruments. The Company will now earn a higher implicit rate of return on these assets going forward such that this loss is essentially a deferral of accounting earnings to future periods.

The decreased assumption for ABCP from 1.10 percentage points over BA's to 0.25 percentage points over BA's, as described earlier in this MD&A, has created an unrealized gain of $16.4 million for the year. Offsetting this gain, was an unrealized loss of $10.9 million which the Company recorded in the first quarter of 2009 to account for the expected normalization of Prime/BA spreads over the next five year time horizon. The changes in fair value related to the Company's interest rate swaps, securities sold short,

mortgages accumulated for sale, and mortgage commitments had offsetting effects such that the Company recorded only a small net gain on these during 2009.

Brokerage Fees Expense

Brokerage fees expense decreased 4% to $98.7 million from $102.9 million. The decrease is partially the result of single-family residential origination, which decreased 1% year-over-year. The Company also realized a decrease in this expense due to the timing of mortgage securitizations. As the Company originates mortgages to be securitized, it capitalizes the related broker fee to the mortgage. When the mortgage is subsequently securitized, the fee is expensed. Comparing the end of 2009 to the end of 2008, this accounting treatment has reduced the amount of brokerage fees by approximately $3.4 million, resulting in a 3% decrease in the overall expense.

Salaries and Benefits Expense

Salaries and benefits expense increased 19% to $48.2 million from $40.4 million. The increase is due primarily to the employee costs associated with commercial mortgage origination. The Company compensates its sales staff with a significant portion of the fees earned by the Company. Because of the increased revenue in the year, particularly with respect to placement fees, this compensation increased by $6.5 million year-over-year. Excluding these amounts, the core salaries and benefits expense remained consistent year-over-year in line with the small increase in headcount and reduction in average salaries as attrition has occurred at more senior levels and new staff added at entry level positions. As at December 31, 2009, the Company had 519 employees, compared to 506 as at December 31, 2008. Management salaries were paid to the two senior executives who indirectly own the Class B LP units. The current year's expense is as a result of the compensation arrangement executed on the closing of the initial public offering.

Interest Expense

Interest expense decreased 15% to $13.4 million from $15.7 million. This expense has decreased from the prior year due to the changing interest rate environment during the year. The Company's interest expense is indexed primarily off of BA rates and prime lending rates. Both rates fell dramatically between the years, average prime from 4.81% down to 2.43%, and average BA's from 3.19% to 0.56%. This represents decreases of 49% and 82%, respectively. The decrease has been offset with the Company's increased usage of the credit facility and higher interest rate spreads payable to the syndicate of bank lenders. As discussed in the "Liquidity and cash resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor or securitization. The Company uses a credit facility with a syndicate of banks to fund the mortgages in this period. The Company renewed this agreement in June 2009, keeping the total commitment at $378 million.

Other Operating Expense

Other operating expense decreased 27% to $16.4 million from $22.6 million. In 2008, the Company recorded $6.9 million for provisions related to losses on mortgage and loan investments held on its balance sheet. These provisions were recorded to meet specific mortgage exposures within the commercial real estate market in Canada. The Company has assessed the mortgages held on balance sheet and has recorded a provision for credit losses of $1.3 million in 2009. Without these provisions, these expenses would have decreased by 4% due primarily to discretionary spending cuts pursuant to the expected slow down of single-family residential origination.

Net Income and EBITDA

Net income increased 51% to $163.5 million from $108.0 million. The growth in earnings was derived from the combination of the higher margins associated with mortgage placement and securitization, coupled with stable operating costs. In particular, profitability has increased through higher margins on multi-unit residential mortgage origination and single-family floating rate mortgages as demand for these high credit quality assets increased with the uncertain credit environment which prevailed for much of 2009. EBITDA increased 51% to $165.2 million from $109.7 million. The increase was due to the same factors described for net income.

Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages) and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below.

	Operating Business Segments			
	Residential		Commercial	
	($ 000's except percent amounts)			
Year ended	**December 31, 2009**	**December 31, 2008**	**December 31, 2009**	**December 31, 2008**
Originations	8,468,000	8,757,000	3,319,000	3,129,000
Percentage change	*(3.3%)*		*6.1%*	
Revenue	240,263	229,371	101,453	64,588
Percentage change	*4.7%*		*57.1%*	
Income before income taxes and corporate non-allocated expenses	93,863	75,925	71,120	33,596
Percentage change	*23.6%*		*116.9%*	
Period ended	**December 31, 2009**	**December 31, 2008**	**December 31, 2009**	**December 31, 2008**
Identifiable assets	530,903	399,185	536,787	337,880
Mortgages under administration	31,879,946	26,333,014	15,913,099	14,263,000

Residential Segment

Residential revenues increased by 4.7% although origination decreased 3.3% between 2009 and 2008. The increased revenue is attributed to higher margins earned on prime single-family mortgage origination, primarily with respect to gains on securitization on floating rate mortgages. Income before income taxes increased by 23.6%, reflecting the higher gross margins earned in revenue and a low-cost operating environment.

Identifiable assets have increased from those at December 31, 2008, due to higher mortgages accumulated for sale held at the end of the December 2009.

Commercial Segment

Commercial revenues increased by 57% from the prior year due to greater margins on higher volumes of multi-unit residential product. Although overall origination grew by just 6.1%, this was the result of increased volumes of high margin insured origination net of decreased volumes for lower margin uninsured commercial mortgage product. The increased revenue flowed through to the bottom line and together with lower loan loss expenses of $5.5 million, net income doubled from that recorded in 2008.

Identifiable assets for the commercial sector increased primarily due to increased hedging requirements of $318 million for funded and committed multi-unit residential mortgages to be securitized after year end.

Liquidity and Capital Resources

The Company's liquidity strategy has been to use bank credit to fund working capital requirements and to use cash flow from operations to fund longer-term assets, providing a relatively low leveraged balance sheet. The Company's credit facilities are typically drawn to fund: (1) mortgages accumulated for sale, (2) deferred placement fees receivable, (3) securitization receivables, and (4) mortgage and loan investments. The Company has a credit facility with a syndicate of five banks for a total credit of $378.3 million (2008 - $378.3 million). This Facility was renewed in June 2009 for a 364 day term on substantially the same terms as the previous banking agreement except for higher interest rates commensurate with the then current credit environment. Subsequent to year end, the Company elected to reduce the commitment under the credit facility to $300.3 million as less expensive funding sources became available. Bank indebtedness also includes borrowings obtained through securitization transactions, outstanding cheques, and overdraft facilities. At December 31, 2009, the Company has also entered into repurchase transactions with financial institutions to borrow $221.9 million related to $223.5 million of mortgages and NHA-MBS securities held in mortgages accumulated for sale on the balance sheet.

At December 31, 2009, outstanding bank indebtedness was $249.3 million (December 31, 2008 - $331.0 million) of which $159.8 million (December 31, 2008 - $224.6 million) was drawn to fund mortgages accumulated for sale. At December 31, 2009, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $98.1 million (December 31, 2008 – $64.0 million), (2) securitization receivables of $104.0 million (December 31, 2008 - $51.1 million) and (3) mortgage and loan investments of $54.7 million (December 31, 2008 - $75.4 million). The difference between bank indebtedness and mortgages accumulated for sale, which the Company considers a proxy for true leverage, has decreased between December 2008 and December 2009 and now stands at $89.5 million. This represents a debt-to-equity ratio of approximately 0.42 to 1 which the Company believes is at a conservative level. This ratio has decreased from 0.74 to 1 as at December 31, 2008 as the Company has increased its equity through retained earnings.

The Company funds a portion of its mortgage originations with institutional placements and sales to securitization vehicles on the same day as the advance of the related mortgage. The remaining originations, primarily residential, are funded by the Company on behalf of institutional investors or securitization vehicles on the day of the advance of the mortgage. On specified days, typically weekly, the Company aggregates all mortgages "warehoused" to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs for sales to securitization vehicles, although the Company can dictate the date of sale into the vehicle at its discretion. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this "warehouse" period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for six to eighteen month terms, to bridge existing borrowers in the interim period between long-term financing solutions. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees and securitization receivables and other miscellaneous longer term financing needs.

A portion of the Company's capital has been employed to support its ABCP programs, primarily to provide credit enhancements as required by rating agencies. The largest part of this investment was made

on behalf of the Alt–A program. As at December 31, 2009, this investment was $26.1 million. Now that this program has been discontinued, this investment will be repaid to the Company (less any losses in excess of the Company's credit loss assumptions) over the term of the related mortgages. Since June 30, 2008, when First National stopped offering the Alt-A product, the Company has received repayment of approximately $16.6 million of this collateral. The cash flow associated with this return of collateral will provide more liquidity to the Company in future periods. This positive cash flow has been offset with the need for additional liquidity to manage the administration of defaulted mortgages in the Alt-A program. As this program has paid down with no addition of new assets, the ratio of defaulted mortgages to the total mortgages in the program has become skewed. In order to keep these ratios at an acceptable level for the Trust, the Company repurchased approximately $40.9 million of defaulted mortgages in 2009. Most of these mortgages were in the midst of the foreclosure process such that the Company liquidated $29.5 million of these mortgages during the year, experiencing credit losses at expected rates. At December 31, 2009, the Company employs an assumption for credit losses in the Alt-A program of 0.70% per annum. To date, this assumption has been more than enough to absorb all actual losses experienced in the program. The Company believes that prudent management of this program will continue to require some level of liquidity from the Company throughout its term.

As demonstrated previously, the Company continues to see strong demand for its mortgage product from institutional investors and liquidity from bank-sponsored commercial paper conduits. The Company's strategy of using diverse funding sources has allowed the Company to thrive, significantly increasing its profitability in 2009. By focusing on the prime mortgage market, the Company believes it will continue to attract bids for mortgages as its institutional customers seek government-insured assets for investment purposes. The Company also believes it can manage any liquidity issues that would arise from a year-long slowdown in origination volumes. Based on cash flow received in the fourth quarter of 2009, the Company estimates that it will receive approximately $53 million of cash annually from its servicing operations and $52 million of cash flow from previously recorded securitization and deferred placement fees receivables. Together this $105 million of annual cash flow would be sufficient to support the almost $90 million of distributions which the current distribution rate would require. Although a simplified analysis, it does highlight the sustainability of the Company's business model and distribution policy through periods of economic weakness.

Financial Instruments and Risk Management

With the adoption of the accounting standards surrounding financial instruments, the Company's income is subject to more volatility. This is particularly true for the deferred placement fees and securitization receivables together with the cash collateral and subordinate short-term notes held by securitization trusts. The Company had a choice between categorizing these assets as held-for-trading or available-for-sale. The accounting standard does not allow these assets to be treated as held-to-maturity, although this has always been the Company's intention. Each alternative available to the Company requires these assets to be recorded at their fair market value. The Company has elected to treat these assets as held-for-trading such that changes in market value are recorded in the statement of income. By electing to classify these assets as available-for-sale, the Company would have been required to allocate mark-to-market amounts between "normal" income and comprehensive income. Management believes this would needlessly increase the complexity of the financial statements. Effectively, these assets will now be treated much like bonds earning the Company a coupon at the different discount rates used by the Company. The discount rates used represent the interest rate associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the securitization's residual cash flows. As such, as rates in the bond market change, so will the recorded value of the Company's securitization related assets. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company has no intention of attempting to hedge this exposure due to the cost and complexity required to do so. Further, the Company does not intend to sell these assets before maturity. The accounting standard has had no impact on distributable cash.

The Company believes its hedging policies are suitably disciplined such that the related mark-to-market adjustments will be insignificant; however, in the event that effective economic hedging does not occur, the resulting gains and losses will be included in the current period's income. The Company uses bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is sold to securitization trusts and the underlying cost of funding is fixed. As interest rates change, the value of these interest rate hedges varies inversely with the value of the mortgage contract. As interest rates increase, a gain will be recorded on the hedge which should be offset by a loss on the sale of the mortgage to the purchaser as the mortgage rate committed to the borrower is fixed at the point of commitment. For residential mortgages, primarily mortgages for the Company's own inventory, only a portion of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2009, the Company does not have any forward bond positions related to its residential programs.

For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages for sale to the Company's own securitization vehicles. As at December 31, 2009, the Company had entered into $41 million in notional value forward bond sales. The change in mark-to-market value of the hedges from January 1, 2009 to December 31, 2009 has been expensed through the statement of income.

The Company is party to an amortizing fix for float rate swap to economically hedge the interest rate exposure related to certain mortgages held on balance sheet which the Company considers as replacement assets for its CMB activities. As at December 31, 2009, the notional value of this swap is $33.0 million. Market swap rates increased slightly in the period since the end of December 2008; as such, the net mark-to-market adjustment for the year was a gain of $528 for the Company. The amortizing swap matures in September 2013.

As described above, the Company uses various strategies to reduce interest rate risk. The financial statements also disclose the sensitivity which the deferred placement fees and securitization receivable have to changing discount rates. In the normal course of business, the Company also takes credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the date of sale or securitization. This can be illustrated by the Company's experience with commercial mortgages originated for the CMBS market in the spring of 2007. These mortgages were originated at credit spreads designed to be profitable to the Company when sold to a bank sponsored CMBS conduit. Unfortunately for the Company, when these mortgages funded, the CMBS market had shut down. The alternative to this channel was more expensive as credit spreads elsewhere in the marketplace for this type of mortgage had moved wider. The Company adjusted for market suggested increases in credit spreads in 2007 and 2008, adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from what it was at the end of 2008. Overall credit spreads stopped widening such that the Company applied the same spreads to these mortgages and the Company did not record any additional unrealized loss or gains related to credit spread movement. Despite the fact that the Company had entered into effective economic interest rate hedges, the exposure to credit spreads remained. This risk is inherent in the Company's business model and cannot be hedged economically. Although the Company has recorded these losses in its past financial results, the mortgages themselves are all in good standing and continue to pay monthly principal and interest payments at the contracted terms of the mortgages. If scheduled repayment continues for the full term of the mortgages, the Company will earn higher mortgage investment income equivalent to the amount of the cumulative losses recorded.

The same exposure to risk has also been described in the valuation of the Company's securitization receivable through ABCP conduits. The Company is exposed to the risk that 30 day ABCP rates are greater than 30-day BA rates. Initially it considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the Company, and the strong covenant of the bank sponsored conduits with which the Company transacted. As described earlier in this discussion, 30-day ABCP traded at approximately 1.10 percentage points over BA's as at December 31, 2008 but by the end of December 2009, were priced flat to BA's. At the same time the Company has leveraged on changing credit spreads. This has been demonstrated through the increase in volume and profitability of the NHA-MBS program and significant increases in gains on deferred placement fees from the sale of prime insured mortgages.

As at December 31, 2009, the Company has various exposures to changing credit spreads. The Company has $68 million of exposure related to commercial mortgages originated originally for the CMBS market. As described earlier, there are $1.4 billion of mortgages in securitization conduits that are exposed to BA – ABCP spread risk. In mortgages accumulated for sale there are $375 million of mortgages that are susceptible to some degree of changing credit spreads.

Normal Course Issuer Bid and Distribution Re-investment Program "DRIP"

To assist the Company in managing its liquidity, both of these programs were introduced in 2008. In August 2008, the Company was approved by the Toronto Stock Exchange to make a normal course issuer bid to purchase for cancellation up to 632,817 Units, representing approximately 5% of the Units issued and outstanding. Purchases under the bid were permitted to begin on August 8, 2008 and end no later than August 7, 2009. No Units were purchased under provisions of the bid and management did not renew the bid at maturity. Upon approval by the board of directors in March 2008, the DRIP program was made available to unitholders in April 2008; the Company suspended the DRIP after the July 2008 distribution paid on August 15, 2008.

Capital Expenditures

First National's business is not a capital-intensive business. Historically, capital expenditures have included technology software and hardware, facility improvements and office furniture. During the year ended December 31, 2009, the Company purchased new computers and office and communication equipment to support primarily its single-family residential business.

Going forward, the Company expects capital expenditures will be approximately $1.5 million annually and primarily relate to technology (software and hardware). Capital expenditures are expected to be funded from operating cash flow.

Summary of Contractual Obligations

The Company's long-term obligations include five-to-ten year premises leases for its four offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits a fully-serviced basis, and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

		Payments Due By Period			
	Total	0-1 Years	1-3 Years	4-5 Years	After 5 Years
			(in $ thousands)		
Lease Obligations	6,992	3,037	3,471	484	—
Servicing Liability	21,022	7,647	8,734	3,134	1,507
Total Contractual Obligations	28,014	10,684	12,205	3,618	1,507

Guarantees

First National Financial Operating Trust (the "Trust") and First National Financial GP Corporation (FNFLP's general partner, the "GP") have entered into postponement of claim and guarantees with respect to FNFLP's borrowings under its credit facility. The guarantee is supported by first ranking security over all the present and future assets of the Trust, including a first ranking pledge of all securities held by the Trust in FNFLP and the GP.

Critical Accounting Policies and Estimates

FNFLP prepares its financial statements in accordance with GAAP, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions, which it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis.

The significant accounting policies of First National are described in Note 2 to the audited financial statements prepared as at December 31, 2009. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on securitization and deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages to special purpose entities ("Trusts") through securitizations as well as its gains or losses on those mortgages placed with institutions earning a deferred fee. Under GAAP, valuing a gain on sale requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future net cash flows) in the mortgages. These retained interests are reflected on the Company's balance sheet as securitization receivables and deferred placement fees receivable. The key assumptions used in the valuation of gains on securitization and deferred placement fees are spread, prepayment rates, the annual expected credit losses, and the discount rate used to present value future expected residual cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company uses different rates for its various programs that average approximately 18% for residential mortgages and 33% for commercial floating rate mortgages. The Company assumes there is virtually no prepayment on commercial fixed rate mortgages. Credit losses are also reviewed on a monthly basis, in the context of the type of mortgages securitized. For the largest portion of the Company's securitizations, the mortgages are either insured or low ratio mortgages for which the Company does not provide for the event of a credit loss.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the life of the mortgages. The assumptions underlying the estimates used for the year ended December 31, 2009, continue to be consistent with those used for the year ended December 31, 2008 and the quarters ended March 31, June 30, and September 30, 2009, with the exception of some assumptions for prepayment and credit losses. For adjustable rate insured single-family residential mortgages, the Company increased the assumption for annual prepayment from 16% to 20.6% in the third quarter of 2009 and from 20.6% to 25.6% in the fourth quarter of 2009. This change was the result an anticipated trend of higher rates of conversion to fixed rate mortgages identified during each quarter. For the securitization of Alt-A mortgages, the Company currently assumes a credit loss rate of 0.70% per annum. The Company increased this assumption in 2009 from 0.35% used prior to December 31, 2008 as the loss rates on this portfolio increased. For the securitization of small multi-unit residential and commercial mortgages, the Company used a credit loss rate of 0.25% per annum. Both these rates are greater than the actual rates experienced by the Company to date, but which management feels are appropriate estimates of losses that will average over the life of the mortgages being securitized.

Inherent in the determination of the Company's securitization receivable is also an assumption about the relationship of short-term interest rates, specifically the spread between one-month BA and one-month high quality ABCP. Historically, the Company built its financial models with the assumption that the spread between these two rates would always be quite narrow. As described previously in this discussion, this relationship deviated from historical norms beginning in the third quarter of 2007 and then moved even wider in the fourth quarter of 2008 before narrowing during the course of 2009 such that the spread between these instruments is very tight as at December 31, 2009. As described previously, the Company has adjusted its securitization receivable to account for this change in circumstances. Currently the Company has assumed that ABCP spreads are 0.25 percentage points over one-month BA.

The Company has elected to treat its financial assets and liabilities, including deferred placement fees receivable, securitization receivables, mortgages accumulated for sale, cash collateral and short-term subordinated loans, and bonds sold short as held-for-trading. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases.

Future Accounting Changes

International Financial Reporting Standards (IFRS)

In January 2006, the Canadian Accounting Standards Board announced its decision requiring all publicly accountable entities to report under International Financial Reporting Standards (IFRS). This decision establishes standards for financial reporting with increased clarity and consistency in the global marketplace. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and will be applicable for the Company's first quarter of 2011. One issue that has become evident is the difference in accounting for securitization transactions. Under current GAAP, the Company's securitizations are all considered "true sales" for accounting purposes such that the Company has recorded gains on securitization when these mortgages were sold to various securitization conduits. Under current IFRS standards, these securitizations will likely not meet the definition of a "true sale" and instead will be accounted for as a secured financing. Accordingly the Company believes that all of its securitizations (through ABCP conduits, NHA-MBS and direct CMB issuance) will not qualify for sale accounting; however it believes that its deferred placement transactions will continue to meet the criteria for off-balance sheet treatment. Because the ABCP programs are

generally amortizing down while deferred placement transactions continue to grow, it is difficult at this time to evaluate the extent of the impact of these changes as at January 1, 2011.

As described in the Revenue and Funding Sources of this MD&A, the Company decided to differentiate revenue earned from transactions that provide the Company future cash flow streams. In the past, the Company treated all such transactions as "gains on securitization"; now "gains on deferred placement fees" will be disclosed separately. This change in presentation will assist stakeholders with the transition to IFRS as the Company believes that the mortgages related to "deferred placement fees receivable" will be more likely to receive off-balance sheet treatment and the current accounting treatment will continue to be appropriate under IFRS. The "securitization receivable" consists primarily of direct securitizations through ABCP, NHA-MBS, and the CMB. In these cases the Company believes that for most, if not all, of these transactions, off-balance sheet treatment will not be permitted under current IFRS and these receivables will be effectively reversed against opening equity as at January 1, 2011. In March 2009 the International Accounting Standards Board published an exposure draft ("ED") on "Derecognition". This ED describes new criteria for obtaining off-balance sheet accounting when financial assets are sold/transferred. This proposed standard focuses on the effective control of the related assets as opposed to the risk/ reward framework that was the foundation of the existing standard. Should this standard be adopted in its current form, the Company may have to treat other mortgage assets as on-balance sheet assets, including those currently accounted for as "deferred placement fees", due to new tests of "control" being defined in the accounting standards. This exposure draft has attracted much opinion and criticism from the accounting community and has yet to be finalized at this time.

The Company's project team has completed its initial impact assessment and commenced system changes to gather financial information that will be required for the conversion. Detailed diagnostic work shops have taken place and the Company has been working with its external auditors to assess the impact. The Company is now in the process of producing the requisite documentation to support its position in adopting the new international accounting standards under IFRS and is preparing a pro-forma balance sheet as at December 31, 2009 based on the new standards. The Company will continue to evaluate the impact of these new standards and will report accordingly in future MD&A.

Controls over Financial Reporting

No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Risk and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company including: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events, cash collateral and retained interest, reliance on multi-unit residential and commercial mortgages, general economic conditions, government regulation, competition, reliance on mortgage insurers, reliance on key personnel, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, environmental liability, and risk related to Alt-A mortgages which experience higher arrears rates and credit losses than prime mortgages. In addition, risks associated with the structure of the Fund include those related to the dependence on FNFLP, leverage and restrictive covenants, cash distributions

which are not guaranteed and will fluctuate with FNFLP's performance, the nature of Units, distribution of securities on redemption or termination of the Fund, restrictions on potential growth, unitholder liability, undiversified and illiquid holding in the Trust, the market price of Units, dilution of existing unitholders and FNFLP unitholders, statutory remedies, control of the Company and contractual restrictions and income tax matters. Risk and risk exposure are managed through a combination of insurance, a system of internal controls, and sound operating practices. The Company's key business model is to originate mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Fund's business, reference should be made to the Annual Information Form of the Fund.

Income Tax Matters and Conversion to a Corporation

Amendments to the Tax Act enacted June 22, 2007 affect the taxation of certain publicly traded trusts and their beneficiaries (the "SIFT Rules"). The Fund will benefit from a transitional period, and will not be subject to the SIFT Rules until January 2011 provided the Fund experiences only normal growth and no undue expansion, as described below, before then. When the SIFT Rules are applicable to the Fund, it will be liable for tax at a rate comparable to the combined federal and provincial corporate tax rate on all or a significant portion of its income distributed to unitholders, and unitholders will receive Fund income distributions as eligible dividends. The application of the SIFT Rules to the Fund is expected to result in adverse tax consequences to the Fund and certain unitholders (in particular, unitholders that are tax exempt or non-residents of Canada) and may impact the future level of distributions made by the Fund. The enactment of the SIFT Rules and their ultimate application to the Fund may reduce the value of Fund units and hence increase the cost to the Fund of raising capital in the public capital markets.

The Department of Finance (Canada) has indicated that, while there is no intention to prevent normal growth of existing trusts during the transition period, any undue expansion of a particular trust could result in loss of the benefit of the transitional period. On December 15, 2006, the Department of Finance (Canada) issued guidelines with respect to what will be considered normal growth in this context. While the Fund does not intend to raise capital in excess of the safe harbour limits outlined in these guidelines, there is a risk that the adverse tax consequences resulting from the SIFT Rules could be realized sooner than 2011.

As a result of the enactment of the SIFT Rules, the Fund has been required to account for future income taxes under the asset and liability method, whereby future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future income tax assets are recorded in the consolidated financial statements to the extent that realization of such benefits is more likely than not. See the description above under "Accrued Future Tax Liability on Intangible Assets" and "Accrued Future Tax Liability on Investment in FNFLP".

Currently, a trust will not be considered to be a mutual fund trust if it is established or maintained primarily for the benefit of non residents unless all or substantially all of its property is property other than taxable Canadian property as defined in the Tax Act. On September 16, 2004, the Minister of Finance (Canada) released draft amendments to the Tax Act. Under the draft amendments, a trust would lose its status as a mutual fund trust if the aggregate fair market value of all units issued by the trust held

by one or more non-resident persons or partnerships that are not Canadian partnerships is more than 50% of the aggregate fair market value of all the units issued by the trust where more than 10% (based on fair market value) of the trust's property is taxable Canadian property or certain other types of property. To date, the Department of Finance has not tabled a Notice of Ways and Means Motion which includes these proposed changes, and the Department of Finance has indicated that the implementation of the proposed changes has been suspended pending further consultation with interested parties. Depending upon the final form of these proposed changes, if enacted, it may be necessary to amend the Fund's declaration of trust to take into account any new restrictions. This amendment may be made without unitholder approval.

The Company believes that to remain a trust after the SIFT rules come into effect in 2011 would not be in the best interest of unitholders. Although the rates of taxation applicable to the Company's earnings would be similar, these taxes would be marginally higher if the Fund were to remain as a mutual fund trust. Additionally, any earnings not distributed by the Fund would be taxed at the highest marginal personal tax rates. In order to provide the Company with the most flexibility, management believes a conversion to a corporation is the most prudent course of action. Management has begun discussions with its tax advisors and plans to use tax free rollover provisions to reorganize the current trust structure. Generally speaking, the reorganization plan will be brought before all unitholders for approval and will be timed to take full advantage of the current beneficial tax rules until they expire on December 31, 2010.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as ''may'', ''will, ''should'', ''expect'', ''plan'', ''anticipate'', ''believe'', ''intend'', ''estimate'', ''predict'', ''potential'', ''continue'' or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward looking-information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers and changes in interest rates outlined under ''Risk and Uncertainties Affecting the Business''. In evaluating this information, the reader should specifically consider various factors, including the risks outlined under ''Risk and Uncertainties Affecting the Business'', which may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of March 9, 2010, and is subject to change after such date. However, management and the Fund disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

Despite the challenging economic environment, the Company achieved record results in 2009. These results were the product of several favourable market conditions and the execution of the Company's strategy. Single-family origination volumes remained at levels similar to those experienced in 2008, prime mortgage spreads provided the Company with additional margin for gains on securitization, multi-unit residential origination spreads remained wide as competitors stayed on the sidelines, and ABCP spreads moved in to more rational levels. The mortgage broker distribution channel continued to grow relative to other distribution channels, as did the Company's leadership position within it.

As the Company has shown in its results, the credit tightening that began in August 2007 has created opportunities due to the departure of several competitors from the market and the widening out of credit spreads. These departures improved the Company's ability to gain origination volume and assisted it in achieving attractive pricing for its CMHC-insured multi-family mortgage product. This product, like prime single-family residential, has always been one of the reasons for the Company's strong market position. First National has taken advantage of these market conditions and produced the record quarter described throughout this MD&A.

Current economic statistics suggest some lingering uncertainty about the length of the current recession. For the Company, management believes this will mean that overall single family origination levels in 2010 will be comparable to those experienced in 2009. The stabilization of credit markets which began in the second quarter continues and the excess liquidity in the capital markets has increased funding opportunities for the Company. However, this increased liquidity has also put pressure on mortgage spreads as the Company's competitors have re-entered the market. Increased competition will reduce the margins the Company enjoyed in 2009. The Company expects tighter mortgage spreads in both the prime single-family and the multi-family residential segments of its business. Offsetting these reductions will be higher income and cash flow derived from the growing $47 billion portfolio of mortgages under administration and a reduced cost of funding.

As described earlier, the tax treatment of income trusts is changing and the Company is planning to restructure and become a corporation on or about January 1, 2011. Beginning in 2011, the Company plans to replace its distributions with dividend payments. The results of both 2010 and 2011 will have a bearing on the Company's new dividend policy, as will the tax rates imposed by Canadian tax authorities. Accordingly, it is difficult to give definitive direction at this time; however, at a minimum the Company expects to set its initial annual dividend at $1.50 per share less the applicable liability for current income taxes.