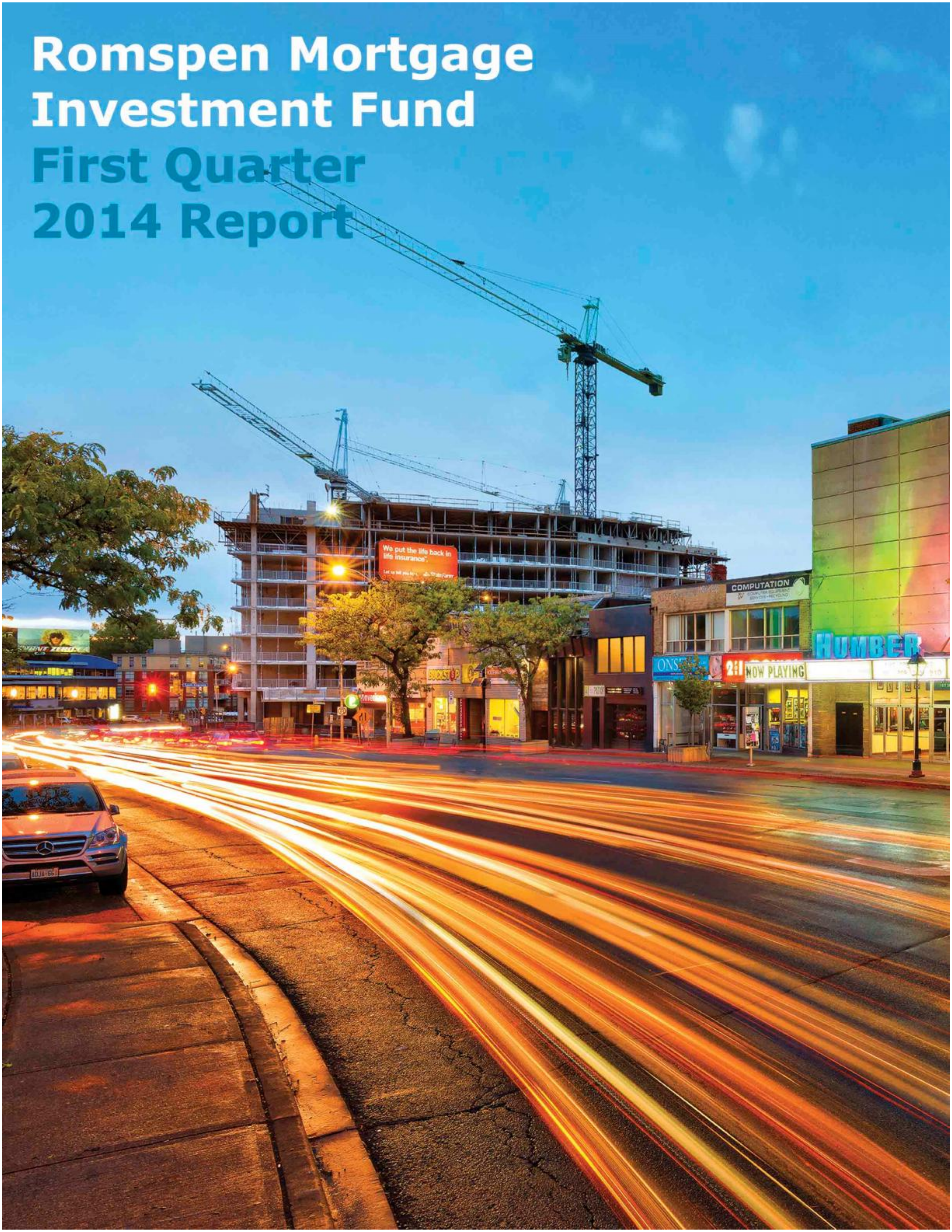
# Romspen Mortgage Investment Fund
# First Quarter 2014 Report



Romspen has a long-term track record of successful mortgage investing. With its origins in the mid-60's, Romspen is one of the largest non-bank commercial/industrial mortgage lenders in Canada. Our investors are high-net-worth individuals, foundations, endowments and pension plans. The Fund's investment mandate is focused on capital preservation, strong absolute returns, and performance consistency.

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Cover Image:
Jane/Bloor Retail Development
Toronto, Ontario

# TRUSTEES' LETTER

Dear Fellow Investors:

Romspen's performance in the first quarter was in line with expectations. Over the past 12 months, the Fund has outperformed major fixed income benchmarks.

### Financial Highlights

Net income for the first quarter of 2014 was $21.3 million or $0.19 per unit compared to $18.1 million or $0.18 per unit a year ago. Results included an unrealized foreign exchange gain of $0.8 million during the quarter from US mortgage investments. Interest revenues rose reflecting the larger mortgage portfolio. Unitholder distributions were $0.18 per unit during the first quarter, equal to a year ago.

As at March 31, the net mortgage portfolio was $1.2 billion, an increase of 19% compared to a year ago. The portfolio growth corresponds with increased construction and development activity by mid-market borrowers and continued US growth in the portfolio. Within the portfolio, we remain well diversified across property types and continue to diversify our geographic exposure through growth in the US market. The weighted average interest rate of the mortgage portfolio at March 31 was marginally lower at 10.5% compared to 10.7% a year ago.

The Fund had net debt (debt less unrestricted cash) of $103.9 million at the end of the first quarter compared to a net debt of $35.6 million a year ago after an active fourth quarter of 2013. Total unitholder capital invested was $1.15 billion at quarter end. The total loss provision at quarter end increased to $18.0 million, thereby maintaining a strong margin of safety on our balance sheet against potential losses.

Net asset value at March 31 was $9.94 per unit, a gain of $0.02 per unit compared to last year due to unrealized foreign exchange gains. With increased US dollar exposure in the portfolio, and a GAAP requirement to report the changing values of currencies at fair market value, net income and NAV will experience more fluctuation than in the past. At quarter end, 97% of the Fund's CDN/US dollar portfolio exposure was hedged as part of our policy to mitigate foreign exchange loss exposure.

### Comparative Performance

The compounded net yield to unitholders for the first quarter of 2014 was 1.8%, similar to a year ago. This compares with T-bills, DEX Short Term Bond Index ("DEX-STBI"), and the S&P/TSX, which yielded 0.2%, 1.1%, and 6.1% respectively on a year-to-date basis.

For the twelve-month period ended March 31, the Fund's compounded net yield to unitholders was 7.4%. This compares to T-bills, DEX-STBI, and S&P/TSX returning at 1.0%, 1.9%, and 16.0% respectively.

### Commentary and Outlook

While the recovery from the recession has been frustratingly weak and long, this plodding progress has, so far, proven enduring. A large part of the underpinning of this has been the artificially low interest rate environment accompanied by a host of other accommodative monetary policies. Going forward, the key question remains the impact of the looming withdrawal of credit stimulus by the US central bank as the tapering process continues. Our current view is that while there may be some upward movement in rates, it is likely lower than normal rates will prevail for some time yet.

Absolute interest rates remain at historic lows and safe assets remain in short supply, thereby making the task of finding suitable mortgage investments that much harder. As competition for transactions has escalated, we increasingly "pass" on deals we view as mis-priced risk by more aggressive lenders. While our returns have been affected by these factors and are lower than our historical performance or what we would like to see, they are a marketplace reality at present. We continue to stick to our historic and tested underwriting standards and act conservatively in managing for risk and not for rate.

At present, the US market opportunities we see generally represent more attractive value than comparable Canadian properties. This reflects the recovering US economic scenario from the depths of the credit crisis combined with severe restrictions on US lenders from accounting rules and regulation that has curbed there lending capability in many markets along with a softening of economic activity in Canada. The US portfolio, represented $226 million or 18% of the mortgage portfolio at the end of the first quarter, compared to $123 million or 12% in the year ago period. In total, the US portfolio includes 26 loans with the majority concentrated in Pennsylvania, Colorado, North Carolina, Hawaii and Florida.

On behalf of the Romspen team, we thank you for your on-going support. For further information, please contact Investor Relations at 416-966-1100, or consult our website: www.romspen.com.

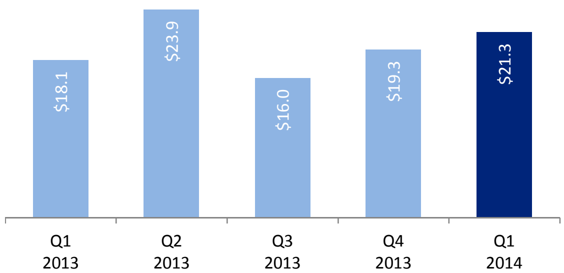
Respectfully submitted,

| | | | |
|---|---|---|---|
| Sheldon Esbin | Mark Hilson | Arthur Resnick | Wesley Roitman |

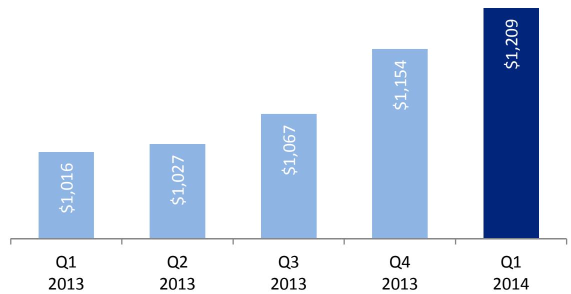
Trustees of the Fund
June 5, 2014

## Key Metrics

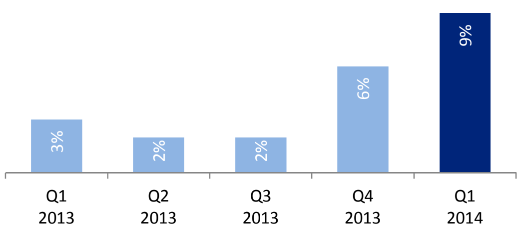
**Net Earnings** ($millions)



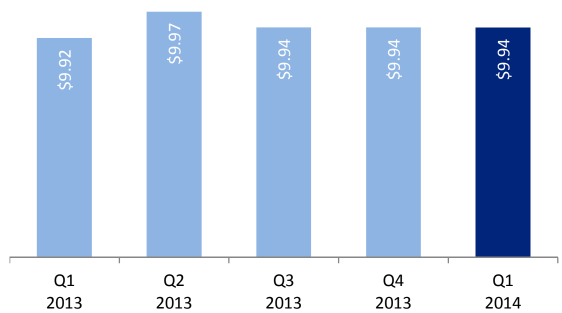

**Mortgage Portfolio** ($millions)



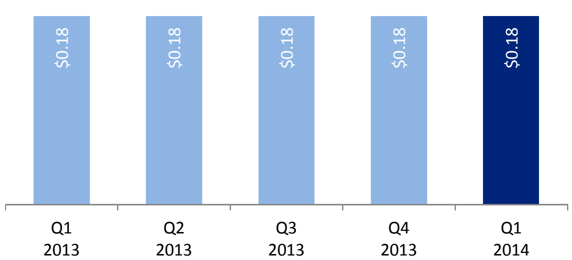

**Net Leverage** (% of mortgage portfolio)



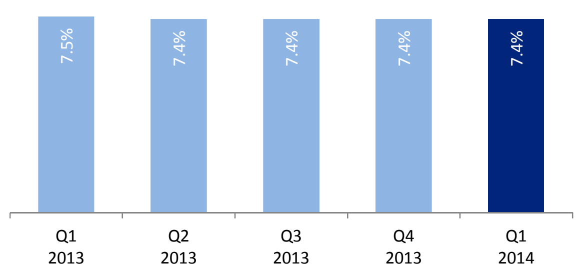

**Unitholder Value** ($/unit)




**Unitholder Distributions** ($/unit)

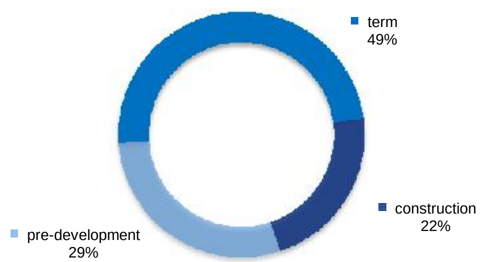



**Trailing 12 Month Net Compounded Return** (%)

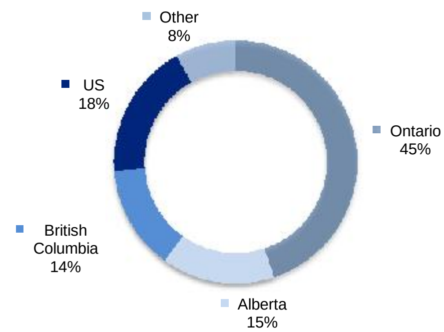


## Mortgage Portfolio Profile
As of March 31, 2014

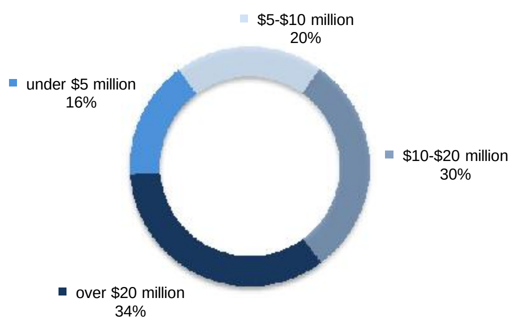
### By Type



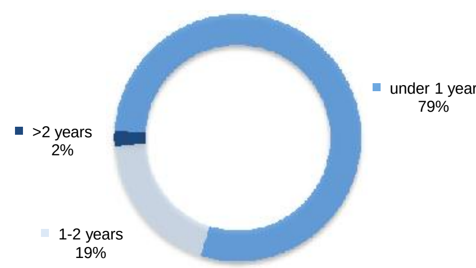

### By Geography



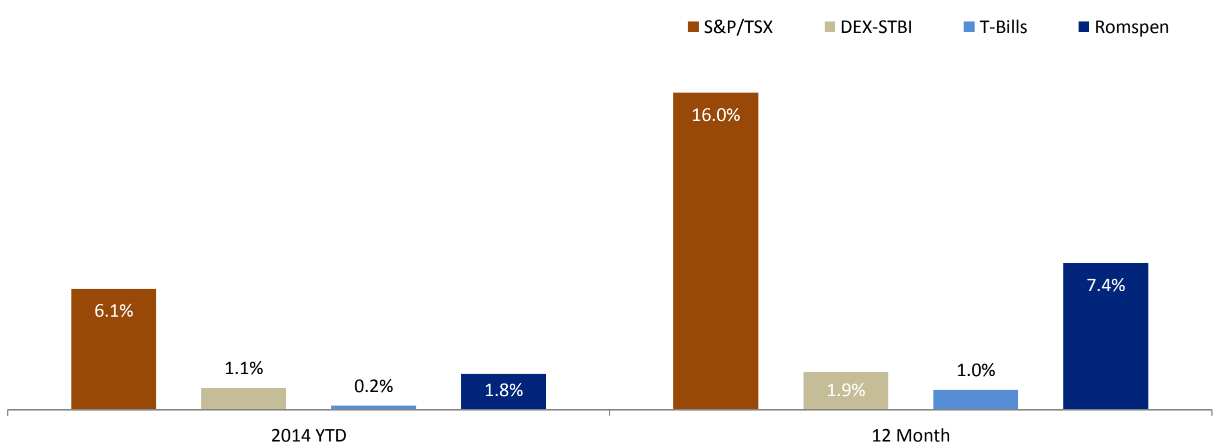

### By Amount




### By Maturity




## Comparative Performance
Net Compounded Return - %



## MANAGEMENT'S DISCUSSION & ANALYSIS

### Responsibility Of Management

*This Management's Discussion and Analysis ("MD&A") for Romspen Mortgage Investment Fund ("the Fund") should be read in conjunction with the financial statements and notes thereto for the quarter ended March 31, 2014 included herein and the audited financial statements and MD&A for the year ended December 31, 2013. Investment in the Fund is subject to certain risks and uncertainties described in the Fund's Offering Memorandum, which should be read in conjunction with this MD&A. These documents are available on our website at: www.romspen.com.*

*Management is responsible for the information disclosed in this MD&A. The Fund has in place appropriate procedures, systems and controls to ensure such information is materially complete and reliable. In addition, the Fund's trustees have reviewed and approved the MD&A and the financial statements for the quarter ended March 31, 2014.*

*This MD&A contains certain forward-looking statements and non-GAAP financial measures, see "Forward-Looking Statements" and "Non-GAAP Financial Measures".*

### Forward-Looking Statements

From time to time, the Fund makes written and verbal forward-looking statements. These are included in its quarterly Management's Discussion and Analysis ("MD&A"), Fund presentations and other Fund communications.

Forward-looking statements include, but are not limited to, business objectives and targets, Fund strategies, operations, anticipated financial results and the outlook for the Fund, its industry, and the Canadian economy. These statements regarding future performance are "financial outlooks" within the meaning of National Instrument 52-102. Forward-looking statements are typically identified by words such as "believe", "expect", "anticipate", "estimate", "plan", "may", and "could" or other similar expressions. By their very nature, these statements require us to make assumptions and are subject to inherent risks and uncertainties, general and specific, which may cause actual results to differ materially from the expectations expressed in the forward-looking statements. These risks and uncertainties include, but are not limited to, global capital market activity, changes in government monetary and economic policies, changes in interest rates, inflation levels and general economic conditions, legislative and regulatory developments, competition and technological change. The preceding list is not exhaustive of possible factors. These and other factors should be considered carefully and readers are cautioned not to place undue reliance on these forward-looking statements. The Fund does not undertake to update any forward-looking statements, whether written or verbal, that may be made from time to time by it or on its behalf except as required by securities laws.

### Non-GAAP Financial Measures

This MD&A contains certain non-GAAP financial measures. A non-GAAP financial measure is defined as a numerical measure of the Fund's historical or future financial performance, financial position, or cash flows that excludes amounts or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the financial statements or includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented. Non-GAAP financial measures disclosed herein are meant to provide additional information and insight regarding the historical operating results and financial position of the Fund. These measures are not in accordance with, or a substitute for, GAAP and may be different from or inconsistent with non-GAAP financial measures used by others.

### Introduction

The Fund is an unincorporated closed-end investment trust established under the laws of the Province of Ontario pursuant to a trust indenture dated as at May 20, 2005. The Fund is a non-bank lender providing and investing primarily in short-term and medium-term commercial mortgages. The Fund is the sole limited partner in the Romspen Mortgage Limited Partnership (the "Partnership") and conducts its lending activities primarily through the Partnership. The objective of the Fund is to provide stable and secure cash distributions of income while preserving equity.

Romspen Investment Corporation ("Romspen") is the Fund Manager and acts as the primary loan originator, underwriter, administrator and syndicator for the Partnership. Romspen also acts as administrator of the Fund's affairs. Romspen and its principals, through predecessor companies, have been in the business of mortgage origination, servicing and syndication since 1966.

The Fund commenced operations on January 16, 2006, and raised $158.9 million pursuant to the Exchange Offering, whereby Romspen's investors exchanged their syndicated mortgage interests for units of the Fund, and $15.3 million pursuant to the Unit Offering described in its Offering Memorandum dated March 15, 2005.

On June 22, 2007, new federal legislation came into force that altered the taxation regime for specified investment flow-through trusts or partnerships ("SIFT") (the "SIFT Rules"). Under the SIFT Rules, certain distributions from a SIFT will no longer be deductible in computing a SIFT's taxable income and a SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general corporate tax rate. Distributions paid by a SIFT as returns of capital will not be subject to the tax. As its units are not listed on a stock exchange or other public market, the Fund is not subject to the SIFT tax regime.

The Offering Memorandum, financial statements and additional information on the Fund are available and updated regularly on the Fund's website at: www.romspen.com. Unitholders who would like further information may also contact the Investor Relations department of the Fund at: 416-966-1100.

### Mortgage Portfolio

As of March 31, 2014, the Fund's mortgage portfolio, net of fair value provisions, was $1,209 billion compared with $1,016 million at March 31, 2013. This increase of $193 million or 19% reflects the increased activity in mortgage markets supported by a strong inflow of investor capital. The portfolio increased to 148 mortgages versus 138 in the prior year.

Approximately 95% of the portfolio was invested in first mortgages at March 31, 2014 which is unchanged from a year ago. The weighted average interest rate of the portfolio decreased marginally to 10.5% at the end of the first quarter versus 10.7% a year ago.

The portfolio continues to consist mainly of short-term mortgages. Approximately 79% of the portfolio's mortgage investments mature within one year (March 31, 2013 – 74%) and 98% mature within two years (March 31, 2013 – 97%). In addition, all of our mortgages are open for repayment prior to maturity. The short-term nature of the Fund's portfolio permits opportunities to continually and rapidly evolve the portfolio in response to changes in the real estate and credit markets. The Fund Manager believes this flexibility is far more important in our market niche than securing long-term fixed interest rates.

As of March 31, 2014, approximately 45% of our mortgage investments were in Ontario, which is unchanged from a year ago. Approximately 29% of the Portfolio was invested in Western Canada, 8% in other provinces and 18% in the US. The Fund Manager believes this level of diversification adds stability to the Fund's performance by reducing dependency on the economic activity and cycles in any given geographic region.

Total fair value provisions as of March 31, 2014 were $18.0 million, which represented 1.5% of the original cost of the Fund's mortgage investments as at March 31, 2014. No losses were recognized during the first quarter. The fair value provision is based on assumptions relating to the Fund's mortgage investments and only the passage of time will determine the actual performance of the mortgages. The fair value provision will continue to be reviewed by the Fund Manager and the Fund's trustees and, if appropriate, will be adjusted.

### Income Statement Highlights

Total revenues for the quarter ended March 31, 2014 were $27.9 million compared to $21.9 million in the previous year. The change in revenue reflects an increase in the size of the portfolio as well as foreign exchange gains. These gains reflect an appreciation of the US dollar against the Canadian dollar.

Net earnings for the quarter were higher at $21.3 million compared to $18.1 million for the first quarter last year for similar reasons to those listed above offset by a growth in the reserve of $1.9 million to increase the safety of the

Fund. The basic weighted average earnings per unit for the quarter was $0.19 per unit but after removing the unrealized foreign exchange gain, the remaining $0.18 per unit was the same as the prior year.

The Fund distributed $20.6 million or $0.18 per unit during the first quarter (2013 - $18.4 million or $0.18 per unit). The simple and compounded net yield to unitholders for the three month period ended March 31, 2014 were both 1.8%. The net yield to unitholders on a simple and compound basis, for the preceding twelve-month period were 7.2% and 7.4% respectively.

Management fees payable to the Fund Manager and other general and administrative expenses of the Fund were $3.3 million for the quarter compared to $2.8 million in the previous year. These expenses were higher than the previous year and reflect the larger portfolio value.

### Balance Sheet Highlights

Total assets as of March 31, 2014 were $1,274 million compared to $1,081 million a year ago. Total assets are comprised primarily of mortgages recorded at fair market value and accrued interest receivable on those mortgages.

Total liabilities excluding units submitted for redemption as of March 31, 2014 were $125.6 million compared with $53.9 million a year earlier. Liabilities at the end of the first quarter were comprised mainly of $115.7 million line of credit and $8.8 million in accounts payable and distributions payable to unitholders. Drawings under the revolving loan facility, together with net cash proceeds of the Unit Offering, are used to increase the Fund's mortgage portfolio. The revolving loan facility bears interest not exceeding prime plus 1.625% and is secured by all assets of the Partnership and a pledge of all Partnership units held by the Fund. Net debt (debt less unrestricted cash) stood at $103.9 million (9% of mortgage portfolio) at quarter end versus $35.6 million (4% of mortgage portfolio) a year ago.

Unitholders' equity plus units submitted for redemption as of March 31, 2014 were $1,148 million compared with $1,027 million as of March 31, 2013. The increase is primarily from proceeds of issuances of $196.1 million in excess of redemptions of $76.5 million during the previous 12 months. These amounts represented approximately ten dollars per unit outstanding at the end of each reporting period. There were a total of 115,435,464 units outstanding on March 31, 2014 compared to 103,528,571 on March 31, 2013. There are no options or other commitments to issue additional units.

### Liquidity And Capital Resources

Pursuant to the trust indenture, 100% of the Fund's net earnings are generally distributed to unitholders. This means that growth in the mortgage portfolio can only be achieved through the raising of additional unitholder equity and utilizing available borrowing capacity. The Fund was slightly levered as of March 31, 2014 with 8% borrowed as a percentage of the book value of mortgages, the same as a year ago.

During the three months ended March 31, 2014, proceeds from the issuance of units net of redemptions and costs were $41.4 million compared to $29.8 million during the same period in 2013.

The Fund's mortgages are predominantly short-term in nature with the result that continual repayment by borrowers creates liquidity for ongoing mortgage investments.

### Related Party Transactions

Romspen acts as mortgage manager for the Partnership and administrator for the Fund. The trustees of the Fund are all principals of Romspen. In consideration for its services, Romspen receives a fee equal to 1% per annum, calculated daily and paid monthly, of the total of all mortgage investments plus the fair value of any non-mortgage investments. Romspen also receives all lender, broker, origination, commitment, renewal, extension, discharge, participation, and other administrative fees charged to borrowers. In addition, the Partnership has granted to Romspen the option to purchase any mortgage investment held by the Partnership for a purchase price equal to the principal amount of such mortgage plus any accrued interest.

From time to time, the Partnership may invest in mortgage loans made to borrowers who are related to Romspen or the trustees of the Fund. The Partnership may also invest in mortgages which are syndicated among Romspen, the Fund's trustees, or related parties. The Partnership's interests in such syndications rank either pari-passu with, or in priority to, the related party investors.

These related party transactions are further discussed in the notes to the accompanying consolidated financial statements.

## Risk Management

The Fund is exposed to various financial instrument risks in the normal course of business. The Fund manager and trustees have put in place various procedures and safeguards to mitigate these risks in order to ensure the preservation of capital as well as the achievement of acceptable and consistent rates of return. For details on financial instrument risks and management's response to these risks, please see note 14 of the Financial Statements.

## Outlook

While the world economy is in recovery mode it is still fragile and interest rates remain at historic lows. In Canada, recent forecasts have been tapered to adjust to softening business conditions, both domestic and abroad. This environment has resulted in the Bank of Canada holding the bank rate steady with little change expected in the medium term.

While the US market has experienced some level of stability, financing dislocation remains prevalent and property values attractive for mortgage underwriting. These conditions will tend to favour US mortgage investments in general over those in Canada where values tend to be extended and market dynamics are softening somewhat. We expect these conditions to persist for some time as the recovery continues and we expect US mortgages will continue to grow through the balance of the year at a faster rate than Canadian mortgages. While the market shows strong demand for mortgage lending, there is evidence of what we view as underpriced risk activity by more aggressive lenders. These factors have unfavourably impacted our current returns in comparison with our historical performance or desired returns, as we continue to align our underwriting process with our conservative investment mandate.

We continue to work through non-performing loans to maximize recovery values and are experiencing continued progress on numerous fronts. While this process is sometimes painfully slow, it is often the best means of maximizing value rather than looking for expedient solutions or being a forced-seller in a down market.

Our deal pipeline continues to remain stable with attractive opportunities on both sides of the border and we believe to be well positioned for continued growth in 2014. We have a stable, experienced team; our underwriting practices are well ingrained throughout the organization as we continue to be selective in choosing those mortgage opportunities with the most attractive risk/return profiles. The first quarter showed moderate mortgage activity for the Fund and we expect to see similar portfolio growth in the second quarter of 2014 with returns broadly consistent with last year.

# Consolidated GAAP Financial Statements

## ROMSPEN MORTGAGE INVESTMENT FUND

Three months ended March 31, 2014 (Unaudited)

## CONSOLIDATED BALANCE SHEET

March 31, 2014, with comparative figures for 2013

(In thousands of dollars, except per unit amounts, unless otherwise noted)

| | March 31, 2014 (Unaudited) | December 31, 2013 (Audited) | March 31, 2013 (Unaudited) |
|---|---|---|---|
| **ASSETS** | | | |
| Cash | $ 11,787 | $ 27,027 | $ 8,358 |
| Restricted cash (note 5) | 1,183 | 1,183 | 1,183 |
| Accrued interest receivable | 45,833 | 42,391 | 49,502 |
| Mortgages, net of fair value provision (note 4) | 1,209,353 | 1,153,683 | 1,016,335 |
| Sundry assets | 5,368 | 5,227 | 5,224 |
| | $ 1,273,524 | $ 1,229,511 | $ 1,080,602 |
| **LIABILITIES AND UNITHOLDERS' EQUITY** | | | |
| Liabilities: | | | |
| Revolving loan facility (note 6) | $ 115,722 | $ 99,353 | $ 44,000 |
| Accounts payable and accrued liabilities (note 12(f)) | 1,881 | 1,700 | 1,653 |
| Unrealized loss on foreign exchange forward contracts | 888 | 1,376 | - |
| Deferred revenue | 141 | 167 | 138 |
| Prepaid unit capital | - | 14,325 | 1,944 |
| Unitholders' distributions payable | 6,926 | 6,679 | 6,212 |
| | 125,558 | 123,600 | 53,947 |
| Units submitted for redemption (note 8) | 6,723 | 3,972 | 4,728 |
| Unitholders' equity (note 8) | 1,141,243 | 1,101,939 | 1,021,927 |
| Commitments and contingent liabilities (note 13) | | | |
| | $ 1,273,524 | $ 1,229,511 | $ 1,080,602 |
| Net asset value per unit (note 9) | $ 9.94 | 9.94 | 9.92 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENT OF EARNINGS

Three months ended March 31, 2014, with comparative figures for 2013

(In thousands of dollars, except per unit amounts, unless otherwise noted

| | 3 months ended March 31, 2014 (Unaudited) | 3 months ended March 31, 2013 (Unaudited) |
|---|---|---|
| **REVENUE** | | |
| Mortgage interest | $ 25,625 | $ 21,555 |
| Other income | 545 | 355 |
| Realized foreign exchange gain | 948 | - |
| Unrealized foreign exchange gain | 754 | - |
| | 27,872 | 21,910 |
| **EXPENSES** | | |
| Management fees (note 12) | 2,954 | 2,539 |
| Interest | 790 | 664 |
| Unrealized loss in value of mortgage investments | 1,914 | 300 |
| Realized loss (gain) on mortgage investments | 561 | 5 |
| Audit fees | 45 | 21 |
| Legal fees | 30 | 21 |
| Other | 317 | 236 |
| | 6,611 | 3,786 |
| Net earnings | $21,261 | $ 18,124 |
| Net earnings per unit (note 8) | $ 0.19 | $ 0.18 |
| Weighted average number of units issued and outstanding (note 9) | 114,451,534 | 102,326,803 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

Three months ended March 31, 2014, with comparative figures for 2013

(In thousands of dollars, except per unit amounts, unless otherwise noted)

| | March 31, 2014 (Unaudited) | December 31, 2013 (Audited) | March 31, 2013 (Unaudited) |
|---|---|---|---|
| UNIT CAPITAL | | | |
| Balance, beginning of period | $ 1,110,355 | $ 1,001,371 | $ 1,001,371 |
| Proceeds from issuance of units, net of redemptions (note 8) | 41,368 | 107,978 | 29,784 |
| Penalties on redemptions | 2 | - | - |
| Reduction in units submitted for redemption (note 8) | (2,751) | 1,006 | 250 |
| Balance, end of period | $ 1,148,974 | $ 1,110,355 | $ 1,031,405 |
| CUMULATIVE EARNINGS | | | |
| Balance, beginning of period | $ 353,657 | $ 276,301 | $ 276,301 |
| Net earnings for the period | 21,261 | 77,356 | 18,124 |
| Balance, end of period | $ 374,918 | $ 353,657 | $ 294,425 |
| CUMULATIVE DISTRIBUTIONS TO UNITHOLDERS | | | |
| Balance, beginning of period | $ (362,073) | (285,492) | (285,492) |
| Distributions to unitholders (note 10) | (20,576) | (76,581) | (18,411) |
| Balance, end of period | $ (382,649) | $ (362,073) | $ (303,903) |
| Unitholders' equity | $ 1,141,243 | $ 1,101,939 | $ 1,021,927 |
| Units issued and outstanding, excluding units submitted for redemption (note 8) | 114,759,413 | 110,910,245 | 103,051,953 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS

Three months ended March 31, 2014, with comparative figures for 2013

(In thousands of dollars, except per unit amounts, unless otherwise noted)

| | 3 months ended March 31, 2014 (Unaudited) | 3 months ended March 31, 2013 (Unaudited) |
|---|---|---|
| CASH PROVIDED BY (USED IN) | | |
| Operations: | | |
| Net earnings | $ 21,261 | $ 18,124 |
| Items not affecting cash: | | |
| Amortization of revolving loan facility financing costs | 47 | - |
| Unrealized loss in value of mortgages | 1,914 | 300 |
| Realized loss (gain) on mortgage investments | 561 | 5 |
| Amortization of discount income | (264) | (440) |
| Unrealized F/X loss (gain) | (754) | - |
| Change in non-cash operating items: | | |
| Accrued interest receivable | (3,370) | (4,867) |
| Accounts payable and accrued liabilities | 429 | 263 |
| Other assets | (188) | (640) |
| Deferred revenue | (27) | (37) |
| | 19,609 | 12,708 |
| FINANCING | | |
| Proceeds from issuance of units, net of offering costs & redemptions | 41,368 | 29,784 |
| Penalties on redemptions | 2 | - |
| Prepaid unit capital | (14,325) | 1,544 |
| Change in revolving loan facility | 13,500 | (1,894) |
| Distributions to unitholders | (20,576) | (18,411) |
| | 19,969 | 11,023 |
| INVESTMENTS | | |
| Funding of mortgages | (156,491) | (146,229) |
| Discharge of mortgages | 101,673 | 125,110 |
| | (54,818) | (21,119) |
| Increase/(decrease) in cash | (15,240) | 2,612 |
| Cash & restricted cash, beginning of period | 28,210 | 6,929 |
| Cash, end of period | $ 12,970 | $ 9,541 |
| Supplemental cash flow information: | | |
| Interest paid | $ 790 | $ 664 |

Romspen Mortgage Investment Fund (the "Fund") is an unincorporated closed-end investment trust established under the laws of the Province of Ontario, pursuant to a trust indenture dated as at May 20, 2005. The Fund is the sole limited partner in the Romspen Mortgage Limited Partnership (the "Partnership") and conducts its lending activities primarily through the Partnership. The objective of the Fund is to provide stable and secure cash distributions of income, while preserving unitholders' equity.

Romspen Investment Corporation ("Romspen") is the Fund's mortgage manager and acts as the primary loan originator, underwriter, administrator and syndicator for the Partnership. Romspen also acts as administrator for the Fund's affairs.

The Fund commenced operations on January 16, 2006. Under an exchange offering completed in January 2006, mortgages in the aggregate principal amount of $158,855 were exchanged for 15,885,461 units of the Fund.

## 1. Basis of presentation

These consolidated financial statements have been prepared in accordance with Part V of Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Fund and the Partnership.

## 2. Significant accounting policies

**A) Mortgage investments** In accordance with Accounting Guidelines 18, Investment Companies, the Fund's investments are recorded at fair value, as defined by the Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3855, Financial Instruments - Recognition and Measurement ("Section 3855"). The unitholders' equity of the Fund for financial reporting purposes is calculated in accordance with Section 3855.

Certain of the Fund's mortgages are in arrears and realization by the Fund may result in a shortfall. In determining fair value of individual mortgages, management considers the length of time the mortgage has been in arrears, the overall financial strength of the borrowers and the residual value of the security pledged.

Any unrealized changes in the fair value of mortgage investments are recorded in the consolidated statements of earnings as an unrealized fair value adjustment. A realized change in the fair value of a mortgage as a result of a disposition or repayment is recorded as a realized fair value adjustment.

**B) Revenue recognition**

**i) Interest income** Interest income is accounted for on the accrual basis. Funding and participation fees received are amortized over the expected term of the mortgage.

**ii) Discount income** The Fund may acquire mortgage portfolios from third parties at fair market value. A mortgage discount will exist to the extent that the fair market value of a mortgage is less than its par value. The discount is allocated between a valuation reserve component and an accretion component. The valuation reserve component represents the risk of credit loss, while the accretion component represents the part of the discount to be recognized to income over time, thereby adjusting the yield on the mortgage from its face rate to an effective yield. The accretion component is amortized to income over the term of the related mortgage through the application of the effective interest rate method. The valuation reserve component is only recognized into income upon payout, less any realized credit loss.

**C) Use of estimates** The preparation of financial statements requires management to make estimates and assumptions that 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 year. The most significant estimates that the Fund is required to make relate to the fair value of the mortgage investments in (a) above. The estimates may include: assumptions regarding local real estate market conditions; interest rates and the availability of credit; cost and terms of financing; the impact of present or future legislation or regulation; prior encumbrances and other factors affecting the mortgage and underlying security of the mortgage investments. Actual results may differ from those estimates.

These assumptions are limited by the availability of reliable comparable data, economic uncertainty, ongoing geopolitical concerns and the uncertainty of predictions concerning future events. Credit markets, equity markets and consumer spending are factors in the uncertainty inherent in such estimates and assumptions. Accordingly, by their nature, estimates of fair value are subjective and do not necessarily result in precise determinations. Should the underlying assumptions change, the estimated fair value could change by a material amount.

**D) Foreign Currency Translation** Investment transactions and income and expenses in foreign currencies have been translated into Canadian dollars at the rates of exchange prevailing at the time of the transactions. The fair value of mortgages and cash denominated in foreign currencies has been translated into Canadian dollars at the rates of exchange prevailing at year end. Foreign exchange gains and losses on the receipts of payments on mortgage investments are included in Realized Gains/Loss on Foreign Exchange on the Consolidated Statement of Earnings.

**E) Foreign Exchange Forward Contracts** The Fund holds derivative financial instruments to hedge its foreign currency risk exposure on mortgage investments denominated in a foreign currency. Derivatives are recognized initially at fair value, with transaction costs recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value at the end of each reporting period. Any resulting gain or loss is recognized in profit or loss.

The Fund determines fair value on its foreign exchange forward contracts based on the difference between the contract forward rate and the forward bid rate.

**F) Net earnings per unit** Net earnings per unit are computed by dividing net earnings for the year by the weighted average number of units issued and outstanding during the year.

**G) Prepaid unit capital** Prepaid unit capital consists of subscription amounts received in advance of the unit issuance date.

**H) Financial Instruments-recognition and measurement** Section 3855 establishes standards for recognizing and measuring financial assets and financial liabilities, including non-financial derivatives. In accordance with this standard, the Fund has classified its financial assets as one the following: held-to-maturity; loans and receivables; held-for-trading or available-for-sale. All financial liabilities must be classified as: held-for-trading or other financial liabilities. The Fund's designations are as follows:

i) Mortgage investments are classified as held-for-trading and are measured at fair value.

ii) Cash, restricted cash, accrued interest receivable and other assets are classified as loans and receivables and are measured at amortized cost.

iii) The revolving loan facility, accounts payable and accrued liabilities, prepaid unit capital, unitholders' distributions payable and units submitted for redemption are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method.

## 3. Future accounting standards issued and not yet adopted

On February 13, 2008, the Canadian Accounting Standards Board ("AcSB") confirmed that publicly accountable enterprises would be required to adopt International Financial Reporting Standards ("IFRS"), as published by the International Accounting Standards Board ("IASB"), on January 1, 2011. However, the AcSB deferred the mandatory IFRS changeover date for Canadian investment funds to January 1, 2014. Consequently, the Fund will publish its first annual audited financial statements in accordance with IFRS for the year ending December 31, 2014, with comparatives for the year ending December 31, 2013, and prepare an opening IFRS statement of net assets as at January 1, 2013. The Fund has not identified any changes that will impact net asset value ("NAV") per unit as a result of the changeover to IFRS. However, this determination is subject to change as the Fund finalizes its assessment of the impact of IFRS, and the impact of new standards issued by the IASB prior to the Fund's adoption of IFRS (see commentary below). This criteria contained within International Accounting Standard ("IAS") 32, Financial Instruments - Presentation ("IAS 32") may require unitholders' equity to be classified as a liability within the Fund's balance sheet, unless certain conditions are met. The Fund is currently assessing its unitholder structure to confirm the appropriate classification in accordance with IFRS.

Upon adoption of IFRS, the Fund will apply IFRS 13, Fair Value Measurement ("IFRS 13"). IFRS 13 defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. It applies when other IFRSs require or permit fair value measurement. If an asset or a liability measured at fair value has a bid price and an ask price, it requires valuation to be based on a price with the bid-ask spread that is most representative of fair value. It allows the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. This may result in eliminating the difference between the NAV per unit and net assets per unit under current Canadian generally accepted accounting principles.

In October 31, 2012, the IASB published Investment Entities (Amendment to IFRS 10, IFRS 12 and IAS 27), which provides an exemption from consolidation of subsidiaries under IFRS 10, Consolidated Financial Statements for entities which meet the definition of an 'investment entitiy'. A qualifying investment entity is required to account for investments in controlled entities - as well as investments in associates and joint ventures - at fair value through profit or loss; the only exception would be subsidiaries that are considered an extension of the investment entity's investing activities. The consolidation exception is mandatory - not optional. The Fund is currently evaluating the potential impact of this change on mortgage investments for which the Fund has acquired control of the underlying properties (note 4).

## 4. Mortgage investments

The following is a summary of the mortgages:

In thousands of dollars, except per unit amounts, unless otherwise noted

| | | | 2014 | 2013 |
|---|---|---|---|---|
| | Number of mortgages | Original cost | Fair Value | Fair Value |
| First mortgages | 137 | 1,161,405 | 1,148,715 | 970,176 |
| Second mortgages | 10 | 54,332 | 48,981 | 34,502 |
| Third mortgages | 1 | 11,657 | 11,657 | 11,657 |
| | 148 | 1,227,394 | 1,209,353 | 1,016,335 |

The following is a summary of the original cost of mortgages segmented by interest rate at March 31, 2014:

In thousands of dollars, except per unit amounts, unless otherwise noted

| Interest Rates | 2014 | 2013 |
|---|---|---|
| Less than 10.00% | 412,116 | 341,600 |
| 10.01% - 11.00% | 480,043 | 257,788 |
| 11.01% - 12.00% | 250,803 | 289,938 |
| 12.01% - 20.00% | 77,984 | 135,337 |
| Over 20.00% | 6,448 | 3,974 |
| | 1,227,394 | 1,028,637 |

The following is a summary of the original cost of mortgages segmented by type of mortgage at March 31, 2014:

In thousands of dollars, except per unit amounts, unless otherwise noted

| | 2014 | 2013 |
|---|---|---|
| Pre-development | 351,708 | 257,633 |
| Construction | 266,494 | 233,707 |
| Term | 609,192 | 537,297 |
| | 1,227,394 | 1,028,637 |

The following is a summary of the original cost of mortgages segmented by geography at March 31, 2014:

In thousands of dollars, except per unit amounts, unless otherwise noted

| | 2014 | 2013 |
|---|---|---|
| Ontario | 550,364 | 453,078 |
| Alberta | 187,038 | 245,580 |
| British Columbia | 167,573 | 147,531 |
| Other Provinces | 96,918 | 59,294 |
| United States | 225,501 | 123,154 |
| | 1,227,394 | 1,028,637 |

CPA Handbook Section 3862, Financial Instruments - Disclosures ("Section 3862"), establishes enhanced disclosure requirements for fair value measurements of financial instruments and liquidity risks. Section 3862 establishes a three-level valuation hierarchy for disclosure of financial instruments measured at fair value based upon the degree to which the inputs used to value an asset or liability as of the measurement date are observable:

• Level 1 - quoted (unadjusted) in active markets for identical assets or liabilities;

• Level 2 - inputs other than quoted prices in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

• Level 3 - inputs for the assets or liability that are not based on observable market data (unobservable inputs).

Foreign exchange forward contracts have been classified in Level 2 of the hierarchy.

The Fund's mortgage investments are measured at fair value using unobservable inputs. As a result, all mortgage investments have been classified in Level 3 of the valuation hierarchy.

A reconciliation of Level 3 assets for the year ended March 31 is as follows:

In thousands of dollars, except per unit amounts, unless otherwise noted

| | 2014 | 2013 |
|---|---|---|
| Mortgage investment balance, Beginning of year | $ 1,153,683 | $ 995,082 |
| Funding of mortgage investments | 156,491 | 146,229 |
| Discharge of mortgage investments | (101,673) | (125,111) |
| Unrealized loss in the value of Mortgage investments | (1,914) | (300) |
| Realized gain (loss) on mortgage investments | (561) | (5) |
| Amortization of discount | 264 | 440 |
| Foreign currency adjustment on mortgages | 3,063 | - |
| Mortgage Investment Balance, end of year | $ 1,209,353 | $ 1,016,335 |

The mortgages are secured by real property and other security, bear interest at a weighted average rate of 10.5% at March 31, 2014 (2013 – 10.7%).

Credit risk arises from the possibility that mortgagors may be unable to fulfill their obligations. In accordance with the Fund's policies, the Fund mitigates this risk by ensuring that its mix of mortgages is diversified and by limited exposure to any one mortgagor or property.

As part of the assessment of fair value, management of the Fund routinely reviews each mortgage for impairment to determine whether or not a mortgage should be recorded at its estimated realizable value.

Principal repayments based on contractual maturity dates are as follows:

In thousands of dollars, except per unit amounts, unless otherwise noted

| | | |
|---|---|---|
| 2014 and earlier | $ | 886,701 |
| 2015 | | 310,156 |
| 2016 | | 26,461 |
| 2017 | | 1,355 |
| 2018 and after | | 2,721 |
| | $ | 1,227,394 |

Included in 2014 and earlier category are loans which are past due or on a month-to month arrangement.

Borrowers have the option to repay principal at any time prior to the maturity date. The properties described below are included in the principal repayments chart above under the 2014 and earlier contractual maturity categories. The Partnership has acquired control of the following properties in order to finish development and divest of the property with the goal of maximizing the return to investors.

In thousands of dollars, except per unit amounts, unless otherwise noted

| Company | Property | Description | Mortgage Value ('000s) |
|---|---|---|---|
| 1460518 Alberta Inc. | 9420 51st Avenue, Edmonton, AB | Office complex | $ 17,994 |
| 2220740 Ontario Inc. | Old Lakeshore Road, Collingwood, ON | Land for res. development | $ 821 |
| 3231451 Nova Scotia Ltd. | 24 Harbourside Drive, Wolfville, NS | Condominium development | $ 5,295 |
| Aspen Lakes Communities Ltd. | Blackfalds, AB | Land for res. development | $ 6,676 |
| 22411497 Ontario Ltd. | 430 Ottawa Street, Almonte, ON | Retail plaza | $ 5,555 |
| Big Mac Athletic Corp. | Langford, BC | Office complex | $ 8,358 |
| Romspen FC Homes Inc. | Abbotsford, BC | Residential subdivision | $ 4,338 |
| RIC Management Inc.(in trust) | 1 Dunsford Lane, Wymbolwood Beach, ON | Commercial development | $ 1,159 |
| 1604954 Alberta Ltd. | 1925 & 1933 18th Ave NE, Calgary, AB | Office Complex | $ 108 |
| 1411786 Alberta Ltd. | Hamlet of Balzac, AB | Land for res. development | $ 2,777 |
| Royal Oaks Homes Ltd. | Moncton, NB | Residential subdivision | $ 11,306 |
| 2270386 Ontario Limited | 160 Brooks Road, Cayuga, ON | Landfill | $ 20,603 |
| 2204604 OntarInc. | Collingwood, ON | Commercial/ Residential | $ 14,213 |
| 1593785 Alberta Ltd. | Rocky View, AB | Land for industrial development | $ 1,408 |
| Romspen South Street, LLC | 44-45 South State Street, Concord, NH | Multi Unit Residential | $ 863 |
| Romspen Club Holdings Inc. | Southern U.S. | Various Golf Courses | $ 5,014 |

## 5. Restricted cash

Restricted cash represents irrevocable standby letters of credit issued by the Fund.

## 6. Revolving loan facility

The Partnership entered into a revolving loan facility on July 16, 2012 and it was amended on February 3, 2014 with an increased maximum amount of $180,000 (2013 - $100,000) including borrowings of up to $70,000 denominated in US dollars. Approximately $64,278 (2013 - $56,000) is available and $115,722 has been drawn as at March 31, 2014 (2013 - $44,000). Interest on the loan is charged at a maximum of prime rate plus 1.625%. The minimum and maximum amounts drawn under the revolving loan facility during the three months ended March 31, 2014 were $53,500 and $109,000 (2013 - $nil and $80,000), respectively. The loan is secured by all assets of the Partnership and a pledge of all Partnership units held by the Fund. The loan matures on July 18, 2014.

The costs associated with the establishment of the revolving loan facility are amortized over the one-year initial term of the facility and have been included in other assets for $87 (2013 - $430), net of accumulated amortization of $228 (2013 - $106).

## 7. Foreign Exchange Forward Contracts

The following table sets out the fair values and the notional amount of foreign exchange forward contract derivative assets and liabilities held by the Fund as at December 31, 2013:

In thousands of dollars, except per unit amounts, unless otherwise noted

| Expiration Date | Currency to be received – Canadian | Currency to be delivered | Fair Value | Unrealized Value |
|---|---|---|---|---|
| December 19, 2014 | 7,560 | U.S. Dollars | 8,291 | (731) |
| February 8, 2015 | 2,054 | U.S. Dollars | 2,211 | (157) |
| | 9,614 | | 10,502 | (888) |

The foreign exchange forward contracts are used to hedge the Fund's exposure to loans denominated in U.S. dollars. Included in the consolidated statement of earnings are unrealized losses on foreign exchange forward contracts of $888 and unrealized foreign exchange gains on mortgage investments for corresponding mortgage investments.

The unrealized loss on foreign exchange forward contracts is offset by unrealized gains on mortgage investments in the consolidated statement of earnings.

## 8. Unitholders' equity

The beneficial interests in the Fund are represented by a single class of units, which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions. Unitholders have a limited right to redeem their units, on a monthly basis, upon a minimum of 30 days' notice. Partial or complete redemption of units is limited on a monthly basis to 1% of the aggregate fair market value of units outstanding on the valuation date immediately preceding the said redemption date. Redemption notices on any given redemption date shall maintain their order of priority until the unit redemption price for such units has been paid in full. Additionally, the trustees shall be entitled in their sole discretion to extend the time for payment of any unit redemption prices if, in the reasonable opinion of the trustees, such payment would be materially prejudicial to the interests of the remaining unitholders in the Fund.

In the extraordinary circumstance where the number of units properly tendered for redemption ("Tendered Units") by unitholders ("Tendering Unitholders") on any given Redemption Date exceeds 3% of the total number of units outstanding on such Redemption Date, the trustees are entitled in their sole discretion to modify or suspend unitholder redemption rights. Specifically, if the extraordinary circumstance referenced above occurs, the trustees are entitled, in their sole discretion, to implement one of the following measures:

**i) Discounted redemptions** The trustees shall give notice to Tendering Unitholders that their Tendered Units shall be redeemed on the next Redemption Date at a redemption price discounted by a discount factor to be determined by the trustees in their sole discretion, acting reasonably. In determining the discount factor, the trustees may consider such factors as market prices for similar investments that are traded on a stock exchange in Canada, the variation inherent in any estimates used in the calculation of the fair market value of the Tendered Units to be redeemed, the liquidity reasonably available to the Fund and general economic conditions in Canada. Unitholders may choose to retract their redemption request upon receiving notice from the trustees of a discounted redemption; however, unit holders who retract will be prohibited from redeeming the Tendered Units to which their retraction applies for a period of up to 12 months following the date the discounted redemptions are processed.

**ii) Temporary suspension of redemptions** The trustees shall give notice to all unitholders that normal course redemption rights are suspended for a period of up to six months. Issuance of a suspension notice by trustees will have the effect of cancelling all pending redemption requests. At the end of the suspension period, the trustees may call a special meeting of unitholders to approve an extension of the suspension period, failing which normal course redemptions will resume.

As at March 31, 2014, unitholders representing approximately 676,051 units have requested redemption of their units, the redemption of which is subject to the above restrictions. These units have been reclassed to liabilities from unitholders' equity in order to comply with applicable accounting rules. These units, however, continue to have the same rights and no priority over the remaining units. Units submitted for redemption are redeemed at the net asset value.

**A) The following units are issued and outstanding (see chart below):** During the normal course of business, the Fund receives unit issuance and redemption requests from the investors. In 2014, the Fund received requests for redemption of 2,072,631 units (2013 – 1,477,143) and redeemed 1,796,936 units (2013 – 1,148,361) for $17,856 (2013 - $11,387) in accordance with its policies.

The Fund continues to issue new units and receive redemption requests, which will be processed in accordance with the policies mentioned below.

**B) Distribution reinvestment plan and direct unit purchase plan** The Fund has a distribution reinvestment plan and direct unit purchase plan for its unitholders, which allows participants to reinvest their monthly cash distributions in additional units at a unit price equivalent to $10.00 per unit.

In thousands of dollars, except per unit amounts, unless otherwise noted

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Units** | **Amount** | Units | Amount |
| Balance, beginning of year | **111,310,601** | **$ 1,114,190** | 100,559,826 | $ 1,006,212 |
| New units issued | **4,944,157** | **49,442** | 3,285,778 | 32,858 |
| New units issued under distribution reinvestment plan | **977,642** | **9,776** | 831,328 | 8,313 |
| Units redeemed | **(1,796,936)** | **(17,856)** | (1,148,361) | (11,387) |
| Proceeds from issuance of units, net of redemptions | **4,124,863** | **41,362** | 2,968,745 | 29,784 |
| Balance, end of year | **115,435,464** | **$ 1,155,552** | 103,528,571 | $ 1,065,780 |

## 9. Net asset value per unit and net earnings per unit

Net asset value per unit is calculated as total assets less total liabilities allocable to outstanding units, excluding units submitted for redemption, of 114,759,413 as at March 31, 2014 (2013 – 103,051,953).

Net earnings per unit has been computed using the weighted average number of units issued and outstanding of 114,451,534 for the three months ended March 31, 2014 (2013 – 103,326,803).

## 10. Distributions

The Fund makes distributions to the unitholders monthly on or about the 15th day of each month. The Fund's trust indenture requires that the Fund will distribute 100% of the net earnings of the Fund, determined in accordance with the Income Tax Act (Canada), to the unitholders.

For the three months ended March 31, 2014, the Fund declared distributions of $0.18 (2013 - $0.18) per unit and a total of $20,576 (2013 - $18,411) was distributed to the unitholders.

## 11. Income taxes

The Fund is taxed as a mutual fund trust for income tax purposes. Pursuant to the trust indenture, the Fund is required to distribute 100% of its income for income tax purposes each period to such an extent that it will not be liable for income tax under the Income Tax Act (Canada). Therefore, no provision for income taxes is required on earnings of the Fund.

On June 22, 2007, new legislation relating to the federal income taxation of a specified investment flow-through trust or partnership ("SIFT") received royal assent (the "SIFT Rules").

Under the SIFT Rules, certain distributions from a SIFT will no longer be deductible in computing a SIFT's taxable income and a SIFT will be subject to income taxes on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital will not be subject to income taxes.

The Fund is not subject to the SIFT tax regime as its units are not listed or traded on a stock exchange or other public market. Accordingly, the Fund has not recorded a provision for income taxes or future income tax assets or liabilities in respect of the SIFT Rules.

## 12. Related party transactions and balances

Transactions with related parties are in the normal course of business and are recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties and which represents fair market value.

Other than the transactions disclosed elsewhere in these consolidated financial statements, the Fund had the following significant related party transactions:

A) All the trustees of the Fund are owners of Romspen. Under various agreements, Romspen manages all the day-to-day affairs of the Fund and the Partnership. Romspen receives fees totalling 1% per annum, calculated daily and payable monthly, of the principal balance of all mortgage investments and the fair market value of all other non-mortgage investments. For the three months ended March 31, 2014, the amount was $2,954 (2013 - $2,539).

B) Romspen and related entities also receive certain fees directly from the borrower generated from Fund mortgage investments as follows: all lender, broker, origination, commitment, renewal, extension, discharge, participation, insufficient funds and administration fees generated on the mortgages. For the three months ended March 31, 2014, this amount was $5,061 (2013 - $4,679).

C) Romspen charges the Fund for brokering and originating the acquisition of a portfolio of existing loans, calculated as 2% of the loan portfolio. For the three months ended March 31, 2014, the amount was $nil (2013 - $nil).

D) Several of the Fund's mortgages are syndicated with other investors of Romspen, which may include Romspen, members of management of Romspen and officers or trustees of the Fund. The Fund ranks equally with, or in priority to, other members of the syndicate as to receipt of principal and income.

E) As at March 31, 2014, the Fund had three (2013 - five) mortgages outstanding with an original cost of $26,593 (2013 - $43,619), including accrued interest of $2,402 (2013 - $3,621) and fair value of $26,759 (2013 - $41,623) due from mortgagors in which members of management of Romspen own non-controlling equity interests.

F) At the discretion of Romspen, the Fund participated in 50% of the funding fees received by Romspen on certain mortgage advances. Amounts received during the three months ended March 31, 2014 amounted to $nil (2013 - $nil) and $27 (2013 - $37) was recognized in other revenue.

## 13. Commitments and contingent liabilities

A) In the event that management agreements are terminated, the various management agreements between the Fund, the Partnership and Romspen contain provisions for the payment of termination fees of an amount equal to 2% of the fair market value of the Partnership's assets under administration on the date on which the termination notice is received, in addition to any other amounts owing by the Partnership. These amounts will be satisfied by the payment of cash, interests in mortgages or in such combination thereof as determined by the mortgage manager. These agreements continue in force until terminated in accordance with their provisions.

B) The Partnership has granted an irrevocable option to Romspen to purchase, at any time, any or all Partnership mortgages at a purchase price equal to the principal amount of such mortgage plus accrued interest.

C) The Partnership in certain situations provides guarantees for its subsidiaries.

D) The Fund has letters of guarantee outstanding at March 31, 2014 of $6,846 (2013 – 6,821).

## 14. Fair values of financial instruments

Fair value of mortgage investments is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties under no compulsion to act. As there is no quoted price in an active market for these mortgage and loan investments, the Fund manager makes its determination of fair value based on the assessment of the current lending market for mortgage and loan investments of same or similar terms. Typically, these mortgage and loan investment approximate their carrying values given the mortgage and loan investments consist of short-term loans that are repayable at the option of the borrower without yield maintenance or penalties. When collection of the principal amount of a mortgage or loan is no longer reasonably assured, the fair value of the mortgage or loan is adjusted to the fair value of the underlying security.

The fair values of cash, restricted cash, accrued interest receivable, revolving loan facility, accounts payable and accrued liabilities, unitholders' distributions payable and prepaid unit capital approximate their carrying values due to their short-term maturities.

### 15. Financial instrument risk management

**A) Interest rate risk** Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Fund manages this risk by investing primarily in short-term mortgages. The Fund's investment objective is to obtain an acceptable and consistent absolute rate of return that is not related to any market-based interest rate benchmark.

As a result, the credit characteristics of the Fund's mortgages will evolve such that in periods of higher market interest rates, the Fund's mortgages will be those with narrower credit spreads, and vice versa in periods of lower market interest rates compared to other benchmark interest rates.

The majority of the Fund's investments are in fixed rate, short-term mortgages. The Fund generally holds all of its mortgages to maturity. There is no secondary market for the Fund's mortgages and in syndication transactions, these mortgages are generally traded at face value without regard to changes in market interest rates.

The Fund's debt under the revolving loan facility (note 6) bears interest not exceeding the prime rate plus 1.625%.

As at March 31, 2014, if interest rates on the revolving loan facility had been 100 basis points lower or higher, with all other variables held constant, net earnings for the quarter would be affected with a total increase or decrease of $122 (2013 - $193). The Fund monitors the financial markets and can adjust the pricing of renewals and new loans when it deems it appropriate.

**B) Credit risk** Credit risk is the risk of loss due to borrowers under the Fund's mortgages failing to discharge their obligations. The Fund's sole activity is investing in mortgages (note 4) and, therefore, generally all of its assets are exposed to credit risk. Any instability in the real estate sector and adverse change in economic conditions in Canada could result in declines in the value of real property securing the Fund's mortgage investments. The Fund manages credit risk by adhering to the investment and operating policies, as set out in its Offering Memorandum. This includes the following policies:

i) No more than 20% of the Fund's capital may be invested in subordinate mortgages; and

ii) No more than 10% of the Fund's capital may be invested in any single mortgage or to any single borrower.

The Fund focuses its investments in the commercial mortgage market segments described in its Offering Memorandum, which includes development mortgages, construction mortgages, term financing mortgages and residential mortgages. These mortgages generally have the following characteristics:

i) initial terms of 12 to 24 months;

ii) loan to value ratios of approximately 65% at time of underwriting;

iii) significant at-risk capital and/or additional collateral of property owner; and

(iv) full recourse to property owners supported by personal guarantees.

In addition, the Fund's trustees meet regularly to review and approve each mortgage investment and to review the overall portfolio to ensure it is adequately diversified.

**C) Liquidity risk** Liquidity risk is the risk that the Fund will not have sufficient cash to meet its obligations as they become due. The Fund mitigates this risk by monitoring its scheduled mortgage repayments and ensuring that sufficient funds are available in the near term to satisfy all of its obligations. The Fund's obligations are primarily those which arise under the revolving loan facility, the Mortgage Management Agreement and its Declaration of Trust. In the current economic climate and capital markets, the lenders may continue to tighten their lending standards which could make it challenging for the Fund to obtain financing on favourable terms, or to obtain financing at all.

The Fund's revolving loan facility (note 6) was renewed and matures on July 18, 2014. If it is not extended at maturity, repayments under the Fund's mortgage portfolio would be utilized to repay the revolving loan facility. The Fund's mortgages are predominantly short-term in nature, and as such, the continual repayment by borrowers of existing mortgage investments creates liquidity for ongoing mortgage investments and funding commitments.

If the Fund is unable to continue to have access to its revolving loan facility, the size of the Fund's mortgage portfolio will decrease and the income historically generated through holding a larger portfolio by utilizing leverage will not be earned.

The Fund is not obliged to invest in any mortgages originated by the Fund manager and, therefore, the Fund has no future funding obligations in respect of the Fund manager's mortgage commitments. The Fund is obliged to pay management fees to the Fund manager which, are funded out of interest income.

Unitholders in the Fund have the limited right to redeem their units in the Fund, as described in its Offering Memorandum and paragraph 5.25 of the Fund's Declaration of Trust. The trustees are entitled, in their sole discretion, to extend the time for payment of any unitholder redemption if, in their reasonable opinion, such payment would be materially prejudicial to the interests of the remaining unitholders.

**D) Market risk** Market risk is the risk that the fair value of the collateral securing any of the Fund's mortgage investments falls to a level approaching the loan amount. The Fund manager ensures that it is aware of real estate market conditions in the regions in which it operates. Real estate market trends are monitored on an ongoing basis and the Fund manager's lending practices and policies are adjusted when necessary.

**E) Currency risk** Currency risk is the risk that the fair value or future cash flows of the Fund's mortgages will fluctuate based on changes in foreign currency exchange rates. Approximately $211,340 (2013 – 123,154), 17% of the total Fund's mortgages at quarter end are denominated in United States dollars; consequently, the Fund is subject to currency fluctuations that may impact its financial position and results.

**F) Capital risk management** The Fund manages capital to attain its objective of providing stable and secure cash distributions of income while preserving unitholders' equity. The Fund defines capital as being capital raised by issuing Fund units. It is the Fund's policy to distribute 100% of its taxable income to unitholders, with the result that growth in the mortgage portfolio can only be achieved through the raising of additional equity capital and by utilizing available borrowing capacity.

The Fund raises equity capital on a monthly basis during periods where the Fund manager projects a greater volume of mortgage investment opportunities than the Fund's near-term capital would be sufficient to fund. In the event the Fund may have surplus equity capital, the trustees of the Fund have the right to redeem units held by unitholders or to declare a return of capital distribution.

The primary purpose of the Fund's borrowing strategy is to ensure that unitholders' capital is fully invested. As of March 31, 2014, the Fund's borrowings totalled 10% (2013 – 4%) of the book value of its mortgages and the Fund was in compliance with all covenants under its revolving loan facility.

## 16. Comparative figures

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

## 17. Exemption from filing

The Fund is relying on the exemption obtained in National Instrument 81-106, Part 2.11 to not file their financial statements in SEDAR.

## TRUSTEES & MANAGEMENT

Romspen's team of investment professionals is led by six Managing Partners who collectively have over 180 years of finance and real estate experience. The investment team is supported by more than 30 professionals dedicated to the financial control, underwriting, legal and reporting matters of our business. The trustees and the management team are the largest non-institutional investor in the Fund. This alignment is elemental to preserving capital and generating strong consistent returns for all investors.

### Romspen Mortgage Investment Fund

Sheldon Esbin
**Trustee**

Mark Hilson
**Trustee**

Arthur Resnick
**Trustee**

Wesley Roitman
**Trustee**

### Romspen Investment Corporation

Sheldon Esbin
**Managing General Partner**

Mark Hilson
**Managing General Partner**

Wesley Roitman
**Managing General Partner**

Blake Cassidy
**Managing Partner**

Arthur Resnick
**Managing Partner**

Richard Weldon
**Managing Partner**

Arnie Bose
**Vice President, Finance**

Bonnie Bowerman
**Vice President, Underwriting**

Vitor Fonseca
**Vice President and Treasurer**

Mary Gianfriddo
**Vice President, Mortgage Administration**

Pierre Leonard
**Vice President, Origination**

Blair Martin
**Senior Vice President, Underwriting**

Joel Mickelson
**Corporate Counsel**

Dianna Price
**Executive Vice President, Investor Relations**

## UNITHOLDER INFORMATION

### Units

The Fund units represent a beneficial ownership interest in the Romspen Mortgage Investment Fund. The Fund is an unincorporated closed-end investment trust and is the sole limited partner in the Romspen Mortgage Limited Partnership.

### Distributions

Distributions on Fund units are payable on or about the 15th day of each month. The Fund generally distributes its net earnings each year to the unitholders.

### Distribution Reinvestment Plan

The distribution reinvestment plan provides unitholders a means to reinvest cash distributions in new units of the Fund. To participate, registered unitholders should contact Romspen.

### Investor Relations Contact

Requests for the Fund's annual report, quarterly reports, or other corporate communications should be directed to:

Romspen Mortgage Investment Fund
Suite 300, 162 Cumberland Street
Toronto, Ontario M5R 3N5
416-966-1100

### Duplicate Communication

Registered holders of Romspen units may receive more than one copy of shareholder mailings. Every effort is made to avoid duplication, but when units are registered under different names and/or addresses, multiple mailings result. Unitholders who receive but do not require more than one mailing for the same ownership are requested to contact Investor Relations and arrangements will be made to combine the accounts for mailing purposes.

### Auditors

KPMG LLP Chartered Accountants

### Legal Counsel

Gardiner Roberts LLP

### Website

www.romspen.com

ROMSPEN