FIRST NATIONAL FINANCIAL INCOME FUND 2008 ANNUAL REPORT

SERVICE INNOVATION RESULTS

PROFILE First National Financial Income Fund (TSX: FN.UN) owns a 21% interest in First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With more than $40.6 billion in mortgages under administration, First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the growing mortgage broker distribution channel.

Investment Highlights

1. Canada's largest non-bank mortgage originator
2. Leader in high-growth mortgage broker distribution channel
3. High-quality mortgage portfolio
4. Diverse revenue and funding sources

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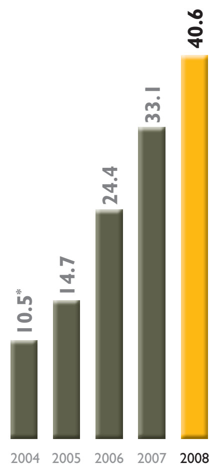
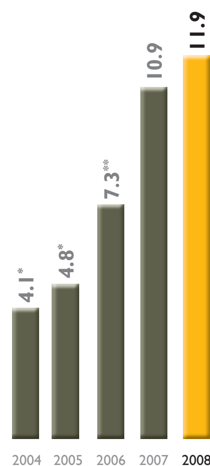
Our 2008 Performance at a Glance

MORTGAGES UNDER ADMINISTRATION
(IN $ BILLIONS)



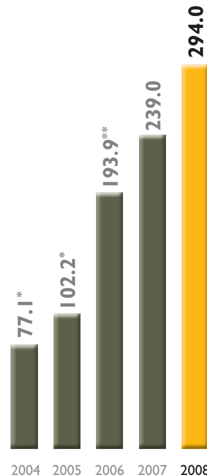
23%
Year-over-year growth
2007 to 2008

MORTGAGE ORIGINATIONS
(IN $ BILLIONS)



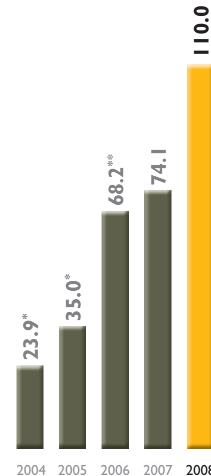
9%
Year-over-year growth
2007 to 2008

REVENUE
(IN $ MILLIONS)



23%
Year-over-year growth
2007 to 2008

ADJUSTED EBITDA
(IN $ MILLIONS)



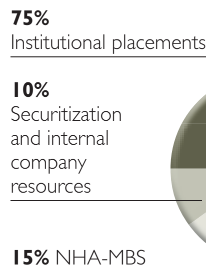
48%
Year-over-year growth
2007 to 2008

FUNDING SOURCES
(AS AT DECEMBER 31, 2008)

75% Institutional placements

10% Securitization and internal company resources

15% NHA-MBS



REVENUE SOURCES**
(AS AT DECEMBER 31, 2008)

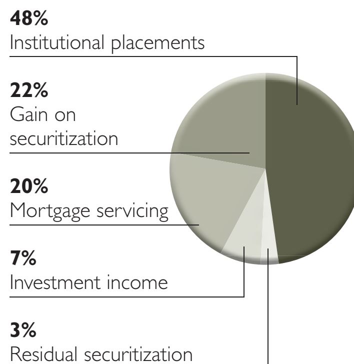
48% Institutional placements

22% Gain on securitization

20% Mortgage servicing

7% Investment income

3% Residual securitization



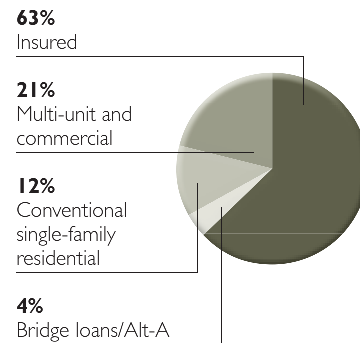
MORTGAGES UNDER ADMINISTRATION
(AS AT DECEMBER 31, 2008)

63% Insured

21% Multi-unit and commercial

12% Conventional single-family residential

4% Bridge loans/Alt-A



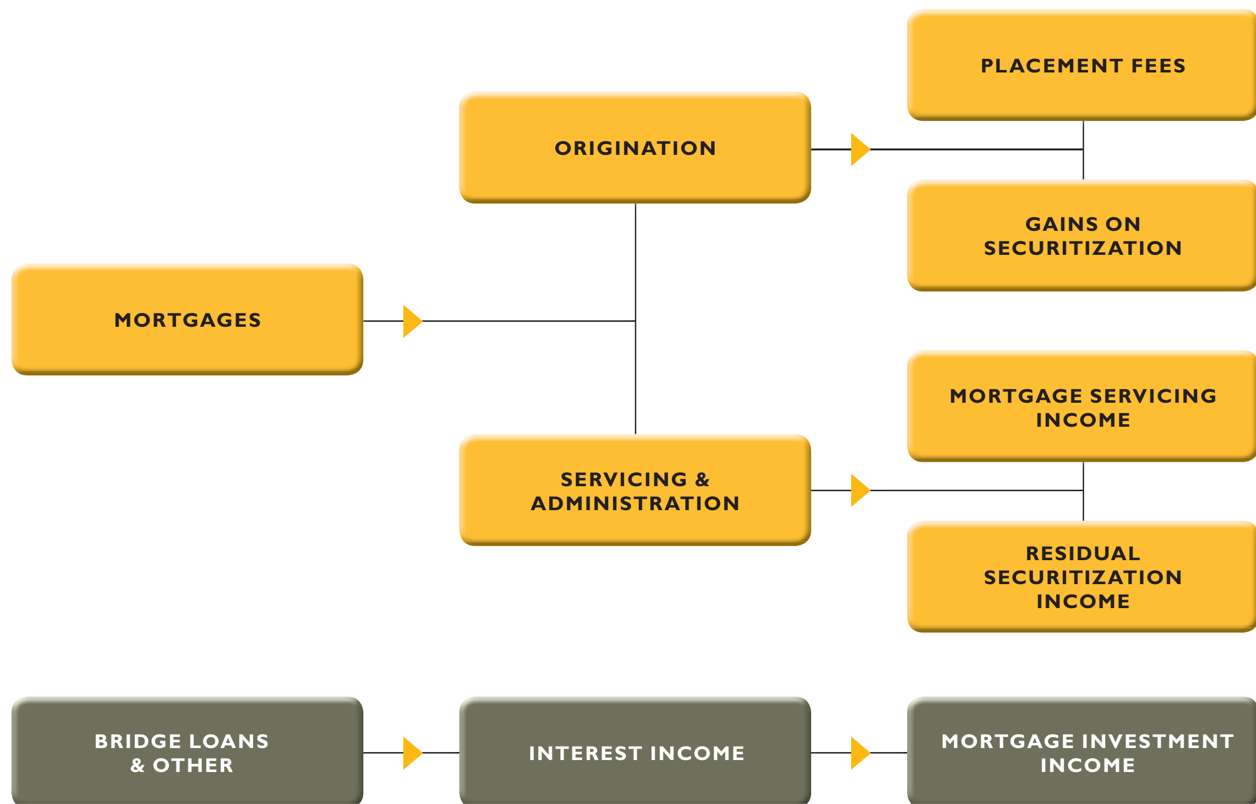
75% INSURED OR CONVENTIONAL SINGLE-FAMILY RESIDENTIAL

* 2004 and 2005 figures for period ended March 31, fiscal year-end for First National Financial Corporation, the Fund's predecessor company.
** 2006 figures reflect the operations of First National Financial Corporation from January 1, 2006 to June 14, 2006 combined with the operations of First National Financial LP from June 15, 2006 to December 31, 2006.

Business and Revenue Models

We originate, underwrite and service mortgages.

Three primary revenue sources: origination, servicing & administration and mortgage investment income.



Fellow Unitholders,

First National continued to deliver strong financial results in 2008 in spite of the adverse impact of an increasingly challenging business environment.

Throughout the year, we executed our strategy of drawing on diverse sources of funding and offering customers a range of high-quality mortgage products to sustain growth in originations, mortgages under administration, revenue and Adjusted EBITDA.

DELIVERING STRONG RESULTS

> Mortgages Under Administration surpassed the $40 billion milestone, driven almost entirely by mortgage originations, which totalled $11.9 billion for the year.
> Revenue grew by 23% to $294 million.
> Net income increased to $108 million, or by 48%.
> Adjusted EBITDA increased by 48% to $110 million.
> The Fund's performance in key metrics led First National to declare its second distribution increase in two years, and the declaration of a year-end special distribution.

Our solid performance was largely driven by steady growth in single-family residential and more robust growth in multi-unit residential originations. In particular, within our primary area of focus, the prime single-family residential mortgage market, demand remained strong and mortgage spreads widened.

As a result, the Fund generated higher profits on our most creditworthy products while still increasing origination volumes. This was fuelled by the Company's steadily increasing market share in the fast-growing mortgage broker distribution channel and our strengthened competitive position in both the residential and commercial mortgage markets.

Other initiatives also contributed to our success. First, in late 2007, the Fund further strengthened its leadership position in the mortgage market with the opening of a single-family origination branch in the Quebec market through the expansion of our existing Montreal office. In 2008, the growing strength of our brand and reputation became more visible in this marketplace, with current year originations in Quebec significantly exceeding our expectations. Second, our status as a seller into the Canada Mortgage Bond program allowed First National to be more competitive such that funding diversification increased and overall funding costs were reduced.

Given the strength of our business model and track record of execution in 2008, the Company is well positioned for continued success in the future, particularly within the commercial mortgage market.

INDUSTRY DEVELOPMENTS

The economic climate weakened considerably towards the end of 2008 and continues to challenge First National and the mortgage lending industry as a whole. The credit market volatility that began in August 2007 has persisted, causing significant fluctuations in credit spreads. As a result of these developments, management acted with prudence, and in the fourth quarter of 2008 recorded a non-cash downward fair value adjustment of approximately $12 million related to its securitization receivables. On the origination side, the weakening economy has resulted in slower year-over-year growth, compared to growth experienced in previous years.

In the current operating environment, we recognize there are external factors that are beyond our control. Nevertheless, we remain confident in the foundation and stability of First National, which has delivered 20 years of service, innovation and, above all, results. Today:

> We are Canada's largest non-bank mortgage originator;
> We are a leader in the fast-growing mortgage broker distribution channel;
> We have a high-quality mortgage portfolio under administration;
> We have diverse funding sources to keep costs down and ensure liquidity; and
> We have sustainable revenue sources to mitigate the effects of fluctuations in origination volume.

CONTINUED GROWTH IN MARKET SHARE

Although the Canadian economy has not seen this level of turmoil since the 1930s, the Canadian financial system remains strong. Nonetheless, we expect residential and commercial originations to decline in 2009. Notwithstanding this slowdown, mortgage servicing is expected to continue to produce steady income and cash flow, while mortgages under administration are expected to increase from current levels.

First National benefits from a diverse nationwide presence, which will help offset the effects of weakness in specific areas. The mortgage broker distribution channel, which now accounts for about one third of all Canadian mortgage originations, continues to grow, as does First National's position within it.

Although First National faces challenges due to credit tightening and the contraction of the commercial mortgage market, we anticipate more opportunities to develop as competitors exit the market and our competitive position continues to grow. Given the strength of our business model and our track record of success, I believe we are in a strong position to take advantage of these opportunities when they occur.

First National has delivered 20 years of service, innovation and, above all, results.

We are confident that our unwavering commitment to our award winning service will be the foundation for our continued success.

LOOKING AHEAD

First National remains focused on our four key priorities for sustainable performance. They are:

1. Minimizing funding costs and ensuring liquidity through diverse and innovative funding sources;
2. Improving efficiencies by lowering operating costs through systems and technology;
3. Maintaining our commitment to excellent service and retaining our market leadership position; and
4. Continuing to grow mortgages under administration by leveraging our leadership position while continuously improving operations and products.

As we look back on the challenges of 2008, I would like to extend a special thank you to our employees, eight of whom celebrated their 20th anniversaries along with First National. To our mortgage brokers and customers, thank you for your support and feedback. To our board members, thank you for your guidance and counsel. Finally, to our unitholders, thank you for your continued trust in us to provide value. It is with your unwavering commitment and dedication that we have built an institution that has delivered 20 years of service, innovation and results.

Yours truly,

Stephen Smith

Stephen Smith
Chairman and President

First National's Board of Directors and management team fully acknowledge the importance of their duty to serve the long-term interests of unitholders.

Sound corporate governance is fundamental for maintaining the confidence of investors and increasing unitholder value. As such, First National is committed to the highest standards of integrity to ensure transparency, compliance and discipline. Our governance system defines the relationships among all of our stakeholders – Board, management and unitholders – and the nurturing of a culture of accountability and responsibility throughout the organization.

POLICIES

The Board supervises and evaluates the management of the Fund, oversees matters related to our strategic direction and assesses results relative to its goals and objectives. The Board has adopted several policies that reflect best practices in governance and disclosure. These include a Disclosure Policy, a Code of Business Conduct, a Whistleblower Policy and an Insider Trading Policy. These policies are compliant with the corporate governance guidelines of the Canadian Securities Administrators. As a public company, the Board continues to update, develop and implement appropriate governance policies and practices as it sees fit.

COMMITTEES

The Board of Directors has established an Audit Committee and a Compensation, Governance and Nominating Committee to assist in the efficient functioning of the Fund's corporate governance strategy.

Audit Committee

The Audit Committee's responsibilities include:

> Management of the relationship with the external auditor including the oversight and supervision of the audit of the Fund's financial statements;

> Oversight and supervision of the quality and integrity of the Fund's financial statements; and

> Oversight and supervision of the adequacy of the Fund's internal accounting controls and procedures, as well as its financial reporting practices.

The Audit Committee consists of three independent directors, all of whom are considered financially literate for the purposes of the Canadian Securities Administrators' Multilateral Instrument 52-110 – Audit Committees.

Committee Members:
John Brough (Chair), Peter Copestake and Robert Mitchell

Compensation, Governance and Nominating Committee

The Compensation, Governance and Nominating Committee's responsibilities include:

> Making recommendations concerning compensation of the Fund's senior executive officers and remuneration of the Board of Directors;

> Developing the Fund's approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;

> Advising the Board of Directors on filling director vacancies;

> Periodically reviewing the composition and effectiveness of the directors and the contributions of individual directors; and

> Adopting and periodically reviewing and updating the Fund's written Disclosure Policy.

The Compensation, Governance and Nominating Committee consists of three independent directors for the purposes of the Canadian Securities Administrators' Multilateral Instrument 58-101– Disclosure of Corporate Governance Practices.

Committee Members:
Stanley Beck (Chair), Peter Copestake and Duncan Jackman

BOARD MEMBERS

Collectively, the Board of Directors has extensive experience in mortgage lending, real estate, strategic planning, law and finance. The Board consists of seven members, five of whom are independent.

Stephen Smith (Chairman) is President and Co-founder of First National Financial. He has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets throughout his career. He is the Vice Chairman of GO Transit, a member of the board of directors of The Dominion of Canada General Insurance Company and The Empire Life Insurance Company, and a governor of The Dominion Institute. Mr. Smith has an M.Sc. (Economics) from the London School of Economics and Political Science and a B.Sc. (Honours) in electrical engineering from Queen's University.

Moray Tawse is Vice President, Mortgage Investments and Co-founder of First National Financial. In addition to directing the operations of all the Company's commercial mortgage origination activities, he is one of Canada's leading experts on commercial real estate and is often called upon to deliver keynote addresses at national real estate symposiums. Prior to co-founding First National, Mr. Tawse was Manager of Mortgages for Guaranty Trust Company of Canada from 1983 until 1988.

Stanley Beck, Q.C. is the President of Granville Arbitrations Limited. He was previously a Professor of Law and Dean at Osgoode Hall Law School. From 1985 to 1990, he served as Chairman of the Ontario Securities Commission. Mr. Beck is also the Chairman of 407 International Inc. and GMP Capital Trust and serves as a director on the boards of Scotia Utility Corp., Scotia NewGrowth Corp. and Hollinger Inc.

John Brough recently retired from his position as President of both Wittington Properties Limited and Torwest Inc., a role he held from 1998 to 2007. From 1996 to 1998, he was Executive Vice President and Chief Financial Officer of iStar Internet, Inc. From 1974 until 1996, he was with Markborough Properties, Inc. where for the last 10 years he served as Senior Vice President and Chief Financial Officer. He is a director of Kinross Gold Corporation, Silver Wheaton Corp., Canadian REIT, Livingston International Inc. and Quadra Mining Ltd. He has a Bachelor of Arts (Economics) degree from the University of Toronto and is a Chartered Accountant.

Peter Copestake serves as a corporate director and consultant to business, academic and government organizations globally and most recently served in the role of Senior Vice President and Treasurer of Manulife Financial. He is currently Chairman Emeritus of the Association for Financial Professionals of Canada, Chair Emeritus of the Society of Canadian Treasurers, Chairman of the Independent Review Committee for the Board of First Trust Portfolios and a member of the board of directors of Manulife Bank and Canadian Derivatives Clearing Corporation. Mr. Copestake has a Master of Business Administration in Finance from Dalhousie University and a Bachelor of Arts from Queen's University.

Duncan Jackman is Chairman, President and Chief Executive Officer of E-L Financial Corporation Ltd., and Chairman and President of Economic Investment Trust Ltd. and United Corporations Ltd. Prior to this, he was a portfolio manager at Cassels Blaikie and an investment analyst at RBC Dominion Securities Inc. Mr. Jackman has a Bachelor of Arts in Literature from McGill University.

Robert Mitchell has been President of Dixon Mitchell Investment Counsel Inc., since 2000. Prior to that, he was Vice President, Investments at Seaboard Life Insurance Company. He is currently a director and audit committee chair for Discovery Parks Holdings Ltd. and a trustee for Discovery Parks Trust. Mr. Mitchell has a Master of Business Administration degree from the University of Western Ontario, a Bachelor of Commerce (Finance) from the University of Calgary and is a CFA charterholder.

Management's Discussion and Analysis

The following management's discussion and analysis of financial condition and results of operations is prepared as of March 3, 2009. 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, 2008 (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, 2007. 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", "Adjusted Net Income", "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. The underwriters were also granted an over-allotment option to purchase 1,200,000 Units at $10.00 per Unit. The option was exercised in full on July 11, 2006. Accordingly, the Fund indirectly held a 19.97% interest in FNFLP and FNFC held an 80.03% controlling interest in FNFLP. Between May and August of 2008, the Fund issued 881,113 units pursuant to its Distribution Reinvestment Plan ("DRIP") such that 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 (loss) for the period	Net Income (loss) per Unit	Total Assets
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**
2007				
Fourth Quarter	$ 2,803	$ 3,297	$ 0.28	$ 103,689
Third Quarter	$ (980)	$ (986)	$ (0.08)	$ 104,574
Second Quarter	$ 2,698	$ (5,508)	$ (0.47)	$ 109,241
First Quarter	$ 2,026	$ 2,020	$ 0.17	$ 109,641

INVESTMENTS

At December 31, 2008, 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, 2008, the Fund's earnings from FNFLP were $22.3 million, amortization of identifiable assets inherent in the investment was $8.9 million and the carrying value of this investment at December 31, 2008 was $110.4 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 to $0.10417 per unit commencing with the May 2007 distribution and then to $0.1125 per unit beginning with the distribution being paid on September 15, 2008. The Fund also announced special distributions in December of the last two years. In 2008 the amount was $0.07 per unit, which was paid on February 17, 2009. In 2007 the amount was $0.06 per unit and was paid on March 17, 2008. For the year, these distributions of approximately $16.8 million were equivalent to the distributions that the Fund received from FNFLP. The current monthly distribution rate represents an annualized distribution rate of $1.35 per unit, a 42.1% increase from the distributions contemplated at the time of the IPO. The following table calculates the payout ratio based on the Fund's pro rata share of distributable cash earned by FNFLP. Note that the amount of distributable cash from FNFLP has been determined using guidance issued by the Canadian Securities Administrators in National Policy 41-201. Please refer to the "Key Performance Indicators" section of the MD&A for a discussion of this change.

For the year ended December 31, 2008, the payout ratio was 99%, as the Fund effectively paid out all of its distributable cash to unitholders. The Company declared the year-end special distribution of $0.07 to top up the regular distributions made throughout the year. Although declared in the fourth quarter, this distribution directly affects the payout ratio determined for the fourth quarter of 2008 as it pertains to distributable cash earned throughout the year. Excluding the special distribution, the fourth quarter payout ratio would have been 110%. This quarter featured both seasonal and economic slowdown in residential origination, higher cost of funding for several securitization conduits, and the realization of cash losses on unrealized fair value adjustments recorded in previous periods. Together these items reduced the amount of cash generated by the Company.

STATEMENT OF DISTRIBUTABLE CASH

(in $000s, except where noted)

	For the quarter ended Dec. 31 2008	*For the year ended Dec. 31 2008*
First National Financial LP		
Distributable Cash from First National Financial LP (1)	**$ 18,795**	**$ 81,818**
First National Financial Income Fund		
Weighted Average Share of Distributable Cash from First National Financial LP (1)	**3,975**	**16,991**
Distributable Cash per Unit ($/Unit) (1)	**0.31**	**1.37**
Distributions Declared	**5,168**	**16,844**
Distributions Declared per Unit ($/Unit)	**$ 0.41**	**$ 1.36**
Payout ratio	**132%**	**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 unitholders. For FNFLP this measure adjusts cash provided by (used in) operating activities by accounting for changes between periods of mortgages accumulated for sale and deducting capital expenditures.

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 on January 1, 2011. Accordingly, the Fund's financial statements for 2007 and 2008 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 reductions announced in December 2007, the effective tax rate for the Fund as at January 1, 2011 was changed to approximately 28.5%. Based on this new rate, the Company accrued a future tax liability of $8.2 million in 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 accrued an additional future tax liability of $1 million. The combined liability of $9.2 million is expected to be drawn down beginning on January 1, 2011, as the Company 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, 2008, these differences were such that the Fund recorded a future tax liability of $1.1 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, 2008. 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, 2008 the Company recorded a provision for future taxes of $1.6 million. This future tax accounting also incorporates the general tax rate reductions as described in the previous section.

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, 2008 and March 3, 2009, 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 First National Financial Corporation, 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 2008, the Company achieved record profitability: capitalizing on strong mortgage origination while optimizing the use of its diverse funding sources. More specifically, 2008 featured sustained growth in originations, mortgages under administration, revenue and Adjusted EBITDA. The demand for prime insured mortgages was strong and wide spreads continued to be the norm. This allowed the Company to earn higher profits on its most creditworthy products and increase origination volumes, particularly in the commercial segment. Management believes the Company's strategy of using diverse sources of funding and offering a full range of mortgage products has contributed to FNFLP's success.

RESULTS SUMMARY

- Mortgages under administration grew to $40.6 billion at December 31, 2008 from $38.8 billion at September 30, 2008 and $33.1 billion at December 31, 2007, representing an annualized and year-over-year increase of 23%;
- Despite the discontinuation of the uninsured Alt-A program, mortgage originations grew to $11.9 billion in the year from $10.9 billion in 2007, an annualized rate of growth of 9%; excluding Alt-A mortgage origination, the growth rate of origination was 15%;
- Revenue for the year ended December 31, 2008 grew by 23% year-over-year, mainly due to the large unrealized charge for $22.9 million related to the fair value adjustment of the Company's securitization assets recorded in 2007. Excluding all realized and unrealized losses on financial instruments, revenues would have increased by 16% on higher placement fees and gains on securitization resulting from higher origination volumes;
- Net Income increased by 48% for the year ended December 31, 2008 compared to the 2007 year end. Excluding all unrealized losses on financial instruments in both years, the increase would have been 24%. This increase resulted from higher volumes and margins experienced in many aspects of the company's business, particularly gains on securitization related to the Company's NHA-MBS program; and
- Adjusted EBITDA increased by 48% for the year ended December 31, 2008 compared to the same period last year. Excluding all unrealized losses on financial instruments in both years, the increase would have been 24%. This increase was due to the same factors cited above for the increase in net income.

SELECTED QUARTERLY INFORMATION FOR RESULTS OF FNFLP

	Revenue	*Net Income for the period*	*Net Income ($/Unit)*	*Total Assets*
2008				
Fourth Quarter	**$ 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**
2007				
Fourth Quarter	$ 68,272	$ 24,050	$ 0.40	$ 460,336
Third Quarter	$ 54,518	$ 5,110	$ 0.09	$ 692,737
Second Quarter	$ 62,631	$ 23,524	$ 0.40	$ 522,301
First Quarter	$ 53,550	$ 20,160	$ 0.34	$ 576,282

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 amounts 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. The one large aberration occurred in the third quarter of 2007 when a charge of $22.9 million related to the fair value adjustment of the Company's securitization assets was taken. If this adjustment was added back, revenue for this quarter would have been $77.4 million and in line with seasonal expectations. A smaller anomaly can also be seen in the comparison of fourth quarter results which exhibit 10% – 25% declines from year to year. This is due to increased credit issues in the Canadian economy that became more prevalent in the fourth quarter of 2008. Both the Company's net income and revenue were decreased as 1. Asset-backed commercial paper ("ABCP") spreads deteriorated which caused an increase in the unrealized losses on financial instruments; and 2. Lower volumes of single-family mortgages were originated decreasing placement fees. Otherwise both revenue and net income have increased from quarter to quarter in 2008 from 2007 due to wider margins on the Company's mortgage sales.

Total assets have remained relatively consistent over the two year period disclosed. Fluctuations are due primarily to changes between the periods in the amount of securities purchased under resale agreements that the Company uses for hedging purposes.

SELECTED ANNUAL FINANCIAL INFORMATION FOR THE COMPANY'S FISCAL YEAR ENDING

($000s, except per unit amounts)

	December 31 2008	*December 31 2007*	*December 31 2006 (1)*
For the Period			
Income Statement Highlights			
Revenue	**$ 293,959**	$ 238,971	$ 156,427
Brokerage fees	**(105,757)**	(102,886)	(67,891)
Other operating expenses	**(78,526)**	(61,999)	(37,007)
EBITDA (2)	**109,675**	74,086	51,529
Amortization of capital assets	**(1,654)**	(1,242)	(803)
Provision for income taxes	**–**	–	(3,312)
Net Income	**108,021**	72,844	47,414
Distributions declared	**81,233**	71,497	30,406
Per Unit Highlights			
Net Income per unit (3)	**1.81**	1.23	0.80
Distributions declared per unit	**1.36**	1.21	0.51
At Period End			
Balance Sheet Highlights			
Total assets	**737,065**	460,336	528,116
Total long-term financial liabilities	**$ –**	$ –	$ –

	December 31 2008	*December 31 2007*	*December 31 2006 (1)*
Reconciliation of EBITDA to Adjusted EBITDA			
EBITDA (2)	**$ 109,675**	$ 74,086	$ 51,529
Historic management compensation expenses (4)	**–**	–	917
Revised management compensation (5)	**–**	–	(1,125)
Adjusted EBITDA (2)	**$ 109,675**	$ 74,086	$ 51,321

(1) December 31, 2006 figures are for the nine-month period ended December 31, 2006.
(2) EBITDA and Adjusted EBITDA are not recognized earnings measures under GAAP and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Adjusted 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 indicators 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.
(3) So that these measures are comparable among the indicated periods, per unit amounts have been calculated as if the Company converted to a partnership on January 1, 2006 and issued 59,086,316 partnership units. Prior to June 15, 2006, the Company had two shares outstanding.
(4) Management compensation for each of the two senior management executives while FNFC operated as a private company.
(5) Normalized compensation for each of the two senior management executives consistent with compensation policies that have been implemented on closing of the IPO.

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 fee and gain on 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, 2008, mortgages under administration totalled $40.6 billion, up from $33.1 billion at December 31, 2007, an annualized rate of increase of 23%. This compares to $38.8 billion at September 30, 2008, representing a quarter-over-quarter increase of 5% and an annualized increase of 19%. For the year ended December 31, 2008, non-originated servicing business contributed $182 million to the $7.5 billion year-over-year increase in MUA.

GROWTH IN ORIGINATION OF HIGHER MARGIN MORTGAGES

The Company's main focus is on the prime single-family mortgage market. Prior to the credit issues currently affecting the market, 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. To augment this servicing income, the Company implemented strategies to increase volumes in higher margin markets such as the Alt-A and commercial mortgage-backed securities ("CMBS") markets. Alt-A describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. These markets were more profitable than conventional mortgage lending markets and added to the economies of scale in the Company's operations by further increasing mortgages under administration.

This strategy has changed significantly with the challenges in the current credit environment. Liquidity and credit concerns have curtailed the issuance of CMBS indefinitely in Canada and the Company has changed its Alt-A offering to focus on a more conservative product. These same concerns have led to increased spreads on prime single-family mortgages relative to Government of Canada bond yields. In the spring of 2007, such spreads for discounted five-year mortgage rates were approximately 1.25 percentage points. For most of 2008, comparable spreads have increased to as high as 3.00 percentage points. As a consequence, "regular" prime single-family mortgages have become "high margin" mortgages, such that the Company earned much higher gains on securitization on its primary mortgage product. While the Company has been successful in increasing volume for its Alt-A product in prior years, tighter underwriting criteria, rising mortgage rates and competition from mortgage insurance companies led the Company to re-align its Alt-A program by discontinuing its uninsured products on May 15, 2008. For the year ended December 31, 2008, the Company originated $225 million of uninsured Alt-A mortgages. This volume contrasts with the prior year when the Company originated $721 million of uninsured Alt-A mortgages.

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 the discontinuance of its uninsured Alt-A product and a slowing housing market, the Company was able to increase its single-family origination volumes to $8.8 billion for the year ended December 31, 2008 from $8.4 billion in the comparative year ended December 31, 2007. The Company has also started the implementation of a paperless administration system for its commercial segment, which will provide improved record keeping and more convenient accessibility for third party investors.

EMPLOYING INNOVATIVE SECURITIZATION TRANSACTIONS TO MINIMIZE FUNDING COSTS

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

As described in the MD&A for the year ended December 31, 2007, ABCP funded by third party sponsored ABCP conduits became frozen in August 2007 due to liquidity and valuation concerns. Similar concerns affected bank-sponsored ABCP channels as well. The Company used both bank and third party channels to indirectly fund a portion of its mortgages under administration. Because of the high credit quality of the Company's mortgages in its third party sponsored conduit, ABCP issued through this channel was entirely repaid in the fourth quarter of 2007. The Company has continued to fund a portion of its assets (approximately $1.8 billion of the $40.6 billion MUA as at December 31, 2008) with bank-sponsored ABCP. Although bank-sponsored ABCP has continued to trade in the marketplace, its cost has varied greatly in the past twelve months due to uncertainty surrounding both the quality of the underlying assets and the bank's ability to support the papers continued liquidity. During the fourth quarter of 2007, ABCP traded in a range from 0.40 to 0.60 percentage points in excess of historical levels. The Company considers historical levels to be even to bankers' acceptances rates ("BA"). Subsequent to year end, these widened spreads tightened to 0.10 percentage points in excess of BA. During the first nine months of 2008, ABCP tended to trade at spreads between a low of 0.10 percentage points and a high of 0.35 percentage points. 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 the federal government became involved in the restructuring of frozen third-party ABCP. Together these events have negatively affected potential ABCP investors resulting in spreads that have increased to approximately 1.10 percentage points in excess of BA as at December 31, 2008.

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 2007, the Company had approximately $2.0 billion of mortgages under administration funded with ABCP, including all of its Alt-A mortgages. The Company's exposure to ABCP at December 31, 2008 has decreased to $1.7 billion. The Company has taken a conservative approach and has changed the assumption of the cost of ABCP in its securitization models on the assumption that 30 day ABCP will trade at 1.10% over BA for the entire term of each mortgage in these programs. Considering that some of these mortgages have terms of up to five years, management believes that the uncertainty in this market will lead to further fluctuations in pricing and considers its current assumption as its best estimate of fair value. The assumption of 1.10% over BA is in contrast to the end of 2007 when these models assumed that ABCP would trade just 0.40 percentage points in excess of BA. Accordingly, in the year, the Company recorded a large downward adjustment to the fair value of the Company's securitization receivables involving ABCP. In total this 0.70 percentage point adjustment resulted in $20.2 million of unrealized loss on financial instruments for the year ended December 31, 2008.

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 $3 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. In addition to these CMHC approvals, the Company's existing NHA-MBS program remains a significant source of funding for the Company as evidenced by pools issued in the year that totalled $1.14 billion.

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. Pursuant to this agreement, the Company indirectly sold approximately $750 million into the CMB. In December 2007, pursuant to the Company's approval as a seller into the CMB, the Company executed a direct sale of $542 million into the issuance. In 2008, the Company sold various pools between $50 and $200 million in size directly into the CMB. 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 relatively 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. As a seller, the Company is also subject to these limitations. In November of 2008, the Company was able to sell approximately $119 million of ten year mortgages into the first ten-year term issuance offered through the CMB program.

KEY PERFORMANCE INDICATORS

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

- Earnings before income taxes, depreciation and amortization after normalizing management compensation while the Company was a private entity ("Adjusted EBITDA"); and
- Distributable cash.

Adjusted EBITDA is not a recognized measure under GAAP. However, management believes that Adjusted EBITDA is a useful measure that provides investors with an indication of cash available for distribution prior to capital expenditures. Adjusted 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. The Fund's method of calculating Adjusted EBITDA may differ from other issuers and, accordingly, Adjusted EBITDA may not be comparable to measures used by other issuers.

($000s)	*Three months ended*		*Year ended*	
	December 31 2008	*December 31 2007*	***December 31 2008***	*December 31 2007*
For the Period				
Revenue	**$ 59,488**	$ 68,272	**$ 293,959**	$ 238,971
Net income	**17,743**	24,050	**108,021**	72,844
Adjusted EBITDA [(1)]	**18,201**	24,389	**109,675**	74,086
At Period end				
Total assets	**737,065**	460,336	**737,065**	460,336
Mortgages under administration	**$ 40,596,013**	$ 33,114,415	**$ 40,596,013**	$ 33,114,415

(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 the Fund prior to distribution is an important measure for investors to monitor. Management cautions investors that due to the Company's nature as a mortgage securitizer, there will be significant variations in this measure from quarter to quarter as the Company collects and invests cash in mortgage securitizations. 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 maintenance 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. In 2007, the Canadian Securities Administrators issued amended guidance for reporting by income trusts. This policy statement recommends various disclosures and, in particular, describes a new framework for measuring the amount of distributable cash generated by an income trust. The new guidance requires the determination of distributable cash to be reconciled to cash provided from operating activities with a deduction for all capital expenditures. In disclosure prior to July 2007, the Company reconciled this measure from Adjusted EBITDA and deducted only "maintenance" capital expenditures. The Company has followed the new guidance, as described above, such that the comparative period calculations of distributable cash have been restated to reflect the current period's presentation.

DETERMINATION OF DISTRIBUTABLE CASH

($000s)	*Three months ended*		*Year ended*	
	December 31 2008	*December 31 2007*	***December 31 2008***	*December 31 2007*
For the Period				
Cash provided by (used in) operating activities	**$ (35,263)**	$ 98,516	**$ (79,797)**	$ 89,972
Add (deduct):				
Change in mortgages accumulated for sale between periods [2]	**54,292**	(83,308)	**162,526**	(14,632)
Less:				
Capital expenditures	**234**	335	**911**	967
Distributable cash [1]	**$ 18,795**	$ 14,873	**$ 81,818**	$ 74,373

(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.

(2) This change excludes $13,993 of mortgages accumulated for sale in the prior period reclassified to mortgage loan and investments in the current presentation of the balance sheet; and non-cash fair market value adjustments inherent in the mortgages accumulated for sale balances.

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, 2008, origination volume grew from $10.9 billion to $11.9 billion or 9% over the prior year.

Placement Fees and Gain on Securitization

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". 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) is recognized as a "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.

Upon the recognition of a "Gain on securitization", the Company establishes a "Securitization receivable" which is amortized as spread income 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 income 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.

For all institutional placements and most mortgages securitized through NHA-MBS, the Company earns "Placement fees". In addition, under certain circumstances, additional revenue from institutional placements and NHA-MBS may be recognized as a "Gain on securitization". 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 $11.9 billion of originations for the year ended December 31, 2008, $8.9 billion was placed with institutional investors and $1.7 billion was originated for the NHA-MBS program.

All loans securitized through the Company's ABCP programs are recognized as a "Gain on securitization", as is a portion of the spread earned from NHA-MBS and some institutional placements. Of the Company's $11.9 billion of originations for the year ended December 31, 2008, $875 million was sold to ABCP conduits and other securitization vehicles, generating "Gain on securitization" revenue.

In the past several years, the Company has experienced significant growth in mortgages funded through its securitization programs. As a result, revenue from "Gain on securitization" has increased accordingly. Since cash flows received from securitized assets are received over the life of the mortgages, and the revenue is recognized upon origination, there will be a timing difference between the recognition of revenue and the receipt of cash. This is similar to the common practice of most companies to record the revenue from sales at the time that goods are sold or shipped and set up a receivable until the cash is actually received.

The financial effect of the timing difference between the recognition of revenue and the receipt of cash is effectively equal to the "Gain on securitization" less "Amortization of securitization receivable" (net of "Amortization of servicing liability") in any given year. For the quarter ended December 30, 2008, the volume of mortgages funded through NHA-MBS, ABCP conduits and institutional placements that earn gains on securitization increased. This timing difference required working capital funding of approximately $36.6 million for the year ended December 31, 2008 ($21.2 million for the year ended December 31, 2007). To the extent that gains on securitization do not increase for a number of years, the effects of the timing difference would be neutralized as new securitization receivables would be offset by collections of existing securitization 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 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.

($000s)	*Three months ended*		*Year ended*	
	December 31 2008	*December 31 2007*	***December 31 2008***	*December 31 2007*
Mortgage Originations by Asset Class				
Single-family residential	**$ 1,910**	$ 2,127	**$ 8,757**	$ 8,368
Multi-unit residential and commercial	**869**	635	**3,129**	2,508
Total originations	**2,779**	2,762	**11,886**	10,876
Funding of Mortgage Originations by Source				
Institutional investors	**1,935**	2,150	**8,875**	8,280
CMBS	**–**	3	**–**	335
NHA-MBS	**570**	133	**1,739**	323
Securitization and Company internal resources	**274**	476	**1,272**	1,938
Total	**2,779**	2,762	**11,886**	10,876
Mortgages Under Administration				
Single-family residential	**26,333**	20,417	**26,333**	20,417
Multi-unit residential and commercial	**14,263**	12,697	**14,263**	12,697
Total	**$ 40,596**	$ 33,114	**$ 40,596**	$ 33,114

The Company experienced steady mortgage origination growth in the year. Total mortgage origination increased 9% to $11.9 billion from $10.9 billion in the comparative year of 2007. This increase reflects the Company's growing competitive position in the commercial mortgage market and its expanding market share in the single-family residential mortgage broker channel in a generally slower market than experienced in 2007. Excluding the $496 million negative impact on originations from the May 15, 2008 discontinuation of the Alt-A program, mortgage origination volumes would have been 15% higher year-over-year.

During the year, Canadian capital markets continued to be volatile. Bond rates declined throughout the year as the credit crisis in the U.S. worsened and economic indicators on both sides of the border deteriorated. This was particularly true for the fourth quarter of 2008 when the credit crisis in Canada peaked. For the Company, these conditions had both favourable and unfavourable effects. As an originator of primarily prime insured mortgages (particularly single-family residential and multi-unit residential), the Company continued to see demand for its products. The Company believes these assets will continue to be desirable, particularly in the current environment in which a premium is placed on federal government credit. With bond yields declining significantly and Canadian mortgage lenders facing higher costs of funding, mortgage spreads remained at historically wide spreads. These higher mortgage spreads enabled the Company's institutional investors to earn higher returns on the mortgages purchased from the Company.

It also allowed the Company to earn larger gains on securitization for the mortgages in which it retained an economic interest. The commercial segment of the Company also benefited from wider spreads on its prime origination due to higher funding costs at its competitors.

At the same time, the Company suffered from higher ABCP funding costs. At December 31, 2007, the Company had adjusted the fair value of its retained interests in ABCP conduits to assume a spread of 0.40 percentage points in excess of BA. Although one month ABCP traded for most of the year at 0.15 percentage points above BA, the bank sponsored conduits used by the Company continued to charge higher costs of funds related to two and three month ABCP costs which were higher than their 30 day quotes. Accordingly the Company's assumption made at the end of 2007 continued to be appropriate. ABCP cost of funds finally began coming down in the third quarter to be in line with the 0.15 rate described above and the Company recorded a small fair value gain in income. This was short lived. By the start of the fourth quarter, fears that the Canadian financial crisis had worsened provoked the government to slash overnight lending rates by 1.50 percentage points in aggregate over the quarter. The banks in turn reduced both their prime and BA rates, with large cuts. However ABCP rates did not react in sympathy. Generally ABCP rates fell only by some 0.75 percentage points so that at December 31, 2008, ABCP traded at approximately 1.10 percentage points above BA. The Company has revised its assumption for ABCP costs by 0.70 percentage points such that its models now assume 30-day ABCP will trade at 1.10 percentage points higher than BA in its calculation of the fair value of its securitization receivable. This has resulted in a downward fair value adjustment of $20.2 million for the year with $21.4 million being recorded in the fourth quarter. This loss was mitigated as the Canadian banks reset their prime lending rates in December 2008 such that an additional 0.25 percentage of spread over BA's was created. Many of First National's securitization programs use BA's to fund Prime indexed mortgages. Similar to the ABCP issue, the Company updated its securitization models to incorporate this wider spread. The result was an unrealized gain of $9.6 million recorded entirely in the fourth quarter of the year.

Total revenues for the year ended December 31, 2008 compared to the same period in 2007 increased by 23% from $239.0 million to $293.0 million; however revenue in both the 2008 and 2007 periods include a reduction from the fair value adjustments related primarily to the volatility of ABCP. Excluding all of these adjustments, revenues would have grown by 16% year-over-year. This growth resulted primarily from higher per unit placement fees and gains on securitization. Mortgage servicing revenue also grew due to the 23% increase in mortgages under administration.

Placement Fees

Comparing the year ended December 31, 2008 to the same period ended December 31, 2007, placement fee revenue increased 12% to $145.9 million from $129.9 million. This was largely due to the growth of mortgages originated for the Company's NHA-MBS program. The Company's competitive position for multi-unit residential mortgage solutions became stronger as many competitors increased their pricing in the face of higher funding costs resulting from the difficult credit environment. Due to this improved competitive position, the Company was able to originate $1.7 billion for its NHA-MBS program; which compares to $323 million in 2007. In contrast, the CMBS market shut down in the middle of 2007 such what was origination of $335 million in 2007 disappeared altogether in 2008. Overall placement fees from commercial segment activities increased by $2.4 million, or 12%, from the prior year. On the residential side, mortgages originated for placement increased by 12% from the prior year; however total residential placement fees revenue grew 21% year-over-year as higher margins and renewal fees supplemented the increase in volume. Lending fees earned on Alt-A origination have offset this growth, as this program's discontinuance resulted in an overall 6% decline in placement fees year-over-year.

Gains on Securitization

Gains on securitization revenue increased 26% to $67.3 million from $53.5 million. The increase was due primarily to gains realized from securitization through the Company's NHA-MBS program. Through the program, the Company recognized both a placement fee (described above) and ongoing interest-only strips on securitized mortgages totalling $1.7 billion in the year. The Company has valued these assets at $12.8 million, which is reflected in gains on securitization revenue. In 2007, the Company only recorded $0.6 million in securitization revenue from this program. Direct and indirect sales into the CMB program have also leveraged the Company's gain on securitization revenue. 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 has benefited from the increased mortgage spreads resulting from the turmoil in the credit markets beginning in August 2007. Due to the most recent credit market uncertainty, spreads continue to be greater than historical norms by almost two percentage points. For these mortgage sales, the Company recorded $13.7 million in additional gains on securitization for 2008, compared to 2007. The Company also experienced a decrease of approximately $12.4 million in gains on securitization revenue because of the discontinuance of its Alt-A program in mid 2008.

Mortgage Servicing Income

Mortgage servicing income increased 21% to $62.3 million from $51.3 million, which was primarily due to the growth in the portfolio of mortgages under administration. This portfolio grew by 23% year-over-year. The residential component grew by 29% 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). However a greater proportion of this year's growth in MUA is represented by the increase in securitized mortgages, which produce residual securitization income as opposed to mortgage servicing income. Another aspect of this revenue is 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, explaining the lower rate of increase compared to the growth realized in the residential mortgages under administration. This income was $9.6 million for the year ended December 31, 2008 and $11.8 million for the comparative year in 2007. 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, 2008 the amount of funds held in trust was $334 million compared to $325 million at December 31, 2007 and the average 30-day CDOR, which is a benchmark for short-term interest rates decreased from 4.54% for 2007 to 3.19% for 2008.

Mortgage Investment Income

Mortgage investment income increased 4% to $22.1 million from $21.3 million. This increase was due to a combination of offsetting factors including: an increase in the amount of securitization receivables, falling bond yields (which impact the interest earned on securitization receivables), falling prime lending rates (which affect gross revenues on mortgage and loan investments), and increased amounts of mortgages accumulated for sale during the year. The investment base consists of mortgage assets held on the balance sheet, including mortgages accumulated for sale, net securitization receivables, mortgage and loan investments and purchased mortgage servicing rights. The amount of these assets held and the interest rates earned thereon, varied significantly during the year as the Company grew its securitization receivables primarily through the NHA-MBS program, decreased its commercial mortgage investment portfolio and earned lower revenues on a per mortgage unit basis as short-term interest rates declined significantly throughout the year. Securitization receivables use government of Canada bond yields as the basis for the determination of appropriate discount rates. Between December 31, 2007 and 2008, these yields fell precipitately, about 1.20 percentage points for a typical five year bond, accounting for decreased revenues of approximately 30%.

Residual Securitization Income

Residual securitization income increased 23% to $9.0 million from $7.3 million. The primary source of this revenue is the amortization of the servicing liability, which represents the servicing portion of the spread received from securitization conduits. The other source is the excess of cash flows received above the expected cash flows assumed in the Company's calculation of the securitization vehicles. The increase is a result of the Company's conservative assumptions used in the estimation of cash flows in the Company's derivation of the securitization receivable. The extra cash flow received over expected cash flows was $2.6 million for the 2008 year and $1.3 million for the 2007 year.

Realized and Unrealized 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 receivables, 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.

During the year, bond yields decreased as capital markets reacted to global credit issues and an uncertain economic outlook. The yield for five-year benchmark bonds decreased from approximately 3.9% as at December 31, 2007 to about 1.7% by the end of December 2008. To adjust to fair market value, the Company decreased the rates at which it discounts the cash flows associated with its securitizations, re-priced the interest rate swaps underlying a portion of these securitizations, and adjusted other assumptions to correspond to current economic circumstances. Together these adjustments accounted for about $0.7 million of unrealized gains in fair market value in the year. For the portion of these gains related to decreasing discount rates, implicitly the Company will now earn a lower rate of return on these assets going forward such that this gain is essentially an acceleration of accounting earnings otherwise earned in the future. The amount of cash flows to be received by the Company from the underlying securitization structures has not been affected by these changing bond yields.

As described earlier the Company has recorded a large unrealized fair value loss in the amount of $20.2 million related to the change in the assumed costs of ABCP in the year and an offsetting unrealized gain of $9.6 million as prime/BA spreads improved by 0.25 percentage points for the Company in the fourth quarter.

The significant decrease in bond yields and changing mortgage spreads during the course of the year have offsetting effects on the fair value of the Company's interest rate swaps, securities sold short, mortgages accumulated for sale, mortgage and loan investments, and mortgage commitments such that the Company recorded net losses of $2.8 million for 2008 on these financial instruments.

Brokerage Fees Expense

Brokerage fees expense increased 3% to $105.8 million from $102.9 million. The increase is primarily the result of single-family residential origination, which increased 5% year-over-year. In 2007, the Company expensed $2.8 million of brokerage fees related to the one-time purchase of $152 million of mortgages. Excluding this item, brokerage fees year-over-year would have increased by 6%. Product mix was also a factor as the Company pays mortgage brokers higher per mortgage fees for the origination of both variable rate residential mortgages and Alt-A mortgages. While the percentage of variable rate mortgages increased, Alt-A business dropped off with the discontinuance of its program fees, together having an offsetting impact on overall broker fees.

Salaries and Benefits Expense

Salaries and benefits expense increased 16% to $40.4 million from $34.9 million. To support the increase in mortgage origination and servicing a larger mortgage portfolio under administration, the Company increased its head count. As at December 31, 2008, the Company had 506 employees, compared to 448 as at December 31, 2007. The 20% increase in the number of employees corresponds to the growth in the mortgages under administration of 23% year-over-year and represents the increased needs of mortgage administration. The increase also pertained to higher sales commissions in the year on commercial mortgage origination which increased 25% from the prior year. These increases were offset by lower bonuses paid to employees in residential origination. Although origination volumes were higher in 2008 than the previous year, these volumes were below the Company's sales targets such that bonuses paid out in 2008 were not as great as those in 2007. Management salaries are paid to the two senior executives who indirectly own the Class B LP units. The current period's expense is as a result of the compensation arrangement executed on the closing of the initial public offering.

Interest Expense

Interest expense increased 19% to $15.7 million from $13.2 million. This expense has increased from the prior year due to Company's increased usage of the credit facility and higher hedge carrying costs mitigated by falling interest rates. The facility was primarily employed for warehousing the larger origination volume that occurred during the quarter. 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. The Company uses the credit facility with its banking syndicate to fund the mortgages in this period. In December 2007, the commitment stood at $300 million. The Company renegotiated this agreement and increased the total commitment to $378 million in April 2008 to provide additional capacity for its growth, particularly in the commercial segment. The cost of carrying the Company's interest rate hedging instruments increased this expense by $2.2 million in 2008 compared to 2007. Effectively the Company receives short term interest rates from the counterparties on these transactions and pays, on the same notional amount, the interest rate coupon on the government of Canada bond coupon. The difference in these rates is accounted for as interest expense by the Company. In 2007 these rates were comparable so that there was no interest cost to these transactions. In 2008, short-term interest rates declined significantly such that there was a large spread between these two rates.

The interest rate payable on the credit facility is largely based on the prime rate. Because the prime rate decreased from 6.00% at the end of 2007 to 3.50% at the end of December 2008, the Company's borrowing costs per unit have similarly decreased, largely offsetting the increased usage.

Other Operating Expense

Other operating expense increased 65% to $22.6 million from $13.7 million. The Company recorded a total of $6.9 million for provisions related to potential losses on mortgage and loan investments held on its balance sheet. These provisions were recorded to meet specific geographical exposures within the commercial real estate market in Canada. Without this provision, the increase in these expenses would have been 15% due primarily to the growth of expenses to service the 23% increase in mortgages under administration year-over-year.

Net Income and Adjusted EBITDA

Net Income increased 48% to $108.0 million from $72.8 million. Net Income in both years includes reductions for fair value adjustment related to securitization assets. Excluding these adjustments primarily related to ABCP, net income grew by 24%, which corresponds to the growth in mortgages under administration and mortgage origination volumes. In particular, profitability has increased through higher margins on both prime single-family and multi-residential mortgage origination as demand for these high credit quality assets has increased with the current credit environment. Adjusted EBITDA increased 48% to $109.7 million from $74.1 million. The increase was due to the same factors described above 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 and commercial mortgages), as summarized below.

Operating Business Segments

($000s except percent amounts)	*Residential*		*Commercial*	
Quarter ended	***December 31 2008***	*December 31 2007*	***December 31 2008***	*December 31 2007*
Originations	**$ 8,757,000**	$ 8,368,000	**$ 3,129,000**	$ 2,508,000
Percentage change	**5%**		**25%**	
Revenue	**$ 229,371**	$ 194,478	**$ 64,588**	$ 44,492
Percentage change	**18%**		**45%**	
Income before income taxes and corporate non-allocated expenses	**$ 75,925**	$ 52,657	**$ 33,596**	$ 21,687
Percentage change	**44%**		**55%**	
Period ended	***December 31 2008***	*December 31 2007*	***December 31 2008***	*December 31 2007*
Identifiable assets	**$ 399,185**	$ 235,770	**$ 337,880**	$ 224,566
Mortgages under administration	**$ 26,333,014**	$ 20,417,446	**$ 14,263,000**	$ 12,696,969

RESIDENTIAL SEGMENT

Residential revenues have increased by 18% from the prior year mainly due to the large unrealized charge for $15.4 million related to the fair value adjustment of the Company's securitization assets recorded in 2007. Without this adjustment, revenue would have increased 9% primarily due to increased origination volumes. The increase has been mitigated by lower gains on securitization revenue related to the discontinuance of the Alt-A program, but augmented by higher servicing revenues on a larger portfolio of mortgages under administration, which grew 23% between December 31, 2007 and December 31, 2008. Income before income taxes, excluding the adjustment for unrealized losses in 2007, grew by 12% reflecting the growth in revenues.

Identifiable assets have increased due to $119 million of additional mortgages accumulated for sale held at the end of December 2008 than at December 31, 2007.

COMMERCIAL SEGMENT

Commercial revenues increased by 45% from the prior year mainly due to the large unrealized charge for $7.5 million related to the fair value adjustment of the Company's securitization assets recorded in 2007 and the revitalization of the Company's NHA-MBS program. Without this adjustment, revenue would have increased by 24% primarily due to increased securitization through the NHA-MBS program which produced higher placement fees as well as $12.8 million of gains on securitization revenue this quarter compared with $0.6 million in 2007. The increased revenue flowed through to drive increased net income, which excluding the adjustment for unrealized losses in 2007 and $6.8 million provision for loss taken this year, would have increased by 37%.

Identifiable assets for the commercial sector increased primarily due to increased securitization receivables related to the NHA-MBS program as well as hedging requirements for funded and committed commercial mortgages. The Company had approximately $63 million more securities sold short for hedging its commercial mortgage pipeline at the end of December 2008 compared to the end of December 2007.

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) securitization receivables, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of five banks which provides for a total of $378.3 million in financing. Bank indebtedness also includes borrowings obtained through securitization transactions, outstanding cheques, and overdraft facilities.

At December 31, 2008, outstanding bank indebtedness was $331.0 million (December 31, 2007 – $198.5 million) of which $224.6 million (December 31, 2007 – $76.0 million) was drawn to fund mortgages accumulated for sale. At December 31, 2008, the Company's other interest-yielding assets included: (1) securitization receivables of $115.1 million (December 31, 2007 – $88.9 million) and (2) mortgage and loan investments of $75.4 million (December 31, 2007 – $82.4 million). The difference between bank indebtedness and mortgages accumulated for sale, which the Company considers a proxy for true leverage, has decreased between December 2007 and December 2008 and now stands at $106.4 million. This represents a debt-to-equity ratio of approximately 0.74 to 1 which the Company believes is at a conservative level. This ratio has decreased significantly from 1.23 to 1 as at December 31, 2007 as the Company has increased its capital base by about $43.8 million. The increase is a result of the Company's success in growing earnings and its distribution reinvestment program. For the year ended December 31, 2008 the Company earned $108.0 million and declared distributions of $81.2 million. The difference of $26.8 million has been retained by the Company in equity. The distribution reinvestment program increased equity by approximately $10.5 million for the year period ended December 31, 2008. This additional capital will provide the Company with a cushion should the current economic downturn adversely affect the Company in future periods.

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 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, 2008, this investment was $36 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 the Alt-A program was discontinued, the Company has been repaid approximately $6.4 million of this investment. The cash flow associated with this return of collateral will provide more liquidity to the Company in future quarters.

Despite the disruption in the ABCP market described 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, increasing its profitability in 2008 by over 50% compared to 2007. 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 2008, the Company estimates that it will receive approximately $50 million of cash annually from its servicing operations and $35 million of cash flow from previously recorded securitization receivables. Together this $85 million of annual cash flow would be sufficient to support the almost $81 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 new accounting standards surrounding financial instruments, the Company's income is subject to more volatility. This is particularly true for the securitization receivable 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 sum of the coupon 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 adoption of the accounting standard has had no immediate 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 vary 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 mortgage fundings within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2008, the Company had entered into $63.5 million in notional value forward bond sales for this residential program. The current contracts were purchased between July 30 and October 7, 2008.

For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund and hedge 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, 2008, the Company had entered into $153.3 million in notional value forward bond sales. The current contracts were purchased during the period from June 9, 2008 to December 30, 2008. The change in mark-to-market value of the hedges from January 1, 2008 to December 31, 2008 has been expensed through the statement of income as described in Notes 2 and 5 to the financial statements pursuant to the adoption of section 3855.

In the fourth quarter, the Company entered into a new amortizing float for fix rate swap to economically hedge the interest rate exposure related to certain mortgages held on balance which the Company has designated as replacement assets for its CMB activities. As at December 31, 2008, the notional value of these swaps is $33.0 million. Market swap rates decreased significantly in the period since the swap was put on to the end of 2008. As such, the net mark-to-market adjustment for the quarter was a loss of $737 for the Company. This partially offsets the fair value gains on the hedged mortgages described above. The amortizing swap matures in September 2013. The Company had also entered into interest rate swaps to immunize the Company's exposure to changing interest rates related to cash flows receivable from purchased servicing rights. With short-term interest rates falling so precipitately in the year, the Company determined that these swaps were no longer appropriate and unwound these in the fourth quarter of 2008. For the year, the Company recorded $708 of fair value gains realized from holding and unwinding these instruments.

As described above, the Company uses various strategies to reduce interest rate risk. The financial statements also disclose the sensitivity which the securitization receivable has 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 is 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 were wider. The Company adjusted for a market suggested increase in credit spread in 2007 and adjusted the value of the mortgages downward. In 2008, the economic environment weakened significantly and credit became scarce as global banking suffered. Again for reasons beyond the Company's control, credit spreads widened such that the Company applied an additional spread to the mortgages and the Company recorded an additional unrealized loss. 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. This risk cannot be hedged economically. Although the Company has recorded these losses, 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 the same amount of these losses but in the form of interest income.

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. 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 securitization gains on the sale of prime insured mortgages.

As at December 31, 2008 the Company has various exposures changing credit spreads. As described in Note 12 to the financial statements, the Company has $69 million of commercial mortgages originated originally for the CMBS market. As described earlier, there are $1.7 billion of mortgages in securitization conduits that are exposed to BA – ABCP spread risk. In mortgages accumulated for sale there are $180 million of mortgages that are susceptible to some degree of changing credit spreads.

DISTRIBUTION RE-INVESTMENT PROGRAM "DRIP"

Upon approval by the Board of Directors in March 2008, the DRIP program was made available to unitholders in April 2008. The program was implemented to (1) provide capital to support the Company's initiatives as a CMB seller and Alt-A securitizer; and (2) give unitholders a convenient way to increase their ownership of the Fund's units on a monthly basis. The DRIP was successful in raising capital of $10.5 million for the Company in the second quarter; however it became clear as the quarter progressed that additional capital was not required due to two primary reasons: (1) as announced in May 2008, the portion of Alt-A origination requiring investment by the Company terminated on July 15, 2008; and (2) the revitalization of the Company's NHA-MBS program has resulted in a much lower upfront investment required from the Company on this type of securitization. The result of these changes has been demonstrated through the significant increase in distributable cash and related reduction of the payout ratio during the year. Accordingly, the Company suspended the DRIP after the July 2008 distribution paid on August 15, 2008.

NORMAL COURSE ISSUER BID

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. As at the date of this discussion, no Units have yet been purchased under provisions of the bid.

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, 2008, the Company purchased new computers, leasehold improvements, and office and communication equipment to support the growth of its single-family residential business, particularly the expansion of its Vancouver office.

Going forward, the Company expects maintenance capital expenditures will be approximately $1 million annually and primarily relate to technology (software and hardware) maintenance. Maintenance 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 and purchases servicing rights on 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
(in $000s)

	Total	0-1 Years	1-3 Years	4-5 Years	After 5 Years
Lease Obligations	$ 9,155	$ 3,019	$ 4,933	$ 1,039	$ 164
Servicing Liability	$ 15,697	$ 5,744	$ 6,482	$ 2,259	$ 1,212
Total Contractual Obligations	$ 24,852	$ 8,763	$ 11,415	$ 3,298	$ 1,376

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, judgements and assumptions that management believes are reasonable based upon the information available. These estimates, judgements 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, 2008 and modified for changes in accounting policies described below. 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 revenue 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. 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. The retained interest is reflected on the Company's balance sheet as securitization receivable.

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, 2008 continue to be consistent with those used for the year ended December 31, 2007 and the quarters ended March 31, June 30, and September 30, 2008. 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 such that the spread between these instruments is approximately 1.10 percentage points as at December 31, 2008. 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 1.10 percentage points over one-month BA.

The key assumptions used in the valuation of gain on securitization 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 16% for residential mortgages and 38% 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. For the securitization of Alt-A mortgages, the Company uses a credit loss rate of 0.35% per annum. For the securitization of small multi-unit residential and commercial mortgages, the Company uses 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.

In January 2007, the Company elected to treat its financial assets and liabilities, including 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 are sold to various securitization conduits. Under IFRS, some of these securitizations will not meet the definition of a "true sale" and instead will be accounted for as a secured financing. At the present time, the Company believes that its securitizations with ABCP conduits will not qualify for sale accounting, but that securitizations under the NHA-MBS program will continue to meet the criteria for off-balance sheet treatment. Because the ABCP programs are generally amortizing down while the NHA-MBS program continues to grow, it is difficult at this time to evaluate the extent of the impact of these changes as at January 1, 2011. The Company will continue to evaluate the impact of these new standards and will report accordingly in future Management's Discussion and Analyses.

Controls over Financial Reporting

No changes were made in the Company's internal controls over financial reporting during the interim period ended December 31, 2008 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

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.

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 3, 2009, 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 challenges of the past year, the Company achieved relatively strong results in the fourth quarter and year ended December 31, 2008. Mortgage spreads have widened for the prime single-family residential mortgage market, First National's primary focus area. This has resulted in wider margins on the Company's origination activities. The mortgage broker distribution channel has continued to grow relative to other distribution channels, as does the Company's leadership position within it.

The commercial mortgage market has contracted during 2008, largely as a result of the credit tightening that began in August 2007. Although this poses challenges for First National, it has also created opportunities due to the departure of several competitors from the market. 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. Given the strength of FNFLP's business model and consistent track record of execution, management believes the Company will remain well-positioned within the commercial mortgage market.

Although the current level of turmoil in global financial markets has not been seen since the 1930s, the Canadian financial system remains strong. Canada has not experienced the excessive real estate speculation and aggressive mortgage lending seen in the United States and elsewhere in the world. Nevertheless, Canada has not been insulated from the consequences of world events and we are currently in the midst of a significant recession. For this reason, the Company expects the overall level of mortgage originations in both residential and commercial markets to decline noticeably in 2009, particularly for single-family residential. Despite this slowdown in origination, management expects to see continuing growth in mortgages under administration – driven by the Company's origination channels – and high levels of continuing income and cash flow from mortgage servicing.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of First National Financial Income Fund for the period from January 1, 2008 to December 31, 2008 and the financial statements of First National Financial LP for the period January 1, 2008 to December 31, 2008 and all information in this annual report are the responsibility of management.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect certain reported amounts which management believes are reasonable.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and the independent auditor. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Ernst & Young LLP, an independent auditing firm, has audited First National Financial Income Fund's 2008 consolidated financial statements and First National Financial LP's 2008 financial statements in accordance with Canadian generally accepted auditing standards and has provided independent audit opinions. The auditors have full and unrestricted access to the Audit Committee to discuss the results of their audits.

Stephen J. R. Smith
Chairman and President

Robert A. Inglis
Chief Financial Officer

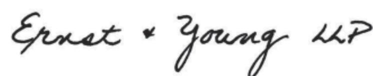
Auditors' Report

To the Unitholders of First National Financial Income Fund

We have audited the consolidated balance sheets of First National Financial Income Fund as at December 31, 2008 and 2007 and the consolidated statements of income (loss) and unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Toronto, Canada,
March 2, 2009.

Chartered Accountants
Licensed Public Accountants

FIRST NATIONAL FINANCIAL INCOME FUND
CONSOLIDATED BALANCE SHEETS
(in $000s)

As at December 31		***2008***		*2007*
ASSETS				
Distributions receivable	**$**	**2,314**	$	1,937
Investment in First National Financial LP *(note 4)*		**110,361**		101,752
		112,675		103,689
LIABILITIES AND EQUITY				
Liabilities				
Distributions payable		**2,314**		1,937
Accounts payable and accrued liabilities		**37**		37
Future income taxes *(note 6)*		**10,300**		7,700
Total liabilities		**12,651**		9,674
Equity				
Unitholders' equity		**100,024**		94,015
	$	**112,675**	$	103,689

See accompanying notes

Approved by the Trustees:

Trustee
John Brough

Trustee
Robert Mitchell

FIRST NATIONAL FINANCIAL INCOME FUND

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND UNITHOLDERS' EQUITY

(in $000s, except per unit amounts and number of units)

Years ended December 31	***2008***	*2007*
REVENUE		
Equity income from investment in First National Financial LP	**$ 13,422**	$ 6,547
EXPENSES		
Trust administration	–	24
Income before income taxes	**13,422**	6,523
Provision for future income taxes *(note 6)*	**1,600**	7,700
Net income (loss) for the year	**$ 11,822**	$ (1,177)
Unitholders' equity, beginning of year	**94,015**	109,470
Issued pursuant to Distribution Reinvestment Plan *(note 3)*	**11,031**	–
Distributions *(note 5)*	**(16,844)**	(14,278)
Unitholders' equity, end of year	**$ 100,024**	$ 94,015
Average number of Units outstanding during the year	**12,307,954**	11,800,000
Earnings (loss) per Unit *(note 8)*		
Basic	**$ 0.96**	$ (0.10)

See accompanying notes

FIRST NATIONAL FINANCIAL INCOME FUND

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in $000s)

Years ended December 31		***2008***		*2007*
OPERATING ACTIVITIES				
Net income (loss) for the year	**$**	**11,822**	$	(1,177)
Add (deduct) items not involving cash				
Provision for future income taxes		**1,600**		7,700
Equity income from investment in First National Financial LP		**(13,422)**		(6,547)
Distributions received from First National Financial LP		**16,467**		13,275
		16,467		13,251
Net change in non-cash working capital balances related to operations		**–**		24
Cash provided by operating activities		**16,467**		13,275
INVESTING ACTIVITIES				
Investment in First National Financial LP	**$**	**(11,031)**	$	–
Cash used in investing activities		**(11,031)**		–
FINANCING ACTIVITIES				
Issuance of Fund Units		**11,031**		–
Distributions paid	**$**	**(16,467)**	$	(13,275)
Cash used in financing activities		**(5,436)**		(13,275)
Net change in cash during the year and cash equivalents, end of year	**$**	**–**	$	–

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008 and 2007
(in $000s, except per unit amounts)

NOTE 1

ORGANIZATION AND BUSINESS OF THE FUND

First National Financial Income Fund [the "Fund"] is an unincorporated, open-ended trust established under the laws of the Province of Ontario on April 19, 2006, pursuant to a Declaration of Trust. The Fund was established to acquire and hold, through a newly constituted wholly owned trust, First National Financial Operating Trust [the "Trust"], investments in the outstanding limited partnership units of First National Financial LP ["FNFLP"]. Pursuant to an underwriting agreement dated June 6, 2006 and initial public offering dated June 15, 2006, 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. The proceeds of the offering, net of underwriters' fees of $6,360, were used to partially fund the indirect acquisition [through the Trust] by the Fund of a 17.94% interest in FNFLP, through the issuance of 10,600,000 Class A LP Units by FNFLP.

Concurrent with the initial public offering and as part of the acquisition agreement between the Fund, FNFLP and First National Financial Corporation ["FNFC" or the "predecessor"], on June 15, 2006, FNFLP purchased all of FNFC's assets and assumed its liabilities, except for income tax liabilities. The consideration for this purchase was:

- the issuance of 48,486,316 exchangeable Class B LP Units;
- an acquisition promissory note of $97,140, of which $10,940 has been accounted for as a distribution in FNFLP's financial statements; and
- a working capital note in the amount of $6,339, representing the difference between the net assets of FNFC as at March 31, 2006, excluding tax liabilities, and the net assets transferred to FNFLP as at June 14, 2006. The issuance of this note has also been accounted for as a distribution in FNFLP's financial statements.

The exchangeable Class B LP Units retained by FNFC are exchangeable on a one-for-one basis for Units of the Fund at any time at the option of FNFC. FNFLP is managed by First National Financial GP Corporation, the general partner, which holds a 0.01% interest in FNFLP. The Fund initially owned 17.94% of the shares of First National Financial GP Corporation and FNFC wholly owned the remaining 82.06%. The ownership of the general partner will change pro rata as the exchangeable Class B LP Units are exchanged for Units in the Fund.

On July 11, 2006, the underwriters exercised an over-allotment option to purchase 1,200,000 Units of the Fund at $10.00 per Unit from FNFC. Pursuant to the Distribution Reinvestment Plan initiated in April 2008, another 881,113 Class A LP Units were issued. Accordingly, as at December 31, 2008 the Fund indirectly holds a 21.15% [2007 – 19.97%] interest in FNFLP and FNFC holds a 78.85% [2007 – 80.03%] controlling interest in FNFLP.

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

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

NOTE 2

BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

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

Income taxes

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

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

Investments in FNFLP and First National Financial GP Corporation

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

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

NOTE 3

FUND UNITS

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

In connection with the initial public offering, the Fund issued 10,600,000 Fund Units on June 15, 2006 at a price of $10.00 per Unit. On July 11, 2006, subject to the over-allotment option, the Fund issued 1,200,000 additional Fund Units at $10.00 per Unit.

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

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

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

The Fund's optional distribution reinvestment plan ["DRIP"] allows eligible Canadian Unitholders to elect to have their cash distributions from the Fund automatically reinvested in additional Units. Unitholders who participate in the DRIP will receive a further bonus distribution of Units equal in value to 5% of each distribution that was reinvested. During the year, the Company issued 881,113 Units pursuant to this plan and invested the proceeds of $11,031 in increased investment in FNFLP.

The following Units are issued and outstanding:

	Number of Units		*Amount*
Balance of Units outstanding, January 1, 2007	11,800,000	$	109,140
Units issued pursuant to the DRIP during 2008	881,113		11,031
Balance of Units outstanding, December 31, 2008	**12,681,113**	**$**	**120,171**

The Fund has treated the excess of the additional cost of its investment in Units associated with the DRIP over the carrying value of the underlying net assets of FNFLP on the same basis as the original purchase of Units on the initial public offering, including a provision related to future income taxes. Accordingly, the Fund has notionally allocated the excess of $11,031 to FNFLP's servicing rights for $12,031, and $1,000 for future tax liabilities.

NOTE 4

INVESTMENT IN FIRST NATIONAL FINANCIAL LP

Investment in First National Financial LP consists of the following:

		2008		*2007*
Units outstanding	**$**	**111,640**	$	111,640
Investment pursuant to DRIP		**12,031**		–
Equity accounting adjustments				
Made prior to beginning of year		**(9,888)**		(2,157)
Equity earnings of First National Financial LP for the year		**22,333**		14,547
Amortization of purchase price discrepancy		**(8,911)**		(8,000)
Distributions received in the year		**(16,844)**		(14,278)
	$	**110,361**	$	101,752

NOTE 5

DISTRIBUTIONS TO UNITHOLDERS

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

		Per Unit		*Amount*
Distributions paid				
2007 regular distribution	$	0.10417	$	1,229
2007 special distribution		0.06000		708
January 2008		0.10417		1,229
February 2008		0.10417		1,229
March 2008		0.10417		1,229
April 2008		0.10417		1,229
May 2008		0.10417		1,272
June 2008		0.10417		1,316
July 2008		0.10417		1,318
August 2008		0.11250		1,427
September 2008		0.11250		1,427
October 2008		0.11250		1,427
November 2008		0.11250		1,427
Distributions payable				
December 31, 2008		0.11250		1,427
2008 special distribution		0.07000		887
			$	18,781

NOTE 6

INCOME TAXES

In June 2007, the Government of Canada enacted new legislation imposing additional income taxes upon publicly traded income trusts, including the Fund, effective January 1, 2011. Prior to June 2007, the Trust estimated the future income taxes on certain temporary differences between amounts recorded on its consolidated balance sheets for book and tax purposes at a nil effective tax rate. Under the legislation and general federal corporate rate reductions announced in December 2007, the Trust now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be 29.5% to December 31, 2011 and 28% thereafter. Temporary differences reversing before 2011 will still give rise to nil future income taxes.

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

On the first issue, because there is a difference between the accounting carrying value of these intangible assets and their underlying tax carrying value, Canadian generally accepted accounting principles require a future income tax liability to be accrued. This was accrued on the initial public offering based on tax rates for income trusts, which at that time was a rate of nil. With new rates being enacted in June 2007 and December 2007, the effective tax rate as at January 1, 2011 was changed to 29.5% and the effective tax rate as at January 1, 2012 was changed to 28%. Based on these new tax rates, the Fund accrued a future income tax liability of $9,200 as at December 31, 2008 [2007 – $8,200]. This liability will, in all likelihood, remain at this amount until January 1, 2011, when it will be drawn down every quarter as the Fund continues to amortize the related intangible assets until 2016.

In June 2007, based on the assets and liabilities of FNFLP, the Fund began estimating its portion of the amount of the temporary differences which were previously not subject to tax and has estimated the periods in which these differences will reverse. The Fund estimates that as at December 31, 2008, FNFLP has a net taxable temporary difference pertaining to the Fund which will reverse after January 1, 2011, such that an accrual of $1,100 of future income taxes is required at year end. The temporary differences relate principally to the difference of net tax carrying values of the securitization receivable, servicing liability, purchased mortgage servicing rights and intangible assets recorded in the financial statements of FNFLP over the net book value of those assets.

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

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

NOTE 7

GUARANTEE

The Fund's wholly-owned subsidiary, First National Financial Operating Trust, has provided guarantees to and subordinated its rights to receive payments from FNFLP in respect of FNFLP's bank credit facility that had an outstanding amount at December 31, 2008 of $320,100 [2007 – $182,200] and an authorized limit of $378,300 [2007 – $300,000]. No fee is charged for this guarantee.

NOTE 8

EARNINGS (LOSS) PER UNIT

Earnings (loss) per Unit are calculated using net income (loss) for the year divided by the equivalent number of Fund Units outstanding at the year end.

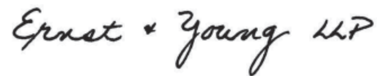
Auditors' Report

To the Partners of First National Financial LP

We have audited the balance sheets of First National Financial LP as at December 31, 2008 and 2007 and the statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Toronto, Canada,
March 2, 2009.

Chartered Accountants
Licensed Public Accountants

FIRST NATIONAL FINANCIAL LP

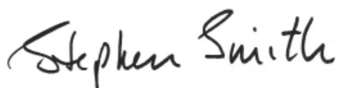
BALANCE SHEETS

(in $000s)

As at December 31		***2008***		*2007*
ASSETS				
Accounts receivable and sundry	**$**	**26,566**	$	19,908
Mortgages accumulated for sale		**224,570**		76,037
Securitization receivable *(note 3)*		**115,081**		88,918
Cash collateral and short-term notes held by securitization trusts *(note 3)*		**54,198**		55,574
Mortgage and loan investments *(note 4)*		**75,450**		82,353
Purchased mortgage servicing rights *(note 5)*		**8,631**		9,754
Securities purchased under resale agreements and owned *(note 10)*		**227,304**		122,864
Capital assets, net *(note 6)*		**5,265**		4,928
Total assets		**737,065**		460,336
LIABILITIES AND EQUITY				
Liabilities				
Bank indebtedness *(note 7)*	**$**	**331,003**	$	198,500
Accounts payable and accrued liabilities *(note 12)*		**16,692**		12,896
Distributions payable		**10,944**		9,700
Servicing liability *(note 3)*		**15,697**		16,124
Securities sold under repurchase agreements and sold short *(note 10)*		**224,882**		123,088
Total liabilities		**599,218**		360,308
Commitments and guarantees *(note 9)*				
Equity				
GP units *(notes 1 and 17)*		**59**		59
Class A LP units *(notes 1 and 17)*		**120,171**		109,140
Exchangeable Class B LP units *(notes 1 and 17)*		**(22,940)**		(22,940)
Retained earnings		**40,557**		13,769
Total equity		**137,847**		100,028
Total liabilities and equity	**$**	**737,065**	$	460,336

See accompanying notes

On behalf of the Board:



Director
Stephen Smith

Director
Moray Tawse

FIRST NATIONAL FINANCIAL LP

STATEMENTS OF INCOME AND RETAINED EARNINGS

(in $000s, except earnings per unit)

Years ended December 31	***2008***	*2007*
REVENUE		
Placement fees	**$ 145,930**	$ 129,926
Gains on securitization *(note 3)*	**67,284**	53,517
Mortgage investment income *(note 4)*	**22,148**	21,331
Mortgage servicing income	**62,258**	51,252
Residual securitization income *(note 3)*	**9,005**	7,276
Realized and unrealized losses on financial instruments *(notes 2 and 12(g))*	**(12,666)**	(24,331)
	293,959	238,971
EXPENSES		
Brokerage fees	**$ 105,757**	$ 102,886
Salaries and benefits	**40,376**	34,858
Interest	**15,663**	13,205
Management salaries	**1,500**	1,500
Other operating	**22,642**	13,678
	185,938	166,127
Net income for the year	**$ 108,021**	$ 72,844
Retained earnings, beginning of year	**13,769**	12,422
Less distributions declared	**(81,233)**	(71,497)
Retained earnings, end of year	**$ 40,557**	$ 13,769
Earnings per unit *(note 15)*		
Basic	**$ 1.81**	$ 1.23

See accompanying notes

FIRST NATIONAL FINANCIAL LP

STATEMENTS OF CASH FLOWS

(in $000s)

Years ended December 31	*2008*	*2007*
OPERATING ACTIVITIES		
Net income for the year	**$ 108,021**	$ 72,844
Add (deduct) items not affecting cash		
Gains on securitization	**(75,506)**	(53,874)
Amortization of securitization receivable	**45,283**	38,656
Amortization of purchased mortgage servicing rights	**1,123**	726
Amortization of capital assets	**1,655**	1,242
Unrealized losses on financial instruments	**6,809**	24,331
Amortization of servicing liability	**(6,399)**	(5,962)
	80,986	77,963
Net change in non-cash working capital balances related to operations *(note 11)*	**(160,783)**	12,008
Cash provided by (used in) operating activities	**(79,797)**	89,971
INVESTING ACTIVITIES		
Additions to capital assets	**$ (1,992)**	$ (2,456)
Investment in cash collateral and short-term notes, net	**1,210**	(14,898)
Investment in mortgage and loan investments	**(60,887)**	(119,196)
Repayment of mortgage and loan investments	**81,436**	90,073
Investment in purchased mortgage servicing rights	**–**	(3,213)
Cash provided by (used in) investing activities	**19,767**	(49,690)
FINANCING ACTIVITIES		
Issuance of Class A LP units *(note 1)*	**$ 11,031**	$ –
Distributions paid	**(79,989)**	(66,475)
Securities purchased under resale agreements and owned	**(104,440)**	110,088
Securities sold under repurchase agreements and sold short	**100,925**	(112,756)
Cash used in financing activities	**(72,473)**	(69,143)
Net increase in bank indebtedness during the year	**(132,503)**	(28,862)
Bank indebtedness, beginning of year	**(198,500)**	(169,638)
Bank indebtedness, end of year	**$ (331,003)**	$ (198,500)
Supplemental cash flow information		
Interest paid	**$ 15,951**	$ 12,989

See accompanying notes

FIRST NATIONAL FINANCIAL LP

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

(in $000s, except per unit amounts or unless otherwise noted)

NOTE 1

GENERAL ORGANIZATION AND BUSINESS OF FIRST NATIONAL FINANCIAL LP

First National Financial LP [the "Company" or "FNFLP"], a limited partnership established under the laws of Ontario, is a Canadian-based originator, underwriter and servicer of predominantly prime single-family residential and multi-unit residential and commercial mortgages.

As a Canada Mortgage and Housing Corporation approved lender, the Company is active in the single-family residential and commercial mortgage markets. As at December 31, 2008, the Company had mortgages under administration of $40,596,013 [2007 – $33,114,415] and cash held in trust of $334,451 [2007 – $324,915]. Mortgages under administration are serviced for financial institutions such as insurance companies, pension funds, mutual funds, trust companies, credit unions and special purpose entities [including trusts], also referred to as securitization vehicles. As at December 31, 2008, the Company administered 133,177 mortgages [2007 – 109,909] for 109 institutional investors [2007 – 109] with an average remaining term to maturity of 51 months [2007 – 57 months].

First National Financial Income Fund [the "Fund"] owns an indirect interest in FNFLP of 21.15% and First National Financial Corporation ["FNFC" or the "predecessor"] holds indirectly the controlling interest of 78.85%. 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. Pursuant to the Fund Distribution Reinvestment Plan initiated in April 2008, the Fund issued 881,113 additional Class A LP units. Accordingly, as at December 31, 2008, the Fund indirectly holds a 21.15% [2007 – 19.97%] interest in FNFLP and FNFC holds 78.85% [2007 – 80.03%] controlling interest in FNFLP.

Pursuant to the Limited Partnership Agreement between FNFLP, the Trust and FNFC dated June 15, 2006, First National Financial GP Corporation, as general partner, has full power and exclusive authority to employ all persons necessary for the conduct of the partnership, to enter into an agreement and to incur any obligation related to the affairs of the partnership and is entitled to full reimbursement of all costs and expenses incurred on behalf of the partnership. As general and administrative costs incurred by First National Financial GP Corporation are on behalf of the partnership, these costs have been reflected in the financial statements of FNFLP.

NOTE 2

SIGNIFICANT ACCOUNTING POLICIES

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Major areas requiring use of estimates by management are the securitization receivable and the fair values of financial assets and liabilities.

Adoption of new accounting standards

On January 1, 2008, the Company adopted three new accounting standards issued by the Canadian Institute of Chartered Accountants ["CICA"]: Section 1535 "Capital Disclosures", Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation". These new standards became effective for the Company on January 1, 2008.

Capital disclosures

Section 1535 specifies the disclosure of [i] an entity's objectives, policies and processes for managing capital; [ii] quantitative data about what the entity regards as capital; [iii] whether the entity has complied with any capital requirements; and [iv] if it has not complied, the consequences of such non-compliance. The Company has included disclosures recommended by the new Section as described below.

Financial instruments – disclosures and presentation

The new standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation", require the disclosure of information with regard to the significance of financial instruments for the Company's financial position and performance and the nature and extent of risks arising from financial instruments to which the Company is exposed and how the Company manages those risks.

Financial instrument classification is as follows:

Accounts receivable and sundry	Loans and receivables
Securities purchased under resale agreement	Loans and receivables
Securitization receivable	Held-for-trading
Mortgages accumulated for sale	Held-for-trading
Cash collateral and short-term notes held by securitization trusts	Held-for-trading
Mortgage commitments	Held-for-trading
Bonds owned and sold short	Held-for-trading
Mortgage and loan investments except for Commercial Mortgage-Backed Securities mortgages	Loans and receivables
Accounts payable and bank indebtedness	Other liabilities
Commercial Mortgage-Backed Securities mortgages included in mortgage and loan investments	Held-for-trading

Revenue recognition

The Company earns revenue from placement, securitization and servicing activities related to its mortgage business. The majority of originated mortgages are funded either by placement of mortgages with institutional investors or the sale of mortgages to securitization conduits. The Company retains servicing rights on substantially all of the mortgages it originates, providing the Company with servicing fees.

Placement fees are earned by the Company for its origination and underwriting activities on a completed transaction basis when the mortgage is funded. Amounts collected or collectible in excess of the mortgage principal are recognized as placement fees.

Securitization revenue consists of gains on securitization and residual securitization income. The Company complies with CICA Accounting Guideline 12, "Transfers of Receivables". Accordingly, gains on securitization are recognized in income at such time as the Company transfers mortgages to securitization vehicles and surrenders control whereby the transferred assets have been isolated presumptively beyond the reach of the Company and its creditors, even in bankruptcy or other receivership. When the Company securitizes mortgages, it generally retains a residual interest, presented in the balance sheets as securitization receivable, and the rights and obligations associated with servicing the mortgages. The measurement of gains or losses recognized on the sale of mortgages depends in part on the previous carrying amount of the transferred mortgages, as allocated between the assets sold and the interests that are retained by the Company as the seller, based on the relative fair value of the assets and the retained interest at the date of transfer. To obtain fair values, quoted market prices are used where available. Since quoted prices are generally not available for retained interests, the Company estimates fair value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected credit loss experience, prepayment rates and discount rates commensurate with the risks involved.

Residual securitization income represents the difference between the actual cash flows received on securitized mortgages and the assumed cash flows, recognized in income as received. Further, subsequent to securitization, the fair value of retained interests is measured quarterly and compared to the securitization receivable at the balance sheet dates. Should the securitization receivable differ from the fair value of the retained interests determined by reference to the underlying remaining expected cash flows, unrealized gain or loss on financial instruments is recorded in the statement of income to adjust the carrying value of the securitization receivable.

The Company services substantially all of the mortgages that it originates whether the mortgage is placed with institutional investors or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. Servicing revenue is recognized in income on an accrual basis and is collected on a monthly basis from institutional investors. For securitized mortgages, the Company retains the rights and obligations to service the mortgages and records a liability for future servicing and a reduction to gains on securitization revenue at the time of transfer. Servicing income related to securitized mortgages is accreted to income over the life of the servicing obligation and included in residual securitization income. Interest income earned by the Company related to servicing activities is classified as mortgage servicing income.

In addition to the foregoing sources of revenue, the Company earns interest income which is recorded on an accrual basis from its interest bearing assets including securitization receivable, mortgage and loan investments and mortgages accumulated for sale. Prior to placement or transfer, funded mortgages are presented in the balance sheets as mortgages accumulated for sale which are typically held for a period of less than 90 days and are carried at fair value.

Brokerage fees

Brokerage fees incurred to originate mortgages are deferred and amortized to income over the term of the underlying mortgage. Upon placement or securitization of the related mortgages, brokerage fees are recorded as an expense.

Cash collateral and short-term notes

Cash collateral and short-term notes held by securitization trusts are classified as held-for-trading under the FVO and recorded at fair value.

Mortgage and loan investments

Mortgage and loan investments are carried at their outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

Mortgage and loan investments are recognized as being impaired when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. An allowance for loan losses is established only for mortgages and loans that are known to be uncollectible. When management considers there to be no probability of collection, the investments are written off.

Mortgages accumulated for sale

Mortgages accumulated for sale are mortgages funded on behalf of the Company's investors. These mortgages are held for terms usually not exceeding 90 days. These mortgages are classified as held-for-trading under the FVO and recorded at fair value.

Purchased mortgage servicing rights

The Company purchases the rights to service mortgages from third parties. Purchased mortgage servicing rights are initially recorded at cost and charged to income over the life of the underlying mortgage servicing obligation. The fair value of such rights is determined on a periodic basis to assess the continued recoverability of the unamortized cost in relation to estimated future cash flows associated with the underlying serviced assets. Any loss arising from an excess of the unamortized cost over the fair value is immediately recorded as a charge to income.

Bonds sold short and bonds purchased under resale agreements

Bonds sold short consist of the short sale of a bond. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment by the Company to resell the bond to the original seller at a specified price. The Company uses combinations of bonds sold short and bonds purchased under resale agreements to economically hedge its mortgage commitments and the portion of mortgages accumulated for sale that it intends to sell.

Bonds sold short are classified as held-for-trading under the FVO and recorded at fair value. The accrued coupon on bonds sold short is recorded as interest expense. Bonds purchased under resale agreements are carried at cost plus accrued interest, which approximates market value. The difference between the cost of the purchase and the predetermined proceeds to be received on a resale agreement is recorded over the term of the hedged mortgages as an offset to interest expense. Transactions are recorded on a settlement date basis.

Bonds owned and bonds sold under repurchase agreements

The Company purchases bonds and enters into bond repurchase agreements to close out economic hedging positions when mortgages are sold to institutional investors or securitization vehicles.

These transactions are accounted for in a similar manner as the transactions described for bonds sold short and bonds purchased under resale agreements.

Income taxes

These financial statements are those of the partnership and do not reflect the assets, liabilities, revenues and expenses of its partners. FNFLP is a partnership carrying on business in Canada, and consequently, is not directly subject to federal or provincial income taxes. The income or loss for income tax purposes of the partnership is required to be allocated to FNFLP's partners.

Cash and cash equivalents

Cash and cash equivalents consist of cash balances with banks and bank indebtedness.

Derivative instruments

Derivative instruments are marked-to-market and recorded at fair value with the changes in fair value recognized in income as they occur. Positive values are recorded as assets and negative values are recorded as liabilities.

Capital assets

Capital assets are recorded at cost, less accumulated amortization, at the following annual rates and bases:

Computer equipment	30% declining balance
Office equipment	20% declining balance
Leasehold improvements	straight-line over the term of the lease
Computer software	30% declining balance except for computer license, which is straight-line over 10 years

Variable interest entities

The Company applies the guidance in CICA Accounting Guideline 15 ["AcG-15"], "Consolidation of Variable Interest Entities" when preparing its financial statements. AcG-15 provides a framework for identifying a variable interest entity ["VIE"] and requires a primary beneficiary to consolidate a VIE. A primary beneficiary is the enterprise that absorbs the majority of the VIE's expected losses or receives a majority of the VIE's residual returns, or both. The Company has interests in VIEs that are not consolidated because the Company is not considered the primary beneficiary.

NOTE 3

SECURITIZATION

The Company securitizes residential and commercial mortgage loans. In all of those securitizations, the Company retains servicing responsibilities and subordinate interests. In approximately 87% [2007 – 59%] of current-period securitizations, the Company securitized fixed-term mortgage loans through the NHA-MBS program and with institutional investors and received a fixed servicing fee for its servicing responsibilities. The remaining 13% [2007 – 41%] of those securitizations consisted of sales of fixed and floating rate mortgages to special purpose entities. In these cases, the Company does not receive an explicit servicing fee; instead, the Company receives subordinated interests consisting of rights to future cash flows arising after the investors in the special purpose entities have received the return for which they contracted, and provides credit enhancement to the special purpose entity in the form of cash collateral accounts and short-term notes. The investors and the special purpose entities have no recourse to the Company's other assets for failure of debtors to pay when due. The Company's retained interests are subject to credit, prepayment and interest rate risks on the transferred receivables.

During the year ended December 31, 2008, the Company securitized $689,311 [2007 – $1,859,808] of mortgage loans to special purpose entities, recognizing gains on securitization of $13,913 [2007 – $44,416]. The Company also recognized gains on securitization of $53,371 [2007 – $9,101], in addition to placement fees, from the placement with institutional investors of $4,804,888 mortgage loans during the year [2007 – $2,680,717]. Gains on securitization are net of losses from interest rate hedging of $8,222 [2007 – $357].

The liability for implicit servicing on securitization was $15,697 as at December 31, 2008 [2007 – $16,124]. In the absence of quoted market rates for servicing securitized assets, management has estimated, based on industry expertise, that the fair market value of this liability approximates its carrying value. Amortization of the servicing liability during the year ended December 31, 2008 amounted to $6,399 [2007 – $5,962] and is included in residual securitization income.

As part of its securitization activities, the Company provides cash collateral and invests in short-term notes for credit enhancement purposes as required by the rating agency. Credit exposure to securitized mortgages is limited to the securitization receivable, cash collateral and amounts invested in the notes. The securitization receivable is paid to the Company by the special purpose entity over the term of the mortgages, as monthly net spread income. The full amount of the cash collateral and the notes held by the securitization trusts, and accrued interest thereon, is also recorded as a receivable and the Company anticipates full recovery of these amounts. As at December 31, 2008, the cash collateral was $40,264 [2007 – $42,202] and the short-term notes were $13,934 [2007 – $13,372].

The key weighted average assumptions used in determining the securitization gains were as follows:

	2008	*2007*
Prepayment rate	**11.1%**	12.9%
Discount rate	**4.6%**	6.4%

There was no credit loss assumption used for insured mortgages as no loss is expected. For uninsured mortgages, the expected weighted average credit loss assumption used was 0.33% [2007 – 0.33%].

Cash flows received from securitization vehicles for the years ended December 31 are as follows:

	2008	*2007*
Proceeds from new securitizations	**$ 5,494,918**	$ 5,445,614
Receipts on securitization receivable	**53,088**	45,023

The Company uses various assumptions to value the securitization receivable [excluding cash collateral and short-term notes held by the securitization trusts], which are set out below in the table, including the rate of unscheduled prepayments. Accordingly, the securitization receivable is subject to measurement uncertainty. The effect of variations between actual experience and assumptions will be recorded in future statements of income and retained earnings.

Key economic weighted average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are as follows:

	Commercial mortgage loans		Residential mortgage loans	
2008	*Fixed rate*	*Adjustable*	*Fixed rate*	*Adjustable*
Fair value of securitization receivable (FVO)	**$ 37,620**	**$ 1,796**	**$ 38,263**	**$ 37,402**
Average life (in months) [1]	**61**	**22**	**45**	**37**
Prepayment speed assumption (annual rate)	**0.0%**	**32.2%**	**15.7%**	**16.3%**
Impact on fair value of 10% adverse change	**$ 19**	**$ 55**	**$ 1,081**	**$ 792**
Impact on fair value of 20% adverse change	**$ 38**	**$ 105**	**$ 2,117**	**$ 1,557**
Residual cash flows discount rate (annual)	**4.8%**	**4.1%**	**4.5%**	**4.4%**
Impact on fair value of 10% adverse change	**$ 449**	**$ 8**	**$ 304**	**$ 240**
Impact on fair value of 20% adverse change	**$ 889**	**$ 15**	**$ 604**	**$ 476**
Expected credit losses	**0.0%**	**0.1%**	**0.0%**	**0.0%**
Impact on fair value of 10% adverse change	**$ 107**	**$ 11**	**$ 410**	**$ 140**
Impact on fair value of 20% adverse change	**$ 214**	**$ 22**	**$ 821**	**$ 280**
Spread assumption	**0.3%**	**0.7%**	**0.5%**	**0.9%**
Impact on fair value of 10% adverse change	**$ 3,942**	**$ 180**	**$ 4,100**	**$ 9,080**
Impact on fair value of 20% adverse change	**$ 7,884**	**$ 359**	**$ 8,201**	**$ 16,959**

	Commercial mortgage loans		*Residential mortgage loans*	
2007	*Fixed rate*	*Adjustable*	*Fixed rate*	*Adjustable*
Fair value of retained interests (FVO)	$ 21,382	$ 1,238	$ 38,014	$ 28,284
Average life (in months) [1]	56	11	44	48
Prepayment speed assumption (annual rate)	0.38%	29.8%	16.7%	16.5%
Impact on fair value of 10% adverse change	$ 15	$ 54	$ 1,014	$ 728
Impact on fair value of 20% adverse change	$ 30	$ 104	$ 1,987	$ 1,428
Residual cash flows discount rate (annual)	6.4%	6.6%	6.3%	6.4%
Impact on fair value of 10% adverse change	$ 282	$ 7	$ 359	$ 264
Impact on fair value of 20% adverse change	$ 556	$ 14	$ 713	$ 524
Expected credit losses	0.07%	0.09%	0.20%	0.05%
Impact on fair value of 10% adverse change	$ 141	$ 10	$ 658	$ 84
Impact on fair value of 20% adverse change	$ 281	$ 20	$ 1,316	$ 168
Spread assumption	0.20%	0.71%	0.74%	0.78%
Impact on fair value of 10% adverse change	$ 2,135	$ 121	$ 3,241	$ 2,824
Impact on fair value of 20% adverse change	$ 4,271	$ 241	$ 6,454	$ 5,649

(1) The weighted-average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments and increased credit losses], which might magnify or counteract the sensitivities.

The Company estimates that the expected cash flows of the securitization receivable will be as follows:

2009	$ 41,605
2010	29,533
2011	20,953
2012	14,470
2013 and thereafter	8,520
	$ 115,081

Mortgages under administration are serviced as follows:

	2008	2007
Institutional investors	**$ 28,723,298**	$ 21,744,749
Securitization vehicles	**6,503,294**	6,007,966
CMBS conduits	**5,369,421**	5,361,700
	$ 40,596,013	$ 33,114,415

The Company's exposure to credit loss is limited to mortgages under administration totalling $1,114,466 [2007 – $1,372,970] of which $20,259 of mortgages have principal and interest payments outstanding as at December 31, 2008 [2007 – $10,620]. The Company incurred actual credit losses, net of recoveries, of $8,250 during the year ended December 31, 2008 [2007 – $1,128].

NOTE 4

MORTGAGE AND LOAN INVESTMENTS

As at December 31, 2008, mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms up to nine years.

Mortgage loan and investments consist of the following:

	2008	*2007*
Mortgage loans, classified as loans and receivable	**$ 55,191**	$ 82,353
Mortgage loans, designated as held for trading	**12,389**	–
Mortgage-backed securities, designated as held for trading	**5,370**	–
Subordinated note	**2,500**	–
	$ 75,450	$ 82,353

Mortgage and loan investments classified as loans and receivable are carried at outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

The following table discloses the composition of FNFLP's portfolio of mortgage and loan investments by geographic region as at December 31, 2008.

Province	***Portfolio balance***	***Percentage of portfolio***
Alberta	**$ 8,457**	**11.21**
British Columbia	**3,221**	**4.27**
Manitoba	**10,230**	**13.56**
New Brunswick	**854**	**1.13**
Newfoundland	**146**	**0.19**
Nunavut	**442**	**0.59**
Nova Scotia	**19**	**0.03**
Ontario	**33,045**	**43.80**
Prince Edward Island	**48**	**0.06**
Quebec	**17,526**	**23.23**
Saskatchewan	**894**	**1.18**
Yukon	**568**	**0.75**
	$ 75,450	**100.00**

These balances are net of discounts of $1,286, provisions for credit losses of $3,437, and a fair value increase of $527.

The portfolio contains $5,938 of insured mortgages and $69,512 of uninsured mortgages and loan investments as at December 31, 2008.

The following table discloses the mortgages that are past due as at December 31, 2008:

Days	Amount
31 to 60	**$ –**
61 to 90	**6,771**
Greater than 90	**2,739**
	$ 9,510

Of the above total amount of $9,510, the Company considers $5,433 as impaired for which it has provided an allowance for potential loss of $3,437 as at December 31, 2008.

Allowance for loan losses

The following table discloses the credit losses of mortgage and loan investments that are impaired:

	2008	*2007*
Balance, beginning of year	**$ 55**	$ –
Provisions for credit losses	**6,795**	55
Write-offs	**(3,413)**	–
Balance, end of year	**$ 3,437**	$ 55

Due to some specific regional issues the Company has experienced credit losses of $6,795 on these items for the year ended December 31, 2008 [2007 – nil]. These losses are included in other operating expenses in the statements of income and retained earnings.

The contractual repricing on the table below is based on the earlier of contractual repricing or maturity dates.

	2008					*2007*
	Within 1 year	*Over 1 to 3 years*	*Over 3 to 5 years*	*Over 5 years*	*Book value*	*Book value*
Residential	**$ 11,379**	**$ –**	**$ –**	**$ –**	**$ 11,379**	$ 4,684
Commercial	**44,711**	**4,654**	**197**	**14,509**	**64,071**	77,669
					$ 75,450	$ 82,353

The maturity profile of mortgage and loan investments is as follows:

2009	$ 56,090
2010	4,654
2011	197
2012	–
2013 and thereafter	14,509
	$ 75,450

The subordinated note was issued by a securitization trust not related to the Company. The Company's exposure is limited to $2,500.

Interest income for the year was $8,711 [2007 – $9,743] and is included in mortgage investment income on the statements of income and retained earnings.

NOTE 5

PURCHASED MORTGAGE SERVICING RIGHTS

Purchased mortgage servicing rights consist of the following components:

	2008			2007		
	Cost	*Accumulated amortization*	*Net book value*	*Cost*	*Accumulated amortization*	*Net book value*
Third-party commercial mortgage servicing rights	**$ 3,614**	**$ 2,283**	**$ 1,331**	$ 3,614	$ 1,708	$ 1,906
Commercial mortgage backed securities primary and master servicing rights	**8,705**	**1,405**	**7,300**	8,705	857	7,848
	$ 12,319	**$ 3,688**	**$ 8,631**	$ 12,319	$ 2,565	$ 9,754

During the year ended December 31, 2008, the Company purchased servicing rights valued at nil [2007 – $3,213]. Amortization charged to income for the year ended December 31, 2008 was $1,123 [2007 – $726].

During the year ended December 31, 2008, management determined that the estimated fair market value of these assets at any time was not less than the Company's unamortized cost; accordingly, no write-downs were recorded during the year.

NOTE 6

CAPITAL ASSETS

Capital assets consist of the following:

	2008			2007		
	Cost	*Accumulated amortization*	*Net book value*	*Cost*	*Accumulated amortization*	*Net book value*
Computer equipment	**$ 5,065**	**$ 2,790**	**$ 2,275**	$ 4,032	$ 2,037	$ 1,995
Office equipment	**2,945**	**1,776**	**1,169**	2,642	1,520	1,122
Leasehold improvements	**1,682**	**984**	**698**	2,012	916	1,096
Computer software	**2,429**	**1,306**	**1,123**	1,443	728	715
	$ 12,121	**$ 6,856**	**$ 5,265**	$ 10,129	$ 5,201	$ 4,928

NOTE 7

BANK INDEBTEDNESS

Bank indebtedness includes a one-year revolving line of credit of $378,300 [2007 – $300,000] maturing in June 2009, of which $320,100 [2007 – $182,200] was drawn at December 31, 2008 and against which the following have been pledged as collateral:

[a] a general security agreement over all assets, other than real property, of the Company; and
[b] a general assignment of all mortgages owned by the Company.

The revolving line of credit bears a variable rate of interest based on prime or bankers' acceptance rates.

NOTE 8

SWAP CONTRACTS

Swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates to a notional amount. The Company used interest rate swaps to manage interest rate exposure relating to variability of interest earned on commercial mortgages held on the balance sheets and to manage interest rate volatility associated with Commercial Mortgage Backed Securities ["CMBS"] payments held in trust as the master servicer. The master servicing swaps were unwound fully in 2008. The swap agreements that the Company entered into are interest rate swaps where two counterparties exchange a series of payments based on different interest rates applied to a notional amount in a single currency.

The following table presents the notional amounts and fair value of swap contracts as at December 31, 2008 and 2007 by remaining term to maturity:

	2008			
	3 to 5 years	***> 5 years***	***Total notional amount***	***Fair value***
Interest rate swap contracts	**$ 33,000**	**$ –**	**$ 33,000**	**$ (737)**

	2007			
	3 to 5 years	*> 5 years*	*Total notional amount*	*Fair value*
Interest rate swap contracts	$ –	$ 6,965	$ 6,965	$ 126

Positive fair values of the interest rate swap contracts are included in accounts receivable and sundry and negative fair values are included in accounts payable and accrued liabilities on the balance sheets.

NOTE 9

COMMITMENTS AND GUARANTEES

As at December 31, 2008, the Company has the following operating lease commitments for its office premises:

2009	3,019
2010	3,037
2011	1,896
2012	719
2013	320
2014 and thereafter	164
	9,155

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,277,364 as at December 31, 2008 [2007 – $1,801,339]. The commitments generally remain open for a period of up to 90 days. These commitments have credit and interest rate risk profiles similar to those mortgages which are currently under administration. Certain of these commitments have been sold to institutional investors while others will expire before being drawn down. Therefore, these amounts do not represent future cash requirements of the Company.

In the normal course of business, the Company enters into a variety of guarantees. Guarantees include contracts where the Company may be required to make payments to a party, based on changes in the value of an asset or liability that the party holds. In addition, contracts under which the Company may be required to make payments if a third party fails to perform under the terms of the contract [such as mortgage servicing contracts] are considered guarantees. The Company has determined that the estimated potential loss from these guarantees is insignificant.

NOTE 10

SECURITIES OWNED AND SOLD SHORT UNDER RESALE AND REPURCHASE AGREEMENTS

The Company's outstanding securities transactions under resale and repurchase agreements have a remaining term to maturity of less than one month.

NOTE 11

STATEMENTS OF CASH FLOWS

The net change in non-cash working capital balances related to operations consists of the following:

	2008	*2007*
Accounts receivable and sundry	**$ (7,396)**	$ (3,957)
Mortgages accumulated for sale, net	**(158,123)**	12,820
Accounts payable and accrued liabilities	**3,492**	(1,877)
Distributions payable	**1,244**	5,022
	$ (160,783)	$ 12,008

NOTE 12

FINANCIAL INSTRUMENTS

Risk management

The various risks to which the Company is exposed and the Company's policies and processes to measure and manage them individually are set out below:

Interest rate risk

Interest rate risk arises when changes in interest rates will affect the fair value of financial instruments.

The Company uses various strategies to reduce interest rate risk. This includes a hedging strategy against interest rate fluctuations provided by offsetting the exposure of the Company's bank indebtedness and funds held in trust. The bank indebtedness consists entirely of floating rate bank debt; the funds held in trust earn the Company interest based on the same floating rate basis [essentially the prime lending rate]. Because both are very similar in terms of amount [bank indebtedness is $331,003 at December 31, 2008, funds held in trust are $334,451 on the same date], the Company considers the arrangement to be a natural hedge against short-term interest rate fluctuations. Accordingly, as short-term interest rates change, the Company is not exposed to large fluctuations in net income.

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on net income of the Company in 2008 and 2007.

	Increase in interest rate		*Decrease in interest rate*	
	2008	*2007*	***2008***	*2007*
100 basis points shift				
Impact on net income and unitholders' equity	**$ 377**	$ 1,263	**$ (377)**	$ (1,263)
200 basis point shift				
Impact on net income and unitholders' equity	**$ 755**	$ 2,526	**$ (755)**	$ (2,526)

The Company's risk management objective is to maintain interest rate spreads from the point that a mortgage commitment is issued to the sale of the mortgage to the related securitization vehicle or institutional investor. 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 borrowers and the time the mortgage is sold to a securitization vehicle and the underlying cost of funding is fixed. As interest rates change, the values of these interest rate dependent financial instruments vary inversely with the values of the mortgage contracts. As interest rates increase, a gain will be recorded on the economic hedge which will be offset by the loss on the sale of the mortgage to the securitization vehicle or institutional investor as the mortgage rate committed to the borrower is fixed at the point of commitment. For single-family mortgages, only a portion of the 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 economically hedged is the expected value of the mortgage funding within the future commitment period.

As at December 31, 2008, the Company administered $68,993 of fixed rate commercial mortgages of which it has a direct interest of $13,941 included in mortgage and loan investments. The larger interests in these mortgages are owned by an arms-length investor and are subject to participation agreements such that this investor receives a floating rate of return on their portion of the mortgages. The Company has exposure to the risk that short term interest rates increase. Accordingly these mortgages are much more sensitive to changes in interest rates than the Company's typical mortgage and loan investments.

The Company's accounts receivable, accounts payable and accrued liabilities, purchased mortgage servicing rights and servicing liability are not exposed to interest rate risk. The Company's floating rate interest bearing assets and liabilities such as mortgage and loan investments and bank indebtedness are subject to interest rate cash flow risk.

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. The Company's credit risk is mainly lending-related in the form of mortgage default. The Company uses stringent underwriting criteria and experienced adjudicators to mitigate this risk. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. The Company's exposure is also mitigated by the short period over which a mortgage is held by the Company prior to securitization.

The maximum credit exposures of the financial assets are their carrying values as reflected on the balance sheets. The Company does not have significant concentration of credit within any particular geographic region or group of customers.

Mortgages accumulated for sale consist primarily of $224,570 first mortgages of which 83% are insured, 12% are uninsured but sold on commitment to institutional investors, and the remainder is low loan-to-value conventional. Securitization receivables and cash collateral and short-term notes held by securitization trusts represent the Company's retained interest in various securitizations as described in note 3. Mortgage and loan investments are primarily first and second mortgage charges on commercial properties with an average loan to value of 65% and average yield of 7% as described in detail in note 4. These mortgages are primarily bridge financing for the Company's borrowers and have a higher exposure to credit risk than the Company's primary commercial mortgage products. The majority of purchased mortgage servicing rights are investments in the servicing component of CMBS securitizations. The Company is at risk that the underlying mortgages default and the servicing cash flows cease. The large portfolio of individual mortgages that underlies these assets is diverse in terms of geographical locations, borrower exposure and underlying type of real estate. This mitigates the potential size of any credit losses. Securities sold under resale agreements are transacted with large regulated Canadian institutions such that credit loss is very remote. Securities owned are all government of Canada bond, and, as such, have virtually no possibility of credit loss.

Liquidity risk and capital resources

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they come due.

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 relatively low leveraged balance sheets. The Company's credit facilities are typically drawn to fund: [i] mortgages accumulated for sale, [ii] securitization receivables, and [iii] mortgage and loan investments. The Company has a credit facility with a syndicate of five banks which provides for a total of $378,300 in financing. Bank indebtedness also includes borrowings obtained through securitization transactions, outstanding cheques, and overdraft facilities.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and credit spreads. The level of market risk to which the Company is exposed varies depending on market conditions, expectations of future interest rates and credit spreads.

Fair value measurement

The fair value of a financial instrument is the amount at which the instrument could be exchanged between arm's-length parties, in circumstances other than a forced or liquidation sale. The Company uses valuation techniques to estimate fair values, including reference to third-party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods for each financial asset and financial liability are described below.

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used including those that are not fully supported by observable market prices or rates. The amount of the change in fair value recognized by the Company in net income for the year ended December 31, 2008 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately $5,202. Although the Company's management believes that the estimated fair values are appropriate at the balance sheet dates, those fair values may differ if other reasonably possible alternative assumptions are used.

Valuation methods and assumptions

The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

[a] Cash collateral and short-term notes held by securitization trusts

The fair value is determined by discounting the expected cash flows related to these assets at estimated market interest rates. These rates are determined based on the amount of variability, mitigated by the assumptions inherent in the calculation of the securitization receivable.

[b] Securitization receivable

The fair value of securitization receivable is determined by internal valuation models consistent with industry practice using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the mortgages securitized at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data. Refer to securitization note 3 for the key assumptions used and sensitivity analysis.

[c] Mortgages accumulated for sale

The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices for discount rates at which similar loans made to borrowers with similar credit profiles and maturities would be discounted and, therefore, reflects changes in interest rates which have occurred since the mortgages were originated. Impaired mortgages are recorded at net realizable value.

[d] Mortgage commitments

The fair value reflects changes in interest rates which have occurred since the mortgage commitments were issued and is determined using standard industry pricing practices.

[e] Bonds sold short or purchased

The fair value of bonds sold short or purchased used by the Company to hedge its interest rate exposure is determined by independent third-party valuation providers using proprietary pricing models, incorporating prevailing market rates and prices on underlying instruments with similar maturities and characteristics.

[f] Other financial assets and liabilities

The fair value of mortgage and loan investments classified as loans and receivable and bank indebtedness corresponds to the respective outstanding amounts due to their short-term maturity profiles.

[g] Impact of changes in fair values

The following table presents changes in the fair values of the Company's financial assets and financial liabilities for the year ended December 31, 2008, all of which have been designated as held-for-trading under the FVO except for the interest rate swaps which are required to be classified as held-for-trading:

	2008	*2007*
Securitization receivable	**$ (10,032)**	$ (15,669)
Mortgages accumulated for sale	**3,528**	(2,972)
Mortgage and loan investments	**527**	–
Bonds sold short and owned	**(7,798)**	(2,892)
Cash collateral and short-term notes held by securitization trusts	**(165)**	(3,011)
Interest rate swaps	**334**	–
Mortgage commitments	**940**	213
	$ (12,666)	$ (24,331)

The above $12,666 include a realized loss of $5,857.

The fair value of financial instruments not listed above approximates their carrying value. The interest rate swaps are included in accounts payable and accrued liabilities and have a carrying value of $737 as at December 31, 2008. Mortgage commitments are also included in accounts payable and accrued liabilities and have a carrying value of $940 as at December 31, 2008.

Fee income

This revenue is interest earned on funds held in trust and is included in mortgage servicing income on the statements of income and retained earnings. These funds are administered by the Company and include borrowers' property tax escrow. For the year ended December 31, 2008, this revenue was $9,577 [2007 – $11,793].

NOTE 13

CAPITAL MANAGEMENT

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's equity and retained earnings. The Company does not have any long-term debt and therefore the net income generated from operations is available for reinvestment in the Company or distribution to the unitholders. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year-over-year sustainable profit growth. The Board of Directors also reviews on a monthly basis the level of distributions paid to the unitholders. There were no changes in the Company's approach to capital management during the year ended December 31, 2008. The Company has a minimum capital requirement as stipulated by its bank credit facility. The agreement requires a debt to equity ratio of 4:1. As at December 31, 2008, the ratio was 2.32:1. The Company was in compliance with the Bank agreement throughout the year.

NOTE 14

INFORMATION ABOUT MAJOR CUSTOMERS

Placement fees, mortgage servicing income and gains on securitization revenue from three Canadian financial institutions represent approximately 51% of the Company's total revenue. During the year ended December 31, 2008, the Company placed 87% [2007 – 55%] of all mortgages it originated with the same three institutional investors.

NOTE 15

EARNINGS PER UNIT

Earnings per unit are calculated as follows:

	2008	*2007*
Net income for the year available to unitholders	**$ 108,021**	$ 72,844
Number of equivalent unitholders [Class A and B]	**59,595**	59,086
Basic earnings per unit	**1.81**	1.23

NOTE 16
EARNINGS BY BUSINESS SEGMENT

The Company operates principally in two segments, being Residential and Commercial. These segments are organized by mortgage type and contain revenue and expenses related to origination, underwriting, securitization and servicing activities. Expenses not allocated to segments relate to compensation paid to senior management. Identifiable assets are those used in the operations of the segments.

		2008	
	Residential	*Commercial*	*Total*
REVENUE			
Placement, securitization and servicing	**$ 218,934**	**$ 52,877**	**$ 271,811**
Mortgage investment income	**10,437**	**11,711**	**22,148**
	229,371	**64,588**	**293,959**
EXPENSES			
Amortization	**1,310**	**345**	**1,655**
Interest	**10,568**	**5,095**	**15,663**
Other operating	**141,568**	**25,552**	**167,120**
Corporate non-allocated expenses	**–**	**–**	**1,500**
	153,446	**30,992**	**185,938**
Net income for the year	**75,925**	**33,596**	**108,021**
Identifiable assets	**399,185**	**337,880**	**737,065**
Capital expenditures	**$ 1,393**	**$ 599**	**$ 1,992**

		2007	
	Residential	*Commercial*	*Total*
REVENUE			
Placement, securitization and servicing	$ 185,271	$ 32,369	$ 217,640
Mortgage investment income	9,207	12,124	21,331
	194,478	44,493	238,971
EXPENSES			
Amortization	982	260	1,242
Interest	8,116	5,089	13,205
Other operating	132,723	17,457	150,180
Corporate non-allocated expenses	–	–	1,500
	141,821	22,806	166,127
Net income for the year	52,657	21,687	72,844
Identifiable assets	235,770	224,566	460,336
Capital expenditures	$ 1,726	$ 730	$ 2,456

NOTE 17

UNITHOLDERS' EQUITY

Pursuant to the Fund Distribution Reinvestment Plan ["DRIP"] initiated in April 2008, eligible Canadian unitholders are allowed to elect to have their cash distributions from the Fund automatically reinvested in additional units. Unitholders who participate in the DRIP will receive a further bonus distribution of units equal in value to 5% of each distribution that was reinvested.

The price of such Plan Units shall be equal to the volume weighted average price of the Trust Units on the Toronto Stock Exchange for the ten business days immediately prior to the applicable Distribution Date.

The following units are issued and outstanding:

	Number of units		*Amount*
GP units			
Units outstanding,			
January 1, 2008 and 2007	1	$	59
Units outstanding,			
December 31, 2008	**1**	**$**	**59**
Class A LP units			
Units outstanding,			
January 1, 2008 and 2007	11,800,000	$	109,140
Issued pursuant to the DRIP			
during the year	881,113		11,031
Units outstanding,			
December 31, 2008	**12,681,113**	**$**	**120,171**
Class B LP units			
Units outstanding,			
January 1, 2008 and 2007	47,286,316	$	(22,940)
Units outstanding,			
December 31, 2008	**47,286,316**	**$**	**(22,940)**

The Company is authorized to issue an unlimited number of GP units, Class A LP units and Class B LP units. The Class B LP units are exchangeable for units of the Fund at the option of the holder subject to certain conditions.

NOTE 18

RELATED PARTY

During the year, one of the Company's borrowers tendered a large commercial mezzanine mortgage. The amount of the mortgage was in excess of the Company's internal investment policies for investments of that nature; however, a business controlled by a senior executive of the Company entered into an agreement with the borrower to fund the mortgage. The Company serviced this mortgage during its term at normal commercial servicing rates. The mortgage funded and was paid out in full in December 2008.

NOTE 19

FUTURE ACCOUNTING CHANGES

International Financial Reporting Standards ["IFRS"]

In January 2006, the Canadian Accounting Standards Board announced its decision requiring all publicly accountable enterprises to report under 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. The Company is currently evaluating the impact of this changeover on its interim and annual financial statements.

NOTE 20

COMPARATIVE FINANCIAL STATEMENTS

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the 2008 financial statements.

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ANNUAL MEETING
May 5, 2009, 10 a.m. ET
TSX Broadcast & Conference Centre
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