



## **HARVEST Banks & Buildings Income Fund**

### **Annual Financial Statements**

**December 31, 2012**

The Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure, can be obtained at your request, and at no cost, by calling us at 866 998 8298; by writing to us at Harvest Portfolios Group, 710 Dorval Drive, Suite 209, Oakville, Ontario, L6K 3V7; by visiting our website at [www.harvestportfolios.com](http://www.harvestportfolios.com); or on SEDAR at [www.sedar.com](http://www.sedar.com).



# HARVEST Banks & Buildings Income Fund

## MANAGEMENT RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying financial statements have been prepared by Harvest Portfolios Group Inc. in its capacity as Manager of the Fund and approved by the Board of Directors of the Manager. The Fund's Manager is responsible for the information and representation contained in these financial statements.

The Manager maintains appropriate processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include certain amounts that are based on estimates and judgments made by the Manager. The significant accounting policies, which the Manager believes are appropriate, are described in Note 2 to the financial statements.

PricewaterhouseCoopers LLP are the external auditors of the Fund. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the financial statements. Their report is set out below.

On behalf of Harvest Portfolios Group Inc.,



Michael Kovacs  
President and Chief Executive Officer



Townsend Haines  
Chief Financial Officer

Oakville, Canada  
March 8, 2013



March 8, 2013

## **Independent Auditor's Report**

### **To the Unitholders of Harvest Banks & Buildings Income Fund (the Fund)**

We have audited the accompanying financial statements of the Fund, which comprise the statement of investments as at December 31, 2012, the statements of financial position as at December 31, 2012 and 2011 and the statements of operations and changes in financial position for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the financial statements**

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

#### **Auditor's responsibility**

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

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

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

#### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2012 and 2011 and the results of its operations and the changes in its financial position for the years then ended in accordance with Canadian generally accepted accounting principles.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants, Licensed Public Accountants**

*PricewaterhouseCoopers LLP*

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

## HARVEST Banks & Buildings Income Fund

<b>STATEMENTS OF FINANCIAL POSITION</b>			
<b>As at December 31,</b>		<b>2012</b>	<b>2011</b>
<b>Assets</b>			
Investments, at fair value (cost:\$18,794,199; 2011 :\$15,267,258)	\$	21,963,933	\$ 17,112,084
Cash and cash equivalents		1,119,830	485,941
Dividends and interest receivable		82,398	131,453
Subscriptions receivable		17,435	-
		<b>23,183,596</b>	<b>17,729,478</b>
<b>Liabilities</b>			
Redemptions payable		73,061	4,220
Distributions payable		53,447	29,723
		<b>126,508</b>	<b>33,943</b>
<b>Net assets representing unitholders' equity</b>	\$	<b>23,057,088</b>	\$ <b>17,695,535</b>
<b>Net assets representing unitholders' equity</b>			
Series R	\$	<b>13,271,109</b>	\$ <b>16,137,857</b>
Series A		<b>9,178,497</b>	<b>1,403,211</b>
Series F		<b>607,482</b>	<b>154,467</b>
<b>Number of units outstanding (Note 3)</b>			
Series R		<b>1,064,817</b>	<b>1,390,604</b>
Series A		<b>739,087</b>	<b>120,977</b>
Series F		<b>48,147</b>	<b>13,283</b>
<b>Net assets per unit (Note 8)</b>			
Series R	\$	<b>12.46</b>	\$ <b>11.60</b>
Series A		<b>12.42</b>	<b>11.60</b>
Series F		<b>12.62</b>	<b>11.63</b>

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

# HARVEST Banks & Buildings Income Fund

<b>STATEMENTS OF OPERATIONS</b>			
<b>For the years ended December 31,</b>		<b>2012</b>	<b>2011</b>
<b>Investment income</b>			
Dividends	\$	734,335	\$ 1,596,169
Interest		80,159	239,203
Less: foreign withholding taxes		(80,059)	(67,478)
		<b>734,435</b>	<b>1,767,894</b>
<b>Expenses</b>			
Management fees (Note 4)		273,247	452,961
Service fees (Note 4)		167,024	151,275
Unitholder reporting costs (Note 4)		57,849	181,447
Audit fees		25,414	24,947
Transfer agency fees		69,500	44,436
Custodian fees and bank charges		44,326	48,783
Independent review committee fees		6,690	16,220
Interest expense ( Note 9)		-	120,832
Filing fees		18,335	54,194
Legal fees		22,884	150,729
		<b>685,269</b>	<b>1,245,824</b>
Expenses absorbed by manager (Note 4)		(63,000)	(49,854)
		622,269	1,195,970
<b>Net investment income</b>	<b>\$</b>	<b>112,166</b>	<b>\$ 571,924</b>
<b>Realized and unrealized gain / (loss) on investments and foreign currencies</b>			
Realized gain on sale of investments		1,452,247	446,843
Realized gain / (loss) on foreign exchange		(4,762)	69,521
Transaction costs		(43,573)	(138,329)
Unrealized appreciation of foreign exchange		451	169
Unrealized appreciation / (depreciation) of investments		1,324,908	(2,651,583)
<b>Net gain/ (loss) on investments</b>	<b>\$</b>	<b>2,729,271</b>	<b>\$ (2,273,379)</b>
<b>Increase /(decrease) in net assets from operations</b>	<b>\$</b>	<b>2,841,437</b>	<b>\$ (1,701,455)</b>
Increase/(decrease) in net assets from operations - <b>Series R</b>	\$	2,097,812	\$ (1,753,578)
Increase in net assets from operations - <b>Series A*</b>		687,975	50,182
Increase in net assets from operations - <b>Series F*</b>		55,650	1,941
Increase /(decrease) in net assets from operations per unit - <b>Series R</b>	\$	1.79	\$ (0.60)
Increase in net assets from operations per unit - <b>Series A*</b>		1.16	0.51
Increase in net assets from operations per unit - <b>Series F*</b>		1.55	0.08

\*Series A & Series F commenced operations on October 22, 2011 and October 27, 2011, respectively.

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



## HARVEST Banks & Buildings Income Fund

<b>STATEMENTS OF CHANGES IN FINANCIAL POSITION</b>			
<b>ALL SERIES</b>			
<b>For the years ended December 31,</b>	<b>2012</b>		<b>2011</b>
<b>Net assets, beginning of the year</b>	\$	<b>17,695,535</b>	\$ <b>28,838,327</b>
Increase / (decrease) in net assets from operations		2,841,437	(1,701,455)
<b>Unitholders' transactions</b>			
Proceeds from issue of units		15,301,660	27,958,576
Reinvestments of distributions		943,708	281,955
Cost of units cancelled		-	(235,233)
Cost of units redeemed		(12,201,531)	(34,312,367)
Agents' fees		-	(618,024)
<b>Net unitholders' transactions</b>	\$	<b>4,043,837</b>	\$ <b>(6,925,093)</b>
<b>Distributions to unitholders</b>			
Net investment income		-	(92,800)
Return of capital		(1,523,721)	(2,423,444)
<b>Total distributions to unitholders</b>	\$	<b>(1,523,721)</b>	\$ <b>(2,516,244)</b>
<b>Net assets, end of the year</b>	\$	<b>23,057,088</b>	\$ <b>17,695,535</b>

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

## HARVEST Banks & Buildings Income Fund

### STATEMENTS OF CHANGES IN FINANCIAL POSITION

#### SERIES R

For the years ended December 31,

	2012	2011
<b>Net assets, beginning of the year</b>	<b>\$ 16,137,857</b>	<b>\$ 28,838,327</b>
Increase / (decrease) in net assets from operations	2,097,812	(1,753,578)
<b>Unitholders' transactions</b>		
Proceeds from issue of units	3,127,309	26,070,534
Reinvestments of distributions	653,371	262,225
Cost of units cancelled	-	(235,233)
Cost of units redeemed	(7,772,978)	(33,936,617)
Agents' fees	-	(618,024)
<b>Net unitholders' transactions</b>	<b>(3,992,298)</b>	<b>(8,457,115)</b>
<b>Distributions to unitholders</b>		
Net investment income	-	(91,834)
Return of capital	(972,262)	(2,397,943)
<b>Total distributions to unitholders</b>	<b>\$ (972,262)</b>	<b>\$ (2,489,777)</b>
<b>Net assets, end of the year</b>	<b>\$ 13,271,109</b>	<b>\$ 16,137,857</b>

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

## HARVEST Banks & Buildings Income Fund

<b>STATEMENT OF CHANGES IN FINANCIAL POSITION</b>			
<b>SERIES A</b>			
<b>For the years ended December 31,</b>	<b>2012</b>		<b>2011</b>
<b>Net assets, beginning of the year</b>	\$	<b>1,403,211</b>	\$ -
Increase in net assets from operations		687,975	50,182
<b>Unitholders' transactions</b>			
Proceeds from issue of units		11,421,272	1,492,005
Reinvestments of distributions		268,889	14,497
Cost of units redeemed		(4,082,555)	(132,239)
<b>Net unitholders' transactions</b>		<b>7,607,606</b>	<b>1,374,263</b>
<b>Distributions to unitholders</b>			
Net investment income		-	(775)
Return of capital		(520,295)	(20,459)
<b>Total distributions to unitholders</b>	\$	<b>(520,295)</b>	\$ <b>(21,234)</b>
<b>Net assets, end of the year</b>	\$	<b>9,178,497</b>	\$ <b>1,403,211</b>

\*Series A commenced operations on October 22, 2011.

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



## HARVEST Banks & Buildings Income Fund

### STATEMENTS OF CHANGES IN FINANCIAL POSITION

#### SERIES F\*

For the years ended December 31,

		2012		2011
Net assets, beginning of the year	\$	154,467	\$	-
Increase in net assets from operations		55,650		1,941
<b>Unitholders' transactions</b>				
Proceeds from issue of units		753,079		396,037
Reinvestments of distributions		21,448		5,233
Cost of units redeemed		(345,998)		(243,511)
<b>Net unitholders' transactions</b>		<b>428,529</b>		<b>157,759</b>
<b>Distributions to unitholders</b>				
Net investment income		-		(191)
Return of capital		(31,164)		(5,042)
<b>Total distributions to unitholders</b>	\$	<b>(31,164)</b>	\$	<b>(5,233)</b>
<b>Net assets, end of the year</b>	\$	<b>607,482</b>	\$	<b>154,467</b>

\*Series F commenced operations on October 27, 2011.

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



# HARVEST Banks & Buildings Income Fund

## STATEMENT OF INVESTMENTS

As at December 31, 2012

Number of Shares	Security	Average Cost (\$)	Fair Value (\$)	% of Net Assets
<b>EQUITIES</b>				
<b>Real Estate Issuers</b>				
14,500	American Capital Agency Corporation	415,883	417,826	1.8
30,000	Annaly Capital Management Inc.	504,276	419,090	1.8
92,500	Artis Real Estate Investment Trust	865,060	1,446,700	6.3
158,824	BTB Real Estate Investment Trust	472,708	676,590	2.9
200,000	C2C Industrial Properties Inc.	910,000	798,000	3.5
50,000	Cominar Real Estate Investment Trust	886,904	1,127,500	4.9
70,000	Crombie Real Estate Investment Trust	779,040	1,032,500	4.5
36,000	Mainstreet Equity Corporation	821,831	1,187,280	5.1
50,000	Primaris Retail Real Estate Investment Trust	1,191,555	1,343,000	5.8
71,490	Timbercreek Mortgage Investment Corp	758,647	726,338	3.1
		<b>7,605,904</b>	<b>9,174,824</b>	<b>39.7</b>
<b>Banking and Other Financial Issuers</b>				
125,000	Bank of America Corporation	1,020,381	1,445,010	6.3
13,000	Bank of Montreal	734,897	790,530	3.4
20,000	Great-West Lifeco Inc.	500,729	485,600	2.1
20,300	JPMorgan Chase & Co.	733,064	889,157	3.9
23,000	Power Corporation of Canada	609,058	581,670	2.5
16,000	Royal Bank of Canada	842,750	956,960	4.2
9,800	State Street Corporation	452,910	458,717	2.0
36,000	Sun Life Financial Inc.	912,750	948,240	4.1
15,000	The Bank of Nova Scotia	781,188	861,300	3.7
14,500	The Toronto-Dominion Bank	1,075,477	1,212,925	5.3
100,000	Tricon Capital Group, Inc.	566,600	634,000	2.7
18,000	The Bank of New York Mellon Corporation	452,790	460,790	2.0
31,000	Wells Fargo & Co.	852,358	1,055,950	4.6
		<b>9,534,952</b>	<b>10,780,849</b>	<b>46.8</b>
<b>Other Public Issuers</b>				
30,000	Inter Pipeline Fund LP, Class A	428,590	704,400	3.1
		<b>428,590</b>	<b>704,400</b>	<b>3.1</b>
<b>Health Care Issuers</b>				
60,000	Amica Mature Lifestyles Inc.	540,000	549,000	2.4
		<b>540,000</b>	<b>549,000</b>	<b>2.4</b>
	<b>Total equities</b>	<b>18,109,446</b>	<b>21,209,073</b>	<b>92.0</b>
<b>Par Value</b>				
393,408	Boralex Inc. 6.75% Jun 30/17	396,162	417,012	1.8
336,000	BTB Real Estate Investment Trust 8.50% Mar 31/13	288,591	337,848	1.5
	<b>Total fixed income</b>	<b>684,753</b>	<b>754,860</b>	<b>3.3</b>
	<b>Total investments</b>	<b>18,794,199</b>	<b>21,963,933</b>	<b>95.3</b>
	<b>Other assets less liabilities</b>		<b>1,093,155</b>	<b>4.7</b>
	<b>Net Assets</b>		<b>23,057,088</b>	<b>100.0</b>

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

## HARVEST Banks & Buildings Income Fund

### CONCENTRATION BY GEOGRAPHY AS AT DECEMBER 31, 2012

As at December 31,	2012		2011	
Country of Issue	\$*	As a % of net assets	\$*	As a % of net assets
Canada	17,886,638	77.7	16,267,282	91.9
United States of America	5,170,450	22.3	1,428,253	8.1
<b>Totals</b>	<b>23,057,088</b>	<b>100.0</b>	<b>17,695,535</b>	<b>100.0</b>

\*Stated in Canadian dollars

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

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

### 1. ORGANIZATION

Harvest Banks & Buildings Income Fund (the “Fund”) is an investment trust established under the laws of the Province of Ontario pursuant to a Declaration of Trust dated September 25, 2009, as amended and restated on October 2, 2009, being the inception date. There was no significant activity in the Fund from the date of inception, October 2, 2009 to commencement of operations on October 23, 2009.

The Fund became an open-end mutual fund on October 18, 2011 (the “Conversion Date”). On the Conversion Date, the Units became redeemable at net asset value per unit on a daily basis, and the Fund became subject to National Instrument 81-102.

The Fund offers Series R, Series A and Series F units, only through registered dealers. Series R is the Series in which all existing unitholders at October 18, 2011 were rolled into on the Conversion Date, on a unit-for-unit basis. New purchases in Series R are available to existing unitholders only, in an initial sales charge option. Series A, which commenced operations on October 22, 2011, are available to all investors in an initial sales charge option and have a higher advisory fee than Series R. Series F units, which commenced operations on October 27, 2011, have no initial sales charge option and no advisory fees and are usually only available to investors who have fee-based accounts with the dealers.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### Basis of presentation

These financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and are presented in Canadian dollars. The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions. Such estimates and assumptions affect reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and reported amounts of income and expenses during the reporting period. Actual results could differ from these estimates.

#### Valuation of investments

The fair value of investments as at the financial reporting date is as follows:

- a) Investments are categorized as held for trading in accordance with CICA Handbook Section 3855 Financial Instruments – Recognition and Measurement. Investments held that are traded on an active market are valued at their bid prices through recognized public stock exchanges or through recognized investment dealers on the valuation date. Investments held include equities, bonds and other debt instruments.
- b) Investments held with no available bid prices are valued at their closing sale price. Investments held that are not traded on an active market are valued using valuation techniques, on such basis and in such a manner established by the Manager. The value of any security for which, in the opinion of the Manager, the published market quotations are not readily available shall be the fair value as determined by the Manager in accordance with Section 3855 methodologies. The fair values of certain securities are determined using valuation models that are based, in part, on assumptions that are not supported by observable market inputs. These methods and procedures may include, but are not limited to, performing comparisons with prices of comparable or similar securities, obtaining valuation related information from issuers and/or other analytical data relating to the investment and using other available indication of value. These values are independently assessed internally to ensure that they are reasonable. However, because of the inherent uncertainty of valuation, the estimated fair values for the aforementioned securities and interests may be materially different from the values that would be used had a ready market for the security existed. The fair values of such securities are affected by the perceived credit risks of the issuer, predictability of cash flows and length of time to maturity. At December 31, 2012 and 2011, there were no securities that required pricing using assumptions.
- c) Unlisted warrants are valued based on a pricing model which considers factors such as the market value of the underlying security, strike price, volatility and terms of the warrant.

# **HARVEST Banks & Buildings Income Fund**

## **NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2012**

National Instrument 81-106 – “Investment Fund Continuous Disclosure” (“NI 81-106”) requires all investment funds to calculate net asset value for all purposes other than for financial statements in accordance with part 14.2, which differs in some respects from the requirements of Section 3855 of Canadian GAAP. Canadian GAAP includes the requirement that the fair value of financial instruments listed on a recognized public stock exchange be valued at their last bid price for securities held in a long position and at their last ask price for securities held in a short position, instead of their close price or the last sale price of the security for the day as required by NI 81-106. This results in differences between net asset value (“NAV”) calculated based on NI 81-106 and on net assets calculated based on Canadian GAAP (“Net assets”). Reconciliation between NAV per unit and Net assets per unit at the period end is provided in Note 8.

### **Cash and cash equivalents**

Cash is comprised of cash on deposit. Cash equivalents are comprised of highly liquid investments having terms to maturity of 90 days or less.

### **Other assets and liabilities**

For the purposes of categorization in accordance with CICA Handbook Section 3862, accrued interest and dividends and other net assets are designated as loans and receivables and recorded at cost or amortized cost. Similarly, amounts due to unitholders for distributions and redemptions are designated as other financial liabilities and reported at cost or amortized cost, which approximates fair value for these assets and liabilities.

### **Transaction costs**

Transaction costs, such as brokerage commissions, incurred on the purchase and sale of securities by the Fund are expensed in accordance with Section 3855 and are recognized in the Statement of Operations in the period in which they are incurred.

### **Investment transactions and income recognition**

Investment transactions are accounted for on the trade date. The cost of investments which represents the amount paid for each security is determined on an average cost basis excluding transaction costs. Realized gains and (losses) from the sale of investments and unrealized appreciation/(depreciation) of investments are calculated on an average cost basis.

Investment income is recorded on an accrual basis. Interest income is recorded on an accrual basis and dividend income is recorded on the ex-dividend date.

Distributions received from income trusts are recorded as income, capital gains or a return of capital, based on the best information available to the Manager. Due to the nature of these investments, actual allocations could vary from this information. Distributions from investment trusts treated as a return of capital reduce the average cost of the underlying investment trust. Distributions received from mutual funds are recognized in the same form in which they are received from the underlying funds.

### **Allocation of income and expense, and realized and unrealized capital gains and losses:**

Management fees directly attributable to a series are charged to that series. The Fund's shared operating expenses, income, and realized and unrealized capital gains and losses are generally allocated proportionately to each series based upon the relative Net Asset Value of each series.

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

### Foreign currency translation

Purchases and sales of investments denominated in foreign currencies and foreign currency dividend and interest income are translated into Canadian dollars at the rate of exchange prevailing at the time of the transactions. Realized and unrealized foreign currency gains or (losses) on investments are included in the Statements of Operations in “Realized gain (loss) on sale of investments” and “Unrealized appreciation (depreciation) of investments”, respectively. Realized and unrealized foreign currency gains or losses on assets, liabilities, and income, other than investments denominated in foreign currencies, are included in the Statements of Operations in “Net realized and unrealized foreign exchange gain (loss)”.

Assets and liabilities in the Statement of Financial Position are translated into Canadian dollars on the statement date.

### Securities valuation

The Net Asset Value per unit of each series is determined at the close of business each day the Toronto Stock Exchange is open for business.

The Net Asset Value of each series of the Fund is computed by calculating the value of that series' proportionate share of the Fund's common assets less common liabilities and less those series-specific liabilities. Expenses directly attributable to a series are charged to that series. Other income and expenses are allocated to each series proportionately based on the relative Net Asset Value of each series.

### Increase (decrease) in net assets from operations per unit

“Increase (decrease) in net assets from operations per unit” in the Statements of Operations represents the increase (decrease) in net assets from operations for the period, attributed to each series, divided by the weighted average units outstanding for that series for the period.

### Fair value of financial instruments

The table below summarizes the fair value of the Fund's financial instruments using the following fair value hierarchy:

**Level 1:** Quoted prices (unadjusted) in active markets for identical assets or liabilities.

**Level 2:** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

**Level 3:** Inputs for the assets or liabilities that are not based on observable market data. Additional quantitative disclosures are required for Level 3 securities.

### Securities classification for the periods ended December 31, 2012 and 2011

Investments at fair value as at December 31, 2012				
	Level 1 (\$)	Level 2 (\$)	Level 3 (\$)	Totals (\$)
<b>Equities</b>				
Common stock	13,315,129	-	-	13,315,129
Mutual fund	726,338	-	-	726,338
Limited partnership	704,400	-	-	704,400
REIT	6,463,206	-	-	6,463,206
<b>Total equities</b>	<b>21,209,073</b>	-	-	<b>21,209,073</b>
<b>Fixed income</b>				
Corporate bonds	754,860	-	-	754,860
<b>Total fixed income</b>	<b>754,860</b>	-	-	<b>754,860</b>
<b>Total investments at fair value</b>	<b>21,963,933</b>	-	-	<b>21,963,933</b>

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

Investments at fair value as at December 31, 2011				
	Level 1 (\$)	Level 2 (\$)	Level 3 (\$)	Totals (\$)
<b>Equities</b>				
Common stock	8,223,806	-	-	8,223,806
Mutual fund	265,096	-	-	265,096
Limited partnership	853,300	-	-	853,300
REIT	7,020,013	-	-	7,020,013
Warrants	-	4,725	-	4,725
<b>Total equities</b>	<b>16,362,215</b>	<b>4,725</b>	<b>-</b>	<b>16,366,940</b>
<b>Fixed income</b>				
Corporate bonds	745,144	-	-	745,144
<b>Total fixed income</b>	<b>745,144</b>	<b>-</b>	<b>-</b>	<b>745,144</b>
<b>Total investments at fair value</b>	<b>17,107,359</b>	<b>4,725</b>	<b>-</b>	<b>17,112,084</b>

There were no Level 3 securities held by the Fund as at December 31, 2012 and 2011. There were no transfers between Level 1 and Level 2 for the periods ended December 31, 2012 and 2011.

### Transition to International Financial Reporting Standards (“IFRS”)

On December 12, 2011, the Canadian Accounting Standards Board (“AcSB”) extended the deferral of the mandatory International Financial Reporting Standards (“IFRS”) changeover date for investment entities to fiscal year beginning on or after January 1, 2014.

In October 2012, the IASB issued Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27), which provides an exception to consolidation for a class of entities that are defined as ‘investment entities’. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating those subsidiaries. The Fund expects to meet the proposed criteria to qualify as investment entities and would measure all controlled investments at fair value with changes in fair value recognized through profit or loss.

In addition, on May 12, 2011, the International Accounting Standards Board (“IASB”) issued IFRS 13 – “Fair Value Measurement”, which defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. It only applies when other IFRS standards require or permit fair value measurement. If an asset or a liability measured at fair value has a bid price and an ask price, it requires valuation to be based on a price within the bid-ask spread that is most representative of fair value. It allows the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. This may result in eliminating the difference between the net asset value per units and net assets per units under current Canadian GAAP.

The Manager is currently assessing the Fund’s Unitholder structure and investments to determine the impact of these standards. The Manager has determined that there will likely be no material impact to the net asset value per units of each series of the Funds due to the changeover to IFRS. The major qualitative impact noted as of December 31, 2012 would be the addition of a statement of cash flows, the classification of puttable instruments, the reporting of future income tax assets or liabilities, where applicable, and additional note disclosures. However, this present determination is subject to change resulting from the issuance of new standards or new interpretations of existing standards.

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

### 3. UNITHOLDERS' EQUITY

The Fund is authorized to issue an unlimited number of transferable units and series.

Units of the Fund are offered for sale on a continuous basis and may be purchased or redeemed on any Valuation Date at the NAV per unit of a particular series. The NAV per unit of a series for the purposes of subscriptions or redemption is computed by dividing the NAV of the Fund attributable to the series (that is, the total fair value of the assets attributable to the series less the liabilities attributable to the series) by the total number of units of the series of the Fund outstanding at such time.

The following units were issued and redeemed during the periods indicated:

	Units outstanding		
	Series R	Series A	Series F
<b>Total outstanding as at December 31, 2010</b>	<b>2,114,483</b>	-	-
Subscriptions	2,060,579	23,466	2,249
Reinvestment of distributions	22,794	-	-
Redemptions	(2,647,108)	(11,592)	(21,365)
Units cancelled	(18,700)	-	-
Transfers between Series	(141,444)	109,103	32,399
<b>Total outstanding as at December 31, 2011</b>	<b>1,390,604</b>	<b>120,977</b>	<b>13,283</b>
Subscriptions	11,495	756,969	44,318
Reinvestment of distributions	53,285	22,014	1,737
Redemptions	(369,741)	(180,841)	(12,084)
Transfers between Series	(20,826)	19,968	893
<b>Total outstanding as at December 31, 2012</b>	<b>1,064,817</b>	<b>739,087</b>	<b>48,147</b>

### Distributions

Monthly distributions to unitholders are declared and paid to unitholders of record on the Valuation Date prior to the month-end, and automatically reinvested into additional units of the Fund at the month-end, unless unitholders specifically requested a cash distribution be paid. The total distributions were \$0.84 per unit (\$0.07 per unit per month) for the year ended December 31, 2012 (2011 - \$0.84).

### 4. EXPENSES

#### Management fees and servicing fees

Harvest Portfolios Group Inc. is the Manager of the Fund and is responsible for managing or arranging for managing the Fund's overall business and operations. The Manager has retained Avenue Investment Management Inc. ("Avenue" or the "Investment Manager") to provide investment management services to the Fund and pays Avenue a fee for its portfolio advisory service, from the management fee received from the Fund, calculated on the basis of the Fund's net assets.

Each series of units pays the Manager an annual management fee based on a percentage of the average daily NAV of the assets of the Fund attributable to that applicable series (the "Management Fee").

Dealers may be paid a servicing fee by the Manager from the Management Fee, in connection with Series A units and Series R units for ongoing services they provide to investors, including investment advice, account statements and newsletters. Generally, the servicing fees, plus applicable taxes, are payable quarterly in arrears based on the total client assets invested in each series of units of the Fund held by all of a Dealer's clients throughout the quarter. The Manager can change or cancel servicing fees at any time.



# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

The fees differ among the series of units of the Fund as set out in the chart below:

Fund Series	Annual Management fee	Dealer Service Fee	Total Fees
R	1.10%	0.40%	1.50%
A	1.10%	1.25%	2.35%
F	1.10%	0.00%	1.10%

### Operating expenses

The Fund is responsible for operating expenses relating to the carrying on of its business, including custodial services, interest, taxes, legal, audit fees, transfer agency services relating to the issue and redemption of units, and the cost of financial and other reports, costs and expenses for the Fund's Independent Review Committee ("IRC"), including fees and expenses of the IRC members and compliance with applicable laws, regulations and policies.

The Manager may, in some cases, absorb a portion of the Fund's operating expenses. The amount of absorption for year ended December 31, 2012 is \$63,000 (2011 - \$49,854). The Manager may cease doing so at any time without notice to unitholders.

### Other expenses

The Manager will be reimbursed by the Fund for all reasonable costs, expenses and liabilities incurred by the Manager for performance of services on behalf of the Fund in connection with the discharge by the Manager of its duties hereunder. Such costs and expenses may include, without limitation: mailing and printing expenses for reports to unitholders and other unitholder communications; a reasonable allocation of salaries, benefits and consulting fees; independent directors of the Manager and other administrative expenses and costs incurred in connection with the Fund's continuous public offering and other obligations. These expenses are allocated by the Manager on a reasonable basis, across all of the Harvest Portfolios Group Inc. funds, and series of each applicable fund. These expenses were \$38,303 for the year ended December 31, 2012 (2011 - \$131,081) and are included in the unitholder reporting costs on the Statements of Operations in the annual financial statements.

## 5. FINANCIAL RISK MANAGEMENT

### Investment Objectives

The Fund's investment objectives are:

- i. to provide unitholders with monthly distributions; and
- ii. to maximize total return for unitholders.

In order to meet the investment objectives, the Fund will be invested in an actively managed portfolio that will consist primarily of Banking Issuers, Other Financial Issuers and Real Estate Issuers.

Investment activities of the Fund expose it to a variety of financial risks: credit risk, liquidity risk and market risk (including interest rate risk, other price risk and currency risk). The Manager seeks to minimize these risks by employing experienced portfolio managers that will manage the security portfolios of the Fund on a daily basis according to market events and the investment objectives of the Fund. To assist in managing risk, the Manager also maintains a governance structure that oversees the Fund's investment activities and monitors compliance with the Fund's stated investment strategy and securities regulations.

### Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. The value of securities in the Fund's portfolio may be affected by the stock market conditions rather than each company's performance. Developments in the market are affected by general economic and financial conditions. Political, social and environmental factors can also affect the value of any investment.

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

### December 31, 2012

As at December 31, 2012, 92.0% (2011 - 92.5%) of the Fund's net assets were traded on public stock exchanges. If equity prices on these exchanges had increased or decreased by 5%, as at year end, with all other factors remaining constant, net assets would have increased or decreased by approximately \$1,060,454 (2011 - \$818,347).

In practice, the actual trading results may differ and the difference could be material.

### Currency risk

Currency risk is the risk that the value of investments denominated in currencies other than the financial currency of the Fund will fluctuate as a result of changes in foreign exchange rates. When a Fund buys an investment priced in a foreign currency and the exchange rate between the Canadian dollar and the foreign currency changes unfavorably, it could reduce the value of the Fund's investment.

The table below summarizes the Fund's exposure to currency risk. Amounts shown are based on the carrying value of monetary and non-monetary assets (including derivatives and the underlying principal (notional) amount of forward currency contracts, if any).

As at December 31,	2012		2011	
Currency	Currency exposure *	As a % of net assets	Currency exposure *	As a % of net assets
U.S. Dollars	\$5,170,450	22.3%	\$1,428,253	8.1%

\*Amounts are stated in Canadian dollars

As at December 31, 2012, if the Canadian dollar had strengthened or weakened by 5% in relation to all foreign currencies, with all other variables held constant, the Fund's net assets would have increased or decreased, respectively, by approximately \$258,523 (2011 - \$71,413) or 1.1% (2011 - 0.4%) of total net assets. In practice, the actual results may differ from this sensitivity analysis and the difference could be material.

### Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair value of financial instruments. A Fund that invests in fixed income securities, such as bonds and money market instruments, is sensitive to changes in interest rates. In general, when interest rates are falling, the value of these investments rises. Moreover, fixed income securities with longer terms to maturity are usually more sensitive to changes in interest rates. If interest rates were to change by 1.0%, the increase/ (decrease) in interest earned by the Fund would change by \$ 7,549 (2011 - \$7,451). A Fund that has an interest-bearing liability is exposed to risks associated with the effects of fluctuations in interest rates on its cash flows. As at December 31, 2012 and 2011, the Fund had no interest bearing liabilities.

The table below summarizes the Fund's exposure to interest rate risks by either the remaining term to maturity or contractual repricing for periods ended December 31, 2012 and, 2011.

Debt Instruments: December 31, 2012	Fair value (\$)	% of Net Assets
Less than 1 year	337,848	1.5
Greater than 1 year	417,012	1.8
<b>Total</b>	<b>754,860</b>	<b>3.3</b>

Debt Instruments: December 31, 2011	Fair value (\$)	% of Net Assets
Less than 1 year	-	-
1 to 3 years	336,000	1.9
3 to 5 years	-	-
Greater than 5 years	409,144	2.3
<b>Total</b>	<b>745,144</b>	<b>4.2</b>

# **HARVEST Banks & Buildings Income Fund**

## **NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2012**

### **Liquidity risk**

Liquidity risk is defined as the risk that a fund may not be able to settle or meet its obligations on time or at a reasonable price. The Fund is exposed to redemptions as units are redeemable on demand and Unitholders may redeem their units on each valuation date. Therefore in order to maintain sufficient liquidity, the Fund primarily invests in securities that are actively traded in public markets and can be readily disposed of to raise liquidity.

As at December 31, 2012 and 2011, all of the Fund's financial liabilities had maturities of less than three months.

### **Credit risk**

Credit risk is the risk that counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund.

All transactions executed by the Fund in listed securities are settled/paid for upon delivery using approved brokers.

The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation.

The Fund's source of credit risk is in its holdings of fixed income debt instruments. The fair value of debt securities includes consideration of the credit worthiness of the debt issuer. This risk is largely mitigated by the standards used to select corporate investments. Ongoing credit assessments are performed on all the Fund's holdings and the exposure level is managed through careful diversification across industry sectors and individual issuers, which helps to minimize this risk. The maximum credit risk of these investments is their fair value at December 31, 2012 and 2011.

At December 31, 2012 and 2011, the Fund was invested in debt securities which were not rated.

## **6. SOFT DOLLAR COMMISSIONS**

Brokerage commissions paid to certain brokers may, in addition to paying for the cost of brokerage services in respect of security transactions, also provide for the cost of investment research services provided to the investment manager.

The value of such research services included in commissions paid to brokers for the years ended December 31, 2012 and 2011 amounted to \$NIL.

## **7. INCOME TAXES**

The Fund qualifies as a mutual fund trust under the provisions of the Income Tax Act (Canada). The Fund is subject to tax on its income including net realized capital gains which are not paid or payable to unitholders. It is the intention of the Fund to distribute all of its net income and sufficient net realized capital gains so the Fund will not be subject to income taxes.

The amount of net realized taxable capital gains available for distribution is reduced by the amount of net capital gains to be retained in the Fund. This is done in order to enable the Fund to fully utilize any available tax credits due to application of the capital gain refund formula attributable to redemptions during the year. In certain circumstances, the fund may distribute a return of capital. A return of capital is taxable but will generally reduce the adjusted cost of the units.

Capital losses may be carried forward indefinitely to reduce future realized capital gains. Non-capital losses may be applied against future taxable income.

As at the Fund's 2012 taxation year, the Fund had \$340,768 of non-capital losses available for income tax purposes.

# HARVEST Banks & Buildings Income Fund

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2012

### Harmonized sales tax

As the manager is a resident of Ontario, the expenses paid by the Fund include HST of 13%. HST is calculated using the residency of unitholders in the Fund as at specific times, rather than the physical location of the manager. A blended rate refund is filed with Revenue Canada on behalf of the Fund, in arrears, using each province's HST rate or GST rate in the case of non-participating provinces. Any refund received is applied against future HST payable.

### 8. NET ASSET VALUE AND NET ASSETS

The net asset value per unit for purposes of unitholder transactions (i.e. purchases, switches, redemptions) and net assets per unit calculated in accordance with Section 3855 is shown below:

Per Unit (\$):	NAV (\$)	Net asset (\$)
<b>As at December 31, 2012</b>		
Series R	\$12.48	\$12.46
Series A	\$12.43	\$12.42
Series F	\$12.63	\$12.62

Per Unit (\$):	NAV (\$)	Net asset (\$)
<b>As at December 31, 2011</b>		
Series R	\$11.62	\$11.60
Series A	\$11.61	\$11.60
Series F	\$11.64	\$11.63

### 9. LOAN FACILITY

The Fund previously established a loan facility with a Canadian chartered bank. The loan function was to borrow for the purpose of making investments in accordance with the Fund's investment objectives and restrictions, and to pledge its assets to secure the borrowings. The loan facility was repaid in full and the facility cancelled on August 15, 2011, prior to the Conversion Date.

The initial interest paid on the drawdown or renewal of the Bankers Acceptance ("BA") was deferred and amortized over the term of the BA, which matured August 15, 2011. For the year ended December 31, 2011, the Fund recorded interest expense of \$120,832.

## HARVEST Banks & Buildings Income Fund

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### CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This document may contain forward-looking statements relating to anticipated future events, results, circumstances, performance or expectations that are not historical facts but instead represent our beliefs regarding future events. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. There is significant risk that predictions and other forward-looking statements will not prove to be accurate. We caution readers of this document not to place undue reliance on our forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed or implied in the forward-looking statements. Actual results may differ materially from management expectations as projected in such forward-looking statements for a variety of reasons, including but not limited to market and general economic conditions, interest rates, regulatory and statutory developments, the effects of competition in the geographic and business areas in which the Fund may invest and the risks detailed from time to time in the Fund's simplified prospectus or offering memorandum. We caution that the foregoing list of factors is not exhaustive and that when relying on forward-looking statements to make decisions with respect to investing in the Fund, investors and others should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Due to the potential impact of these factors, the Fund does not undertake, and specifically disclaims, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable law.