



CONSOLIDATED FINANCIAL STATEMENTS
For the year ended
December 31, 2009

Management's Responsibility for Financial Reporting

The consolidated financial statements of HOMEQ Corporation (the Company) have been prepared by and are the responsibility of the management of the Company. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, including the accounting requirements specified by the Office of the Superintendent of Financial Institutions Canada and reflect, where necessary, management's best estimates and judgments.

Management is also responsible for maintaining systems of internal and administrative controls to provide reasonable assurance that the Company's assets are safeguarded, that transactions are properly executed in accordance with appropriate authorization, and that the accounting systems provide timely, accurate and reliable financial information. Controls include quality standards in hiring and training of employees, written policies, a corporate code of conduct and appropriate management information systems.

The internal control systems are further supported by a legislative compliance framework, which ensures that the Company and its employees comply with all regulatory requirements, as well as a risk management framework that ensures proper risk control, related documentation, and the measurement of the financial impact of risks. In addition, the internal audit function periodically evaluates various aspects of the Company's operations and makes recommendations to management for, among other things, improvements to the control systems.

Every year, the Office of the Superintendent of Financial Institutions Canada makes such examinations and inquiries as deemed necessary to satisfy itself that the Company's subsidiary, HomeEquity Bank is in sound financial position and that it complies with the provisions of the Bank Act (Canada).

The financial statements have been audited on behalf of the shareholders by Ernst & Young LLP, Chartered Accountants, in accordance with Canadian generally accepted auditing standards. The Auditors' Report outlines the scope of their examination and their independent professional opinion on the fairness of these consolidated financial statements. Ernst & Young LLP has full and open access to the Audit Committee.

The internal auditors, the external auditors and the Office of the Superintendent of Financial Institutions Canada meet periodically with the Audit Committee, with management either present or absent, to discuss all aspects of their duties and matters arising therefrom.

The Board of Directors is responsible for assuring that management fulfils its responsibility for financial reporting and internal control. The directors perform this responsibility at meetings where significant accounting, reporting and internal control matters are discussed, and the consolidated financial statements, annual and quarterly reports are reviewed and approved.

The Board's Audit Committee, consisting of independent directors, has reviewed these consolidated financial statements with management and the auditors and has reported the results of this review to the Board of Directors, which has approved the consolidated financial statements.



Steven K. Ranson, CA
President & Chief Executive Officer



Gary Krikler, CA
Senior Vice President & Chief Financial Officer

Auditors' Report

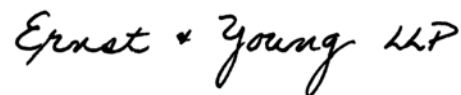
To the Shareholders of
HOMEQ CORPORATION

We have audited the consolidated balance sheets of HOMEQ Corporation as at December 31, 2009 and 2008, and the consolidated statements of income, changes in shareholders' equity 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 consolidated 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 Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada,
March 4, 2010

The image shows a handwritten signature in black ink that reads "Ernst + Young LLP". The signature is written in a cursive, flowing style.

Chartered Accountants
Licensed Public Accountants

HOMEQ CORPORATION
Consolidated Balance Sheets

As at December 31 (in thousands of dollars)	2009 \$	2008 \$
ASSETS		
Cash resources (note 4)		
Cash and cash equivalents	14,516	23,569
Interest bearing deposits with banks	21,972	17,963
	36,488	41,532
Securities (note 5)		
Held-for-trading	12,192	24,502
Loans (note 6)		
Residential reverse mortgages	919,573	869,135
Allowance for credit losses	(2,412)	(572)
	917,161	868,563
Other		
Derivative instruments (note 16)	28,544	44,680
Property and equipment, net of accumulated amortization (note 7)	659	601
Goodwill and other intangible assets (note 8)	19,956	19,281
Future income tax assets (note 9)	594	77
Prepaid expenses and other assets	969	708
	50,722	65,347
	1,016,563	999,944
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits (note 10 and 16)		
Payable on a fixed date	40,093	—
	40,093	—
Other		
Derivative instruments (note 16)	3,347	7,950
Future income tax liabilities (note 9)	12,542	13,090
Income taxes payable	1,873	—
Dividends payable	980	1,228
Accounts payable and accrued liabilities	3,939	2,248
	22,681	24,516
Medium-term debt (notes 11, 15 and 16)	792,328	804,297
Subordinated debt (notes 12, 15 and 16)	50,335	60,407
Unsecured subordinated debt (notes 13 and 15)	10,144	—
	852,807	864,704
	915,581	889,220
Shareholders' equity / Unitholders' equity		
Common shares (notes 1 and 14)	102,794	110,724
Deficit	(1,812)	—
	100,982	110,724
	1,016,563	999,944

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

On behalf of the Board of Directors:



Pierre B. Lebel
 Director



Paul Damp
 Director

HOMEQ CORPORATION
Consolidated Statements of Income

For the years ended December 31 (in thousands of dollars)	2009 \$	2008 \$
Interest income		
Mortgage interest (note 6)	48,532	56,865
Securities	178	1,341
Deposits with banks	105	1,459
	48,815	59,665
Interest expense		
Deposits	133	—
Medium-term debt	24,149	35,450
Subordinated debt	3,187	2,787
Unsecured subordinated debt	186	—
Commercial paper and liquidity line	—	1,233
	27,655	39,470
Net interest income	21,160	20,195
Provision for credit losses (notes 3 and 6)	1,840	276
Net interest income after provision for credit losses	19,320	19,919
Non-interest income		
Mortgage closing fees, net of costs	802	915
Mortgage administration fees	167	128
	969	1,043
Net interest income and non-interest income	20,289	20,962
Non-interest expenses		
Salaries and benefits (note 20)	5,727	5,337
Selling, general and administration (note 21)	6,774	6,910
Amortization of intangible assets	96	96
Amortization of property and equipment	185	207
	12,782	12,550
Income before under noted item	7,507	8,412
Unrealized losses (gains) on derivative instruments (note 16)	8,527	(27,363)
Income (loss) before income taxes	(1,020)	35,775
Current income tax expense	1,873	—
Future income tax expense (recovery)	(1,066)	6,242
Provision for income taxes (note 9)	807	6,242
Net income (loss) and total comprehensive income (loss)	(1,827)	29,533
Average number of common shares outstanding (note 1)	14,209	14,069
Basic and diluted earnings (loss) per share (note 1)	\$(0.129)	\$2.099

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

HOMEQ CORPORATION
Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31 (in thousands of dollars)	2009 \$	2008 \$
Common shares		
Balance at beginning of year	—	—
Conversion from Trust Units (note 1)	102,547	—
Issued during the year	247	—
Balance at end of year	102,794	—
Unitholders' equity		
Balance at beginning of year	110,724	93,912
Issued during the year	238	1,612
Transition adjustment on adoption of financial instruments standard (note 3)	(484)	—
Net income (loss) for the year	(1,975)	29,533
Dividends declared	(5,956)	(14,333)
Conversion to common shares (note 1)	(102,547)	—
Balance at end of year	—	110,724
Deficit		
Balance at beginning of year	—	—
Net income for the year	148	—
Dividends declared	(1,960)	—
Balance at end of year	(1,812)	—
Total Shareholders' equity / Unitholders' equity (note 1)	100,982	110,724

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

HOMEQ CORPORATION
Consolidated Statements of Cash Flows

For the years ended December 31 (in thousands of dollars)	2009 \$	2008 \$
OPERATING ACTIVITIES		
Net income (loss)	(1,827)	29,533
Adjust for non-cash items		
Amortization		
Purchase price premiums and origination fees	3,500	3,676
Deferred origination commissions	1,960	1,515
Deferred deposit commissions	11	—
Debt issue costs	1,227	1,113
Intangible assets	96	96
Property and equipment	185	207
Increase in provision for credit losses	1,840	276
Compensation expense related to long-term incentive plans	488	443
Future income tax expense (recovery)	(1,066)	6,242
Unrealized losses (gains) on derivative instruments	8,527	(27,363)
	14,941	15,738
Changes in non-cash working capital		
Accrual of interest payable on debt and derivatives	(5,016)	(1,698)
Accrual of interest on mortgages	(53,068)	(61,028)
Repayments of accrued interest	36,819	27,589
Other (note 22)	2,993	(1,069)
	(18,272)	(36,206)
Cash used in operating activities	(3,331)	(20,468)
INVESTING ACTIVITIES		
Mortgages originated	(110,195)	(129,622)
Mortgage principal repayments	75,144	56,519
Commissions	(4,598)	(5,061)
Decrease (increase) in securities, net	12,310	(24,502)
Increase in interest bearing deposits with banks, net	(4,009)	(17,963)
Purchase of intangible assets	(461)	(78)
Purchase of property and equipment	(243)	(133)
Cash used in investing activities	(32,052)	(120,840)
FINANCING ACTIVITIES		
Repayments of commercial paper, net	—	(76,075)
Increase in deposits	40,412	—
Increase in deposit broker commissions	(246)	—
Gross proceeds from medium-term debt	150,000	165,000
Repayment of medium-term debt	(155,071)	(2,566)
Repurchase of subordinated debt	(10,000)	—
Gross proceeds from unsecured subordinated debt	10,000	—
Increase in debt issue costs	(599)	(714)
Dividends	(8,166)	(14,623)
Proceeds from shares issued under dividend reinvestment plan	—	1,169
Cash provided by financing activities	26,330	72,191
Net decrease in cash and cash equivalents, during the year	(9,053)	(69,117)
Cash and cash equivalents, beginning of year	23,569	92,686
Cash and cash equivalents, end of year (note 4)	14,516	23,569
Supplemental cash flow information:		
Interest paid	31,325	39,828

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

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

1. ORGANIZATION AND BASIS OF PRESENTATION

HOMEQ Corporation (the Company) was incorporated on March 10, 2009 under the laws of the Province of Ontario. The Company is a holding company which invests in its wholly owned subsidiary, HomeEquity Bank (formerly Canadian Home Income Plan Corporation), which originates and administers reverse mortgages.

On June 30, 2009, Home Equity Income Trust (the Trust) converted to a corporation, by way of a Plan of Arrangement continuing its business operations as HOMEQ Corporation (the Conversion). The Company continues the business of the Trust. Under the Conversion, the unitholders of the Trust exchanged each of their trust units for common shares of the Company, on a one-for-one basis. All references to "shares" refer collectively to common shares subsequent to the Conversion and to trust units prior to the Conversion. All references to "dividends" refer collectively to payments to shareholders subsequent to Conversion and to payments to unitholders prior to the Conversion. These consolidated financial statements of the Company have been prepared using the continuity of interest method for the assets, liabilities and operations of the Trust.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies are summarized as follows:

Basis of consolidation

These consolidated financial statements reflect the financial position and results of operations of the Company consolidated with the financial position and results of operations of its subsidiaries. The Company's principal subsidiary is HomeEquity Bank (formerly Canadian Home Income Plan Corporation). Transactions and balances between the Company and its subsidiaries are eliminated on consolidation.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Allowance for credit losses, fair value of certain financial instruments, income taxes and valuation of goodwill and other intangible assets are areas where management makes significant estimates and assumptions in determining the amounts to be recorded in the consolidated financial statements.

Financial assets and liabilities

The Canadian Institute of Chartered Accountants (CICA) Section 3855, *Financial Instruments – Recognition and Measurement* establishes standards for recognizing and measuring financial assets, financial liabilities and derivatives. It requires that financial assets and financial liabilities (including derivatives) be recognized on the balance sheet when the Company becomes a party to a contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading (based on an intent to sell for short-term profit taking or through an optional irrevocable management election), held-to-maturity, available for sale, loans and receivables or other liabilities. Financial instruments that are either designated as held-for-trading or available-for-sale are required to be measured at fair value at each balance sheet date.

Under these standards, the Company classifies its mortgages as loans receivable and carries them at amortized cost. The Company's liabilities continue to be classified as other liabilities.

Financial instruments

Effective January 1, 2008, the accounting and disclosure requirements of the CICA's two new accounting standards, Section 3862, *Financial Instruments – Disclosures*, and Section 3863, *Financial Instruments – Presentation*, were implemented. Section 3862 requires the disclosure of the significance of financial instruments for the Company's financial position, performance and cash flows and the nature and extent of risks arising from financial instruments to which the Company is exposed during the year and at the balance sheet date, and how the entity manages those risks. Section 3863 carries forward, unchanged, the presentation requirements of Section 3861, *Financial Instruments – Disclosure and Presentation*.

The guidance did not have a material effect on the financial position or earnings of the Company. The Company is exposed to a variety of financial risks in the normal course of business. The financial risk management objectives are described in the Management Discussion and Analysis. The new disclosures required under Section 3862 are included in note 18.

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value of financial instruments

The Company presents cash resources, held-for-trading securities and derivative instruments at fair value. Loans, deposits and certain other assets and certain other liabilities are recorded at amortized cost. Except as disclosed in note 18 to these consolidated financial statements, the carrying values of the Company's financial instruments approximate their fair values.

Capital disclosures

Effective January 1, 2008, the CICA's accounting standard, Section 1535, *Capital Disclosures*, was implemented, which requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital, quantitative data about what is considered capital and whether an entity has complied with any capital requirements and consequences of non-compliance with such capital requirements. The new guidance did not have an effect on the financial position or the earnings of the Company. See note 15.

Cash and cash equivalents

Cash and cash equivalent balances have less than 90 days to maturity from the date of acquisition. Cash and cash equivalents consist of cash, Canadian and provincial securities, interest bearing deposits with banks and corporate notes. Cash and cash equivalents are designated as held-for-trading, and accordingly, are carried at fair value. Changes to fair value are recorded in the consolidated statements of income. Investment interest is recognized on an accrual basis.

Securities

Securities balances have more than 90 days to maturity from the date of acquisition and consist of Canadian and provincial securities and corporate notes. Securities are accounted for at settlement date and designated as held-for-trading, and accordingly, are carried at fair value. Changes to fair value are recorded in the consolidated statements of income. Investment interest is recognized on an accrual basis.

Mortgages

Mortgages are lifetime, interest accruing mortgages that are secured by residential real property. Interest income is recognized on an accrual basis on all mortgages and is due together with repayment of the principal at the time the property is vacated by the homeowner(s).

Mortgage loans (including purchase price premiums, origination fees and commissions) are stated at amortized cost plus accrued interest. Purchase price premiums, origination fees and commissions are deferred and expensed over the estimated period that mortgages earn interest. The carrying value of the mortgage loans approximates fair value as the prevailing interest rates reset in accordance with the provisions of the underlying mortgage terms.

Mortgage early repayment fees are recorded as revenue when received.

Allowance for credit losses

The allowance for credit losses recorded in the consolidated balance sheets is maintained at a level which is considered adequate to absorb credit-related losses to the mortgage loan portfolio. A mortgage allowance is taken when, in the opinion of management, there is no longer reasonable assurance of the collection of the full amount of principal and interest. Mortgage allowances, in an amount which approximates the present value of projected future cash flow shortfalls, are determined based on the mortgage loan outstanding and the most recently appraised value of the underlying property. The Company has both specific and general allowances as described below.

Specific allowances

The Company's policy is to cease accruing interest income on a mortgage having a loan-to-value greater than 83%. Any increase or decrease in specific allowances is included with mortgage interest on the consolidated statements of income.

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

General allowances

General allowances are provided for losses inherent in the mortgage portfolio but not yet specifically identified and therefore not yet captured in the determination of specific allowances. The Company evaluates and monitors the underwriting performance indicators of mortgages as well as changes in the characteristics of the portfolio. These indicators include a review of general real estate conditions and trends and their potential impact on the portfolio, the expected occupancy term and interest rates experienced over the life of a mortgage compared to initial underwriting assumptions.

Prepaid expenses

Prepaid expenses are stated at cost and are amortized over their expected beneficial life.

Income taxes

Income taxes are determined using the liability method. Under this method of tax allocation, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future income tax assets are recognized to the extent that realization is considered more likely than not. Prior to Conversion, the Trust estimated future taxes based on the effective tax rate on reversing temporary differences in 2011 and thereafter. As a result of the Conversion, the Company is taxable and has accordingly estimated future taxes for 2010.

Prior to the Conversion, the Trust qualified as a mutual fund trust under the Income Tax Act (Canada). The Trust distributed all or substantially all of its taxable income to the unitholders. Income tax obligations relating to the distributions are the obligations of the unitholders and accordingly, no current tax provision for income taxes on the income of the Trust was made.

Property and equipment

Computer hardware is recorded at cost and amortized on a straight-line basis over four years. Furniture and equipment are stated at cost and are amortized on a straight-line basis over a term of seven years. Leasehold improvements are recorded at cost and are amortized on a straight-line basis over the term of the related lease. The amortization expense is recognized in the consolidated statements of income.

Deposits

Deposits are payable on a fixed date and consist of fixed-interest rate guaranteed investment certificates. The terms of these deposits range from one year to five years. Deposits are financial liabilities and are measured at cost using the effective interest rate method. Deposit broker commissions are included in deposits on the consolidated balance sheets and are amortized to interest expense over the term of the deposit.

Derivative financial instruments

The Company uses derivative instruments such as interest rate swaps and forward rate agreements, economically hedging the interest term of some of its medium-term, subordinated debt and deposit liabilities to the interest term of the mortgage portfolio to ensure a relatively stable interest rate spread. Derivatives are classified as held-for-trading and are measured at fair value. Unrealized gains or losses from changes in fair value are recognized in the consolidated statements of income. Fair value of derivative instruments is determined using an internal valuation model with observable inputs. Realized amounts receivable or payable on derivatives are accrued and recorded as adjustments to interest expense in the consolidated statements of income.

The Company does not hold or use any derivative contracts for speculative trading purposes. Derivative instruments used are entered into with Schedule 1 Canadian chartered banks to reduce any counterparty risk associated with derivatives.

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Hedge accounting

CICA Section 3865, *Hedges*, specifies the requirements for the use of hedge accounting. When the Company applies hedge accounting, at the inception of a hedging relationship, the Company documents the relationship between the hedging instrument and the hedged item, its risk management objective and its strategy for undertaking the hedge. In order to be deemed effective, the hedging instrument and the hedged item must be highly and inversely correlated such that the changes in fair value of the hedging instrument will substantially offset the effects of the hedged exposure to the Company throughout the term of the hedging relationship. If a hedging relationship becomes ineffective, it no longer qualifies for hedge accounting and any subsequent change in fair value of the hedging instrument is recognized in earnings.

Comprehensive income

CICA Section 1530, *Comprehensive Income*, requires the presentation of a statement of comprehensive income for certain revenues, expenses, gains and losses that are not recorded as part of net earnings but presented in other comprehensive income until it is considered appropriate to recognize it in net earnings. The Company does not have any income from this source and as such a consolidated statement of comprehensive income has not been included in these consolidated financial statements.

Goodwill and other intangible assets

Goodwill reflects the purchase price paid on acquisition of Canadian Home Income Plan Corporation, prior to its continuance as HomEquity Bank, in excess of the fair market value of net tangible assets and identifiable intangible assets acquired. Goodwill is not amortized but is tested for impairment annually.

Costs incurred by HomEquity Bank in obtaining its bank license have been capitalized and are recorded at cost. Bank license costs are not amortized but are tested for impairment annually.

Software is recorded at cost and amortized on a straight-line basis over three years. Amortization expense is recognized in amortization of intangible assets on the consolidated statements of income.

Transaction costs for debt liabilities

Debt issue costs incurred by the Company are capitalized and are included in medium-term debt, subordinated debt and unsecured subordinated debt. These costs are amortized over the term of the debt on an effective interest rate method and are included in interest expense in the consolidated statements of income. The Company does not incur any transaction costs related to financial instruments that are designated as held-for-trading.

Long-term incentive plans

Directors and senior executives participate in long-term incentive plans under which they are eligible to receive Company shares. The plans consist of a restricted share plan for senior executives and deferred share plan for Directors. The restricted shares vest equally over three years. The benefit resulting from the issue of shares under this plan is recorded as salaries and benefits expense in the consolidated statements of income, on a straight-line basis over the vesting period, based on the market price of the Company's shares on the date of grant. The deferred share plan allows the Directors to defer a portion of their compensation until they retire from the Board and receive the equivalent amount in shares of the Company. The amount deferred during the year is recorded as professional services expense in the consolidated statements of income. As the Company intends to settle its obligations related to these plans by issuing shares, the Company's obligations under these plans are presented within shareholders' equity.

Earnings per share

Basic and diluted earnings per share are calculated by dividing net income by the average number of fully paid common shares outstanding during the year.

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

3. CHANGES IN ACCOUNTING POLICIES

Goodwill, intangible assets and financial statement concepts

Effective January 1, 2009, the CICA's new accounting standard, Section 3064, *Goodwill and Intangible Assets*, was adopted by the Company. This standard clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset, and, as a result, start-up costs must be expensed as incurred. Section 1000, *Financial Statement Concepts*, was also amended to provide consistency with the new standard. The new guidance did not have a material effect on the financial position or the earnings of the Company; however the Company reclassified intangible assets relating to application software with net book value of \$55 as at December 31, 2008 from property and equipment to goodwill and other intangible assets on the consolidated balance sheets.

Credit risk and the fair value of financial assets and financial liabilities

Effective January 20, 2009 the CICA's Emerging Issues Committee EIC-173 Abstract, *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, was adopted by the Company. EIC-173 was released due to mixed practice on whether an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of a derivative instrument. The EIC requires the inclusion of credit risk of the counterparty and the Company in determining the fair value of derivative instruments. The EIC requires retrospective adoption without restatement of prior periods.

Under this new guidance, the Company has recorded an adjustment to decrease opening shareholders' equity by \$484 for the year ended December 31, 2009. The adjustment is related solely to the recognition of credit risk on the fair value of derivative instruments as at December 31, 2008.

Financial instruments disclosures

The CICA's Accounting Standards Board amended CICA Handbook Section 3862, *Financial Instruments - Disclosures*, to enhance the disclosure requirements regarding fair value measurements and the liquidity risk of financial instruments. The additional disclosures are provided in note 18.

Income taxes

Prior to the Conversion, the Company qualified as a mutual fund trust under the Income Tax Act (Canada). The Trust distributed all or substantially all of its taxable income to its unitholders. Income tax obligations relating to the distributions are the obligations of the unitholders and accordingly, no current tax provision for income taxes on the income of the Trust was made. As a result of the Conversion, the Company is taxable at corporate rates.

Change in accounting estimate

Allowances for credit losses

During 2009, the Company increased its accounting estimate of allowances for credit losses principally related to general allowances by \$1,741. The increase was related to periodic review and assessment of the Company's general allowance methodology updated to take into account both current circumstances and evolution of the portfolio and business. During 2009, the significant review was undertaken because of factors in the economic environment and the experience gained of a maturing mortgage portfolio, including volatility in housing prices across Canada, increasing number of mortgages which exceed loan-to-value of 50%, expected occupancy terms exceeding original projections and the limitations inherent in the appraisal process. The review incorporated a comprehensive assessment of statistical and qualitative analyses of the underwriting performance of each mortgage as well as changes in the characteristics of the portfolio. The assessment included a review of general real estate conditions and trends and their potential impact on the portfolio, the expected occupancy term and interest rates experienced over the life of a mortgage compared to initial underwriting assumptions.

This change has been fully recorded in the current year as it is a change in estimate. The presentation of the provision has also changed. Previously, the increase or decrease in the general allowance was included in mortgage interest and is now presented separately in the consolidated statements of income as provision for credit losses.

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

4. CASH RESOURCES

The following table shows the details of cash resources on the consolidated balance sheets:

	December 31 2009	December 31 2008
	\$	\$
Cash and non-interest bearing deposits with banks	8,218	6,087
Treasury bills issued or guaranteed by provinces	6,298	10,988
Corporate notes	—	6,494
Cash and cash equivalents	14,516	23,569
Interest bearing deposits with banks	21,972	17,963
Total cash resources	36,488	41,532

5. SECURITIES

For the year ended December 31, 2009, the yield on these investments ranges between 0.24% and 0.53% with a weighted average rate of 0.27% (December 31, 2008 – 2.0%).

The following table shows the details of securities on the consolidated balance sheets:

	Remaining term to maturity			December 31 2009	December 31 2008
	Within 1 year	1 to 5 years	Over 5 years		
	\$	\$	\$	\$	\$
Treasury bills issued or guaranteed by Canada	3,996	—	—	3,996	13,458
Treasury bills issued or guaranteed by provinces	6,499	—	—	6,499	1,495
Other debt securities	1,697	—	—	1,697	9,549
	12,192	—	—	12,192	24,502

6. LOANS

Residential reverse mortgages

The following table shows the details of the residential reverse mortgage balance on the consolidated balance sheets:

	December 31 2009	December 31 2008
	\$	\$
Mortgage principal plus accrued interest	865,659	814,359
Mortgage purchase price premiums, net of accumulated amortization	33,572	36,839
Mortgage origination fees, net of accumulated amortization	2,305	2,538
Deferred commissions, net of accumulated amortization	18,037	15,399
	919,573	869,135

HOMEQ CORPORATION

Notes to Consolidated Financial Statements

(in thousands of dollars except per share amounts)

December 31, 2009 and 2008

6. LOANS (continued)

Geographic region and loan-to-value

The following tables show the composition of the residential reverse mortgage portfolio by geographic distribution and loan-to-value ratio range, which measures the outstanding mortgage balance as a percentage of the appraised value of the property:

Province	December 31 2009	December 31 2008	December 31 2009	December 31 2008
	\$	\$	%	%
Ontario	357,338	349,055	41.3	42.9
British Columbia	312,428	296,758	36.1	36.4
Alberta	105,770	94,274	12.2	11.6
Quebec	54,389	44,606	6.3	5.5
Other	35,734	29,666	4.1	3.6
	865,659	814,359	100.0	100.0

Loan-to-value	December 31 2009	December 31 2008	December 31 2009	December 31 2008
	\$	\$	%	%
Less than 30.0%	173,715	171,280	20.1	21.0
30.1% - 40.0%	242,436	225,849	28.0	27.7
40.1% - 50.0%	246,051	226,884	28.4	27.9
50.1% - 60.0%	135,881	130,057	15.7	16.0
60.1% - 70.0%	54,820	53,018	6.3	6.5
Greater than 70.1%	12,756	7,271	1.5	0.9
	865,659	814,359	100.0	100.0

Impaired loans

The following table shows residential reverse mortgages with a loan-to-value ratio of greater than 83%, which management considers being impaired and the appraised value of those underlying properties:

	December 31 2009	December 31 2008
	\$	\$
Mortgage principal plus accrued interest	1,755	720
Specific allowance	(263)	(164)
	1,492	556
Appraised value of underlying properties	1,798	670

Allowance for credit losses

The following table shows the details of allowance for credit losses on the consolidated balance sheets:

	December 31 2009	December 31 2008
	\$	\$
Specific allowances		
Balance , beginning of year	(164)	(45)
Provision for credit losses	(171)	(119)
Write-offs	70	—
Recoveries	2	—
Balance , end of year	(263)	(164)
General allowances		
Balance , beginning of year	(408)	(251)
Provision for credit losses	(1,741)	(157)
Balance, end of year	(2,149)	(408)
Total allowances	(2,412)	(572)

HOMEQ CORPORATION**Notes to Consolidated Financial Statements**

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December 31, 2009 and 2008**6. LOANS (continued)****Mortgage interest**

The following table shows the details of mortgage interest on the consolidated statements of income:

	December 31 2009	December 31 2008
Interest income	\$ 53,068	\$ 61,028
Early repayment fees	924	1,028
Less:		
Amortization of deferred commissions	(1,960)	(1,515)
Amortization of purchase price premiums and origination costs	(3,500)	(3,676)
	48,532	56,865

7. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	Cost	Accumulated amortization	December 31 2009 Net book value	December 31 2008 Net book value
	\$	\$	\$	\$
Computer hardware	755	384	371	237
Furniture and equipment	116	70	46	59
Leasehold improvements	624	382	242	305
	1,495	836	659	601

8. GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets consist of the following:

	December 31 2009	December 31 2008
Goodwill	\$ 19,109	\$ 19,109
Bank license costs	427	117
Software – amortized (1)	420	55
	19,956	19,281

(1) Software had a cost of \$603 and accumulated amortization of \$183.

9. INCOME TAXES**Components of income tax**

The following table shows the details of the Company's provision for income taxes:

	December 31 2009	December 31 2008
	\$	\$
Current income taxes		
Federal	1,098	—
Provincial	775	—
	1,873	—
Future income taxes		
Federal	(627)	6,242
Provincial	(439)	—
	(1,066)	6,242
Provision for income taxes	807	6,242

HOMEQ CORPORATION**Notes to Consolidated Financial Statements**

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December 31, 2009 and 2008**9. INCOME TAXES (continued)****Reconciliation of income taxes**

The Company's future income tax provision relates to temporary differences at December 31, 2009. At December 31, 2008, the future income tax provision related to the impact of the taxes estimated to be paid by the Company from January 1, 2011. The reconciliation of statutory and effective rates of tax is as follows:

	December 31 2009	December 31 2008
Combined Canadian federal and provincial income tax rate applied to Income (loss) before income taxes	33.0 %	33.5 %
Tax expense (recovery) calculated at statutory rate	\$ (337)	\$ 11,985
Increase (decrease) in income taxes due to:		
Income distributed to unitholders	(340)	(11,985)
Impact of tax rate changes	1,732	6,192
Other	(248)	50
Provision for income taxes	807	6,242

Components of future income tax balances

The tax effects of temporary differences that give rise to the future income tax assets and liabilities are presented below:

	December 31 2009	December 31 2008
Future income tax assets	\$	\$
Property and equipment	14	39
Non-capital losses	—	38
Allowance for credit losses	580	—
	594	77
Future income tax liabilities		
Mortgages	7,367	6,839
Derivative instruments	5,172	6,251
Debt issue and deferred costs	3	—
	12,542	13,090

At December 31, 2009, the Company's estimates of the effective tax rate on reversing temporary differences by tax year are presented in the table below:

	December 31 2009	December 31 2008
	%	%
2010	30.5	—
2011	27.9	29.5
2012	26.1	28.0
2013	25.5	28.0
2014 and thereafter	25.1	28.0

Prior to Conversion, the Trust qualified as a mutual fund trust under the Income Tax Act (Canada). The Trust distributed all or substantially all of its taxable income to its unitholders. Accordingly, the Trust estimated future taxes based on the effective tax rate on reversing temporary differences in 2011 and thereafter. As a result of the Conversion, the Company is taxable and has accordingly estimated future taxes for 2010.

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10. DEPOSITS

All deposits are payable on a fixed date and are issued in Canada.

The following table summarizes the deposits outstanding as at December 31, 2009:

	Maturity term				December 31 2008
	Within 1 year	2 to 3 years	4 to 5 years	December 31 2009	
	\$	\$	\$	\$	\$
Individuals	13,609	15,450	11,118	40,177	—
Adjustment in carrying value of hedged deposits (see note 16)	—	(34)	(50)	(84)	—
	13,609	15,416	11,068	(40,093)	—
Effective interest rate	1.22%	2.33%	3.30%		—

11. MEDIUM-TERM DEBT

The following table summarizes the medium-term debt outstanding as at December 31, 2009:

Series	Expected final payment	Interest basis	Interest rate at December 31 2009	Fair market value at December 31 2009	December 31 2009	December 31 2008
				\$	\$	\$
2007-1	Nov 1, 2009	Fixed rate	—	—	—	150,000
2009-1	Oct 26, 2010	Floating rate (1)	1.838%	150,116	150,000	—
2005-1	Nov 1, 2010	Fixed rate	4.296%	112,193	110,000	110,000
2007-3	May 2, 2011	Fixed rate	5.613%	130,266	125,000	125,000
2008-1	May 16, 2011	Fixed rate	5.764%	172,422	165,000	165,000
2006-3	Aug 1, 2012	Fixed rate	4.542%	118,351	115,000	115,000
2006-1	Feb 1, 2013	Fixed rate	4.637%	107,063	105,000	105,000
2007-2	Jun 15, 2013	Floating rate (2)	1.583%	14,004	14,115	19,186
				804,415	784,115	789,186
Interest payable					7,858	8,722
Interest payable on derivative instruments					—	1,251
Interest receivable on derivative instruments					(3,954)	(1,053)
Debt issue costs, net of accumulated amortization					(1,614)	(2,169)
Adjustment in carrying value of hedged debt (see note 16)					5,923	8,360
					792,328	804,297

(1) Rate is reset on the 26th day of January, April and July 2010 based on the three-month bankers acceptance rate plus 1.40%

(2) Rate is reset each May 1st and November 1st based on the six-month Government of Canada Treasury Bill rate plus 1.283%

The Company has a best efforts obligation to refinance the series 2006-3, 2007-3, 2008-1 and 2009-1 notes on the respective expected final payment dates. If a note remains outstanding after the expected final payment date, the interest will become the one-month Bankers' Acceptance rate plus the following spreads calculated and payable monthly: 2006-3 – 1.25%, 2007-3 – 3.00%, 2008-1 – 4.00% and 2009-1 – 3.00% until legal maturity. The series 2007-1 notes were repaid on November 1, 2009. The legal maturity dates of these notes range from August 1, 2031 to October 26, 2034. Fair value of medium-term debt is determined using average quoted market rates provided to the Company by capital market dealers.

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December 31, 2009 and 2008

12. SUBORDINATED DEBT

The following table summarizes the subordinated debt outstanding as at December 31, 2009:

Series	Expected final payment	Interest basis	Interest rate at December 31 2009	Fair market value at December 31 2009	December 31 2009	December 31 2008
				\$	\$	\$
2007-1B	Nov 1, 2012	Fixed rate	6.663%	9,860	10,000	20,000
2007-2B	Jun 15, 2013	Fixed rate	7.582%	19,935	20,000	20,000
2006-2B	Aug 1, 2013	Fixed rate	5.803%	18,793	20,000	20,000
				48,588	50,000	60,000
Interest payable					719	830
Interest receivable on derivative instruments					(143)	(70)
Debt issue costs, net of accumulated amortization					(241)	(353)
					50,335	60,407

The Company has a best efforts obligation to refinance the series 2006-2B and 2007-1B notes on the respective expected final payment dates. If a note remains outstanding after the expected final payment date, the interest will become the one-month Bankers' Acceptance rate plus the following spreads calculated and payable monthly: 2006-2B – 1.75% and 2007-1B – 3.50% until legal maturity. The legal maturity dates of these notes range from August 1, 2031 to November 1, 2032. The series 2007-2B note is repayable after the 2007-2 medium-term note is repaid in full. On October 23, 2009, the Company repurchased \$10,000 of series 2007-1B with the proceeds of the unsecured subordinated debt (see note 13). Fair value of subordinated debt is determined using average quoted market rates provided to the Company by capital market dealers.

13. UNSECURED SUBORDINATED DEBT

The following table summarizes the subordinated debt outstanding as at December 31, 2009:

Maturity	Interest basis	Interest rate at December 31 2009	Fair market value at December 31 2009	December 31 2009	December 31 2008
			\$	\$	\$
Oct 31, 2014	Fixed rate	9.713%	10,277	10,000	—
Interest payable				183	—
Debt issue costs, net of accumulated amortization				(39)	—
				10,144	—

Fair value of the unsecured subordinated debt is determined using quoted market rates provided to the Company by a capital market dealer.

14. SHARE CAPITAL

A summary of the changes to the Company's share capital pursuant to the Conversion from an income trust to a corporation on December 31, 2009 is as follows:

Share capital

Authorized: An unlimited number of common shares

Issued share capital

	December 31, 2009	
	Number of shares	Amount \$
Balance, beginning of year	—	—
Conversion from Trust units – June 30, 2009	14,215,433	102,547
Shares earned and granted under the long-term incentive plans (1)	23,608	247
Balance, end of year (2)	14,239,041	102,794

(1) Includes vested, non-vested and cancelled shares.

(2) Includes 81,449 restricted shares issued under the Restricted Share Plan and 150,753 deferred shares issued under the Deferred Share Plan.

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14. SHARE CAPITAL (continued)

	December 31, 2009		December 31, 2008	
	Number of units	Proceeds \$	Number of units	Proceeds \$
Trust units				
Balance, beginning of year	14,123,549	—	13,933,047	—
Units issued under distribution reinvestment plan	—	—	148,456	1,169
Units earned and granted under the long-term incentive plans (1)	91,884	238	42,046	443
Conversion to HOMEQ Corporation shares	(14,215,433)	—	—	—
Balance, end of year	—	238	14,123,549	1,612

The Company has two long-term incentive plans: a Restricted Share Plan (RSP) for management and a Deferred Share Plan (DSP) for Directors. Prior to Conversion these plans were unit plans. Upon Conversion, the entitlements to units under the plans were converted to entitlements to an equivalent number of shares, and will continue to be held subject to the terms and conditions of their grant, with no change to the applicable vesting schedules.

A restricted share granted through the RSP entitles the holder to receive, on the vesting date, a share plus the amount of dividends that would have been paid on the shares respectively if the share had been issued on the date of grant. Subject to the achievement of performance conditions, if any, restricted shares vest equally over three years and the total cost of the grant is recognized over the vesting period. As at December 31, 2009, 191,920 restricted shares have been issued since the inception of the plan and 81,449 shares remain within the plan, none of which have vested. For the year ended December 31, 2009 55,000 restricted shares (December 31, 2008 – 27,100) have been issued.

The non-employee Directors may elect to receive their compensation in whole or in part in the form of deferred shares under the DSP in lieu of cash compensation. On retiring from the Board, a Director will receive all deferred shares accumulated in the plan. The maximum number of shares that may be issued under the DSP is limited to 500,000. As at December 31, 2009, the Directors have earned 150,753 shares under the DSP. For the year ended December 31, 2009 60,492 deferred shares (December 31, 2008 – 24,331) have been issued.

For the year ending December 31, 2009, Directors fees and executive compensation expense under the long-term incentive plans was \$488 (December 31, 2008 - \$443). The Company intends to settle the restricted and deferred shares in shares of the Company upon vesting and retirement, respectively. Until such time, these shares do not trade on the Toronto Stock Exchange, have no voting rights and cannot be sold or liquidated early.

15. CAPITAL MANAGEMENT

The overall objective of capital management is to ensure that the Company has sufficient capital to maintain its operations based on current activities and expected business developments in the future and to provide a return to shareholders commensurate with the risk of the business and comparable to other similar companies.

The Company's capital resources consist of retail deposits, senior debt, consisting of medium-term notes, subordinated debt, unsecured subordinated debt and issued Company shares. Historically the Company has used cash flows from operating activities to fund its operations and distributions, and the excess of those cash flows coupled with borrowings under its debt programs have been used to fund growth in the mortgage portfolio.

The Company's subsidiary, HomEquity Bank, received its Letters Patent and Order to Commence as a federally regulated Schedule I bank from the Minister of Finance on October 13, 2009. As a chartered bank, HomEquity Bank has access to retail deposits sourced through deposit brokers, which became part of capital resources. The regulatory capital requirements of HomEquity Bank are specified by the Office of the Superintendent of Financial Institutions (OSFI) in its *Guideline A, Capital Adequacy Requirement (CAR) – Simple Approaches*. The Guideline specifies the types of items included in capital and the measures OSFI will consider in reviewing capital adequacy. The OSFI capital requirements were not applicable to the prior year as the bank charter was only received on October 13, 2009.

There are two capital standards addressed in HomEquity Bank's capital management policy: risk based capital ratios and assets to capital multiple. The Company has implemented policies and procedures to monitor compliance with regulatory capital requirements. HomEquity Bank has implemented an Internal Capital Adequacy Assessment Process supported further by an Economic Capital Assessment which are both based on the Company's assessment of the business risks of HomEquity Bank.

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15. CAPITAL MANAGEMENT (continued)

The total regulatory capital of HomEquity Bank is comprised of Tier 1 and Tier 2 capital as follows:

	December 31 2009
Shareholders' equity per HomEquity Bank's consolidated balance sheet	76,666
Deductions	301
Tier 1 capital	76,365
Unsecured subordinated debt	8,000
Tier 2 capital	8,000
Total regulatory capital	84,365
Credit risk	440,250
Off-balance sheet exposure	6,258
Operational risk	40,331
Total risk-weighted assets	486,839
Capital ratios	
Tier 1 Capital Ratio (1)	15.7
Total Capital Ratio (2)	17.3%
Assets-to-Capital Multiple (3)	11.8x

(1) The Tier 1 Capital Ratio is defined as Tier 1 capital divided by total risk-weighted assets.

(2) The Total Capital Ratio is defined as total regulatory capital divided by total risk-weighted assets.

(3) The Assets-to-Capital Multiple is calculated by dividing total assets, including specified off-balance sheet items net of other specified deductions, by total capital.

During the year ended December 31, 2009 HomEquity Bank complied with the OSFI guideline related to capital ratios and the assets-to-capital multiple. Both the Tier 1 and Total Capital Ratios remain above OSFI's stated minimum capital ratios of 7% and 10%, respectively, for a well capitalized financial institution. HomEquity Bank's Assets-to-Capital Multiple remains below the maximum permitted by OSFI.

HomEquity Bank's wholly owned subsidiary, CHIP Mortgage Trust's ("CMT") borrowings are subject to debt-to-mortgage covenants. The covenants are: a maximum senior debt-to-mortgage ratio of 93% when it has commercial paper outstanding, a maximum of 95% when its senior rated debt consists only of medium-term notes and a maximum total debt-to-mortgage ratio of 98%. CMT is also required to maintain minimum cash on hand equivalent to 2% of its mortgage portfolio value. At December 31, 2009, the senior debt-to-mortgage ratio was 90.4% (December 31, 2008 89.1%), the total debt-to-mortgage ratio was 97.5% (December 31, 2008 96.3%) and CMT held more than the required amount of cash. The Company closely monitors business performance to manage compliance with these covenants.

16. DERIVATIVE INSTRUMENTS

In the normal course of business, the Company enters into interest rate derivative contracts to manage interest rate risk. Derivative financial instruments are financial contracts that derive their value from underlying changes in interest rates or other financial measures.

Interest rate swaps are contracts in which two counterparties agree to exchange cash flows over a period of time based on rates applied to a specified notional principal amount. A typical interest rate swap would require one counterparty to pay interest based on a fixed rate and receive interest based on a variable market interest rate determined from time to time with both calculated on a specified notional principal amount. No exchange of principal amount takes place.

Forward rate agreements are contracts that effectively fix a future interest rate for a period of time. A typical forward rate agreement provides that at a pre-determined future date, a cash settlement will be made between counterparties based upon the difference between a contracted rate and a market rate to be determined in the future, calculated on a specified notional principal amount. No exchange of principal amount takes place.

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16. DERIVATIVE INSTRUMENTS (continued)

Fair values

Fair market values of the interest rate derivatives are determined using the period-end market rates compared to the rates in the derivative contract. Changes in fair value resulting in unrealized gains or losses are recorded in the consolidated statements of income.

Notional amounts

The notional value of derivative financial instruments represents an amount to which a rate or price is applied in order to calculate the exchange of cash flows. Notional principal amounts do not represent the potential gain or loss associated with market risk and are not indicative of the credit risk associated with derivative financial instruments. The notional amounts are not recorded as assets or liabilities on the consolidated balance sheets.

The following table summarizes the fair values, notional principal and weighted average rates of the derivative instruments outstanding as at December 31, 2009. The floating rate for all instruments is based on the CDOR-BA rate for terms ranging from one to twelve months.

Interest rate contracts	Weighted average rate		Notional principal		Fair values	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Receive fixed			\$		\$	
Swaps	4.139%	4.223%	650,000	815,000	28,248	44,511
Forward rate agreements	—	2.764%	—	40,000	—	169
Pay fixed						
Swaps	1.545%	—	25,000	—	288	—
Forward rate agreements	0.330%	—	60,000	—	8	—
ASSETS			735,000	855,000	28,544	44,680
Receive fixed						
Swaps	2.222%	—	35,000	—	188	—
Forward rate agreements	—	—	—	—	—	—
Pay fixed						
Swaps	2.246%	3.904%	211,000	127,000	3,146	7,465
Forward rate agreements	1.169%	2.283%	10,000	136,000	13	485
LIABILITIES			256,000	263,000	3,347	7,950

Maturity terms

The following table summarizes the notional principal and fair value by term to maturity of derivative instruments outstanding as at December 31, 2009. Maturity dates range from May 2010 to November 2014.

	Remaining term to maturity				
	Within 1 year	1 to 3 years	3 to 5 years	December 31 2009	December 31 2008
Notional principal	\$	\$	\$	\$	\$
Swaps	110,000	455,000	110,000	675,000	815,000
Forward rate agreements	60,000	—	—	60,000	40,000
Derivative assets	170,000	455,000	110,000	735,000	855,000
Swaps	102,000	89,000	39,500	230,500	127,000
Forward rate agreements	10,000	—	—	10,000	136,000
Derivative liabilities	112,000	89,000	39,500	240,500	263,000
Fair values					
Swaps	3,076	19,201	6,259	28,536	44,511
Forward rate agreements	8	—	—	8	169
Derivative assets	3,084	19,201	6,259	28,544	44,680
Swaps	199	2,237	898	3,334	7,465
Forward rate agreements	13	—	—	13	485
Derivative liabilities	212	2,237	898	3,347	7,950

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Notes to Consolidated Financial Statements

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16. DERIVATIVE INSTRUMENTS (continued)

Hedge accounting results

The Company's fair value hedges consist of interest rate swaps that are used to protect against changes in fair value of fixed-rate medium-term debt and retail deposits due to movements in market interest rates. Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded as unrealized losses (gains) on derivative instruments in the consolidated statements of income, along with adjustments to the carrying value of the financial instruments that are attributable to the hedged risk. The Company elected under Section 3865 – *Hedges*, to apply hedge accounting to the interest rate swaps detailed below.

During 2008, the Company entered into interest rates swaps having a notional amount of \$159,000 to hedge \$159,000 of the \$165,000 series 2008-1 fixed-rate medium-term debt issued during that year. The hedges are effective at December 31, 2009. The fair value of these swaps is positive \$5,058 at December 31, 2009 (December 31, 2008 – positive \$8,300) and is recorded as derivative instruments asset on the consolidated balance sheets. For the year ended December 31, 2009, the Company has recorded a loss of \$3,242 (December 31, 2008 – gain of \$8,300) to unrealized losses (gains) on derivative instruments in the consolidated statements of income. For the year ended December 31, 2009 the carrying value of the fixed-rate medium-term debt has been adjusted by \$2,437 (December 31, 2008 - \$8,360) with a corresponding gain (2008 – loss) to unrealized losses (gains) on derivative instruments in the consolidated statements of income (See note 11). For the year ended December 31, 2009, a loss of \$805 (December 31, 2008 – \$60) arising from hedge ineffectiveness was recorded.

During 2009, the Company entered into interest rates swaps having a notional amount of \$10,000, to hedge \$10,000 of deposits issued during the year. The hedges are effective at December 31, 2009. The fair value of these swaps is negative \$64 at December 31, 2009 (December 31, 2008 – Nil) and is recorded as derivative instruments liability on the consolidated balance sheets. For the year ended December 31, 2009, the Company has recorded a loss of \$64 (December 31, 2008 – Nil) to unrealized losses (gains) on derivative instruments in the consolidated statements of income. For the year ended December 31, 2009 the carrying value of the deposits has been adjusted by \$84 (December 31, 2008 – Nil) with a corresponding gain (2008 – Nil) to unrealized losses (gains) on derivative instruments in the consolidated statements of income (See note 10). For the year ended December 31, 2009, a gain of \$20 (December 31, 2008 – Nil) arising from hedge ineffectiveness was recorded.

Derivative – related risks

Market risk

Derivative instruments have either no or an insignificant market value at inception. They obtain value, increase or decrease, as relevant interest rates, foreign exchange rates or credit prices change, such that the previously contracted terms of the derivative transactions have become more or less favourable than what can be negotiated under current market conditions for contracts with the same terms and the same remaining period to expiry. The potential for derivatives to increase or decrease in value as a result of the foregoing factors is generally referred to as market risk. This market risk is mitigated as the Company does not hold or use any derivative contracts for speculative trading purposes.

Credit risk

Credit risk on derivative financial instruments is the risk of a financial loss occurring as a result of a default of a counterparty on its obligation to the Company. Credit risk is limited by dealing only with Schedule 1 Canadian Chartered banks as counterparties. The maximum derivative credit exposure to the Company is the fair value of derivative contracts presented in the summary table above. The Company's exposure to risks arising from other financial instruments is disclosed in note 17.

Interest rate contracts	Notional principal	Replacement cost (1)	Credit risk equivalent (2)	Risk-weighted assets (3)	Fair value
Swaps					
Maturing within 1 year	110,000	3,076	3,076	615	3,076
Maturing in 1 to 3 years	455,000	19,201	21,476	4,295	19,201
Maturing in 3 to 5 years	110,000	6,259	6,809	1,362	6,259
Forward rate agreements					
Maturing within 1 year	60,000	8	—	—	8
	735,000	28,544	31,361	6,272	28,544

(1) Replacement costs represents the cost of replacing all contracts that have a positive fair value, using current market rates

(2) Credit risk equivalent represents the total replacement cost plus an amount representing the potential future credit exposure, as outlined in OSFI's Capital Adequacy Guideline

(3) Risk-weighted assets represent the credit risk equivalent, weighted based on the creditworthiness of the counterparty, as prescribed by OSFI.

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17. FINANCIAL INSTRUMENTS – FINANCIAL RISKS

The Company performs regular monitoring of its risks, assessments, and related action plans. Senior Management and the Board of Directors obtain information that allows them to keep informed regarding the effectiveness of their risk management process and activities. The company has a Conduct Review and Risk Management Committee to assist the Board of Directors in fulfilling its responsibilities.

Credit risk (non-derivative)

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations in accordance with agreed terms. Credit risk on the Company's cash and cash equivalents is mitigated by maintaining cash balances at Schedule 1 Canadian Chartered banks. Credit risk on the mortgage loans is mitigated by following Board approved underwriting policies. In particular, during the underwriting process every property is appraised by a certified appraiser with particular attention paid to the property type, location and days on market of each comparative property. The initial appraised value is subsequently discounted, typically by between 7.5% and 30%. A rate of future property appreciation assumed for the life of the mortgage is low in comparison with the Canadian average of approximately 4.4% for the past 20 years. The average rate of assumed appreciation used in the initial underwriting of the existing mortgage portfolio is approximately 1.5%. Each mortgage originated is limited in maximum dollar amount and loan-to-value ratio in accordance with internal guidelines. The Company also obtains a first charge on the underlying property securing the mortgage. Credit risk is mitigated further by the geographic diversity and the collateralization of the portfolio by mortgages with a most recently appraised value of \$2.4 billion.

Interest rate risk

The Company's operating margin is primarily derived from the spread between interest earned on the mortgage portfolio, and the interest paid on the debt and deposits used to fund the portfolio. Mortgages have various interest rate reset terms, ranging from variable to five-year. Interest on the majority of the Company's debt is fixed until maturity. The Company uses derivative contracts to move the fixed rate on the debt to match the rate reset terms of the mortgage portfolio, to mitigate any fluctuations that changes to the underlying benchmark rates may have on its operating margin at the time of the mortgage resets.

Interest rates on approximately 77% of the mortgage portfolio are based on the Government of Canada Treasury-bill and bond rates whereas interest rates on the debt and derivative instruments are based on the Bankers' Acceptance rates. Historically, changes in interest rates do not impact each benchmark rate equally which may result in a reduction in spread.

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December 31, 2009 and 2008**17. FINANCIAL INSTRUMENTS – FINANCIAL RISKS (continued)****Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its obligations when they are due. With respect to medium-term and subordinated debt, the Company mitigates these risks by issuing only highly rated debt, by using a syndicate of several dealers to issue debt, and by staggering the maturities of its debt obligations. With respect to deposits the Company mitigates risk by holding a required amount of cash and cash equivalents to meet maturing deposit liabilities.

The following table summarizes the expected final payment dates of debt principal and interest payable and deposit maturities:

	Within 1 year	2 to 3 years	4 to 5 years	December 31, 2009 Total
	\$	\$	\$	\$
Deposits	13,609	15,416	11,068	40,093
Interest payable on medium-term debt	7,857	—	—	7,857
Interest payable on subordinated debt	719	—	—	719
Interest payable on unsecured subordinated debt	183	—	—	183
Derivative instruments	212	2,237	898	3,347
Interest payable on derivative instruments	—	—	—	—
Debt principal (1)				
Medium-term debt	260,000	405,000	119,115	784,115
Subordinated debt	—	10,000	40,000	50,000
Unsecured subordinated debt	—	—	10,000	10,000
Total	282,580	432,653	181,081	896,314

(1) Certain tranches of debt have refinancing terms upon their expected final payment dates. See notes 11 and 12.

	Within 1 year	2 to 3 years	4 to 5 years	December 31, 2008 Total
	\$	\$	\$	\$
Interest payable on medium-term debt	8,722	—	—	8,722
Interest payable on subordinated debt	830	—	—	830
Derivative instruments	595	2,514	4,841	7,950
Interest payable on derivative instruments	1,250	—	—	1,250
Debt principal (1)				
Medium-term debt	150,000	110,000	529,186	789,186
Subordinated debt	—	—	60,000	60,000
Total	161,397	112,514	594,027	867,938

HOMEQ CORPORATION

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17. FINANCIAL INSTRUMENTS – FINANCIAL RISKS (continued)

Interest rate sensitivity

The Company is exposed to interest rate risk as a result of the mismatch, or gap, between the maturity or repricing date of interest sensitive assets and liabilities. The following table summarizes the gap position at December 31, 2009 for the selected period intervals. Figures in parentheses represent an excess of liabilities over assets or a negative gap position.

The Company estimates that an annualized 100 basis point decrease in interest rates would increase net interest income after tax over the next twelve months by \$130. A 100 basis point increase in interest rates would decrease net income after tax over the next twelve months by a similar amount. These sensitivities are hypothetical and should be used with caution.

2009 (in thousands except % amounts)						Non-	Total
	Floating	0 to 3 months	4 to 12 months	1 to 3 years	Over 3 years	interest rate sensitive	
Assets	\$	\$	\$	\$	\$	\$	\$
Cash resources	8,218	6,298	-	-	-	-	14,516
Weighted average interest rate	0.25%	0.24	-	-	-	-	0.25%
Interest bearing deposits	-	20,376	1,596	-	-	-	21,972
Weighted average interest rate	-	0.27%	0.41%	-	-	-	0.28%
Securities	-	6,499	5,693	-	-	-	12,192
Weighted average interest rate	-	0.25%	0.30%	-	-	-	0.27%
Loans	113,851	135,162	435,111	123,417	55,706	53,914	917,161
Weighted average interest rate	4.46%	5.64%	5.40%	7.21%	8.03%	-	5.40%
Derivative instruments	-	13,601	14,943	-	-	-	28,544
Weighted average interest rate	-	4.43%	4.00%	-	-	-	4.20%
Other assets	-	-	-	-	-	22,178	22,178
Weighted average interest rate	-	-	-	-	-	-	-
Total	122,069	181,936	457,343	123,417	55,706	76,092	1,016,563
Liabilities and shareholders' equity							
Deposits	-	-	13,609	15,450	11,118	(84)	40,093
Weighted average interest rate	-	-	1.22%	2.33%	3.30%	-	-
Medium term debt	-	-	274,115	405,000	105,000	8,213	792,328
Weighted average interest rate	-	-	2.81%	5.37%	4.64%	-	4.33%
Subordinated debt	-	-	-	10,000	40,000	335	50,335
Weighted average interest rate	-	-	-	6.66%	6.69%	-	6.64%
Unsecured subordinated debt	-	-	-	-	10,000	144	10,144
Weighted average interest rate	-	-	-	-	9.71%	-	9.58%
Derivative instruments	-	2,160	1,187	-	-	-	3,347
Weighted average interest rate	-	3.79%	4.06%	-	-	-	3.89%
Other	-	-	-	-	-	19,334	19,334
Weighted average interest rate	-	-	-	-	-	-	-
Shareholders' equity	-	-	-	-	-	100,982	100,982
Weighted average interest rate	-	-	-	-	-	-	-
Total	-	2,160	288,911	430,450	166,118	128,924	1,016,563
Derivative instruments		(142,500)	(321,000)	353,000	110,500	-	-
Interest rate sensitivity gap	122,069	37,276	(152,568)	45,967	88	(52,832)	-
Cumulative gap	122,069	159,345	6,777	52,744	52,832	-	-
2008							
Total assets	174,393	170,176	436,719	89,684	54,101	74,871	999,944
Total liabilities and shareholders' equity	-	5,227	171,909	400,000	280,000	142,808	999,944
Derivative instruments	-	(258,000)	(312,000)	337,000	233,000	-	-
Interest rate sensitivity gap	174,393	(93,051)	(47,190)	26,684	7,101	(67,937)	-
Cumulative gap	174,393	81,342	34,152	60,836	67,937	-	-

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18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table summarizes the fair values of the Company's financial instruments. The estimated fair value amounts are designed to approximate amounts at which financial instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act.

The Company uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value of financial instruments. The classifications are as follows: the use of quoted market prices for identical financial instruments (Level 1); internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3). The Company had no Level 1 and Level 3 financial instruments at December 31, 2009 and there have been no transfers between levels.

Due to the estimation process and the need to use judgement, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

	December 31, 2009			December 31, 2008		
	Carrying value	Fair value	Fair value over carrying value	Carrying value	Fair Value	Fair value over carrying value
Assets						
Cash Resources (1)	36,488	36,488	—	41,532	41,532	—
Securities (1)	12,192	12,192	—	24,502	24,502	—
Loans(2)	917,161	917,161	—	868,563	868,563	—
Derivative instruments (3)	28,544	28,544	—	44,680	44,680	—
Other (4)	22,178	22,178	—	20,667	20,667	—
	1,016,563	1,016,563	—	999,944	999,944	—
Liabilities						
Deposits(5)	40,093	40,549	456	—	—	—
Derivative instruments (3)	3,347	3,347	—	7,950	7,950	—
Other(4)	19,334	19,334	—	16,566	16,566	—
Medium-term debt (6)	792,328	812,628	20,300	804,297	800,089	(4,208)
Subordinated debt (6)	50,355	48,923	(1,432)	60,407	60,418	11
Unsecured subordinated debt (6)	10,144	10,421	277	—	—	—
Shareholders' equity	100,982	100,982	—	110,724	110,724	—
	1,016,583	1,036,184	19,601	999,944	995,747	(4,197)

The fair value amounts of the Company's financial instruments have been determined using the following methods and assumptions:

- (1) Cash resources and securities are valued using internal models using observable market information as inputs (Level 2)
- (2) Loans are recorded at amortized cost. The carrying value of the mortgage loans approximates fair value as the prevailing interest rates reset in accordance with the provisions of the underlying mortgage terms.
- (3) Fair value of derivative instruments is determined using an internal valuation model with observable inputs (Level 2)
- (4) Certain other assets and certain other liabilities are recorded at amortized cost. The carrying value of these other assets and other liabilities are assumed to approximate their fair value due to their short-term nature.
- (5) Fair value of deposits is determined by discounting the contractual cash flows using the market interest rates currently offered for deposits with similar terms.
- (6) Fair value of medium-term debt, subordinated debt and unsecured subordinated debt are determined using average quoted market rates provided to the Company by capital market dealers.

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Notes to Consolidated Financial Statements

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19. COMMITMENTS

The Company's annual lease obligations are as follows:	\$
2010	463
2011	482
2012	480
2013	477
2014	484
Thereafter	490

20. SALARIES AND BENEFITS

The following table shows the details of the salaries and benefits on the consolidated statements of income:

	December 31 2009	December 31 2008
	\$	\$
Mortgage origination	782	780
Mortgage servicing and administration	178	171
Overhead	4,767	4,386
	5,727	5,337

21. SELLING, GENERAL AND ADMINISTRATION

The following table shows the details of selling, general and administration on the consolidated statements of income:

	December 31 2009	December 31 2008
	\$	\$
Marketing	2,028	3,794
Professional services	2,839	1,477
Office expenses	1,183	1,109
Other	335	433
Business and capital taxes	260	—
Mortgage servicing and administration	129	97
	6,774	6,910

22. CONSOLIDATED STATEMENTS OF CASH FLOW

Net change in other non-cash working capital balances is detailed as follows:

	December 31 2009	December 31 2008
	\$	\$
Prepaid expenses and other assets	(261)	4
Intangible assets	(310)	(117)
Income taxes payable	1,873	—
Accounts payable and accrued liabilities	1,691	(956)
	2,993	(1,069)

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23. FUTURE ACCOUNTING CHANGES

Transition to International Financial Reporting Standards

The Canadian Accounting Standards Board has confirmed that International Financial Reporting Standards (IFRS) will replace current Canadian GAAP for publicly accountable enterprises, including the Company, effective for fiscal years beginning on or after January 1, 2011. Accordingly, the Company will report interim and annual financial statements in accordance with IFRS beginning with the quarter ended March 31, 2011. HOMEQ's 2011 interim and annual financial statements will include comparative 2010 financial statements, adjusted to comply with IFRS.

The Company has developed a comprehensive IFRS implementation plan and established an implementation team to prepare for this transition. Early in 2009, the implementation team completed an assessment of the key areas where changes to accounting policies may be required. The team has substantially completed the detailed analysis of IFRS requirements in the key areas and is currently assessing the results of this analysis with advisors and management in order to make a final determination of the changes that may be required to current accounting policies.

24. SUBSEQUENT EVENT

On March 4, 2010 the Company's Board of Directors approved the payment of a quarterly dividend of \$0.07 per share on the outstanding common shares of the Company, which is equivalent to an annual dividend of \$0.28 per share. The dividend was payable to shareholders of record at the close of business on March 29, 2010 and is payable on April 13, 2010.

25. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2009 consolidated financial statements.

CORPORATE INFORMATION

REGISTRAR AND TRANSFER AGENT

Computershare
100 University Avenue
Toronto, Ontario M5J 2Y1
For any inquires please call:
Toll free: 1-800-663-9097

STOCK LISTING

The shares of HOMEQ Corporation
are listed on the
Toronto Stock Exchange under the
symbol HEQ

For further information, please contact:

Gary Krikler, CA

Senior Vice President and Chief Financial Officer

or

Scott G. Cameron, CA

Vice President, Finance



HOMEQ CORPORATION
Suite 600, 45 St. Clair Avenue West
Toronto, Ontario M4V 1K9
Tel: (416) 925-4757 or 1-888-665-1119
Fax: (416) 925-9938
www.homeq.ca