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**INTERIM QUARTERLY REPORT**  
**For the quarter ended**  
**September 30, 2009**

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<b>Financial highlights (\$ thousands except per share and percentage amounts)</b>	Three months ended September 30,		Nine months ended September 30,	
	<b>2009</b>	2008	<b>2009</b>	2008
<b>OPERATING RESULTS</b>				
Net income (loss)	<b>(197)</b>	3,516	<b>(2,172)</b>	13,758
Per share	<b>(0.01)</b>	0.25	<b>(0.15)</b>	0.98
Adjusted net income (loss) (1)	<b>2,086</b>	1,278	<b>5,571</b>	4,092
Per share	<b>0.15</b>	0.09	<b>0.39</b>	0.29
Return on equity (annualized)	<b>(0.8%)</b>	14.4%	<b>(2.7%)</b>	19.1%
Adjusted return on equity (annualized) (2)	<b>9.7%</b>	5.7%	<b>8.5%</b>	6.0%
Spread income (3)	<b>6,609</b>	5,148	<b>18,688</b>	15,718
Spread percentage	<b>3.20%</b>	3.04%	<b>3.11%</b>	3.13%
Dividends per share	—	0.27	<b>0.42</b>	0.81
Mortgage originations	<b>29,460</b>	37,814	<b>66,830</b>	105,068
Trailing four quarter origination cost %	<b>10.8%</b>	9.4%	<b>10.8%</b>	9.4%
Trailing four quarter administration expense %	<b>0.66%</b>	0.67%	<b>0.66%</b>	0.67%
<b>BALANCE SHEET HIGHLIGHTS</b>				
Total assets			<b>984,896</b>	977,883
Mortgage principal plus accrued interest			<b>837,003</b>	798,162
Medium term debt			<b>799,592</b>	805,903
Subordinated debt			<b>60,248</b>	60,354
<b>PORTFOLIO QUALITY</b>				
Appraised value of underlying properties			<b>2,341,599</b>	2,232,966
Average loan to value			<b>35.8%</b>	35.8%
Non-accrual mortgage value			<b>1,311</b>	451
Allowance for credit losses			<b>2,149</b>	251

(1) Adjusted net income (loss) is explained in the Financial Results section on page 9 of the MD&A

(2) Adjusted return on equity is explained in the Financial Results section on page 9 of the MD&A

(3) Spread income, a non-GAAP measure, as discussed on pages 14 and 15 of the MD&A



## TO OUR SHAREHOLDERS:

We are pleased to present the unaudited quarterly financial results for HOMEQ Corporation (HOMEQ or the Company) for the quarter ended September 30, 2009.

On October 13, 2009, HOMEQ announced that its operating subsidiary, Canadian Home Income Plan Corporation, had received its Letters Patent and Order to Commence as a federally regulated Schedule I bank from the Minister of Finance. The new bank is called HomEquity Bank and is a strategic initiative that will allow access to additional cost-effective and reliable sources of funding from retail deposits. Retail deposits will be used to supplement the wholesale funding strategy that HOMEQ has followed since its IPO in 2002. This will directly enhance HOMEQ's ability to offer competitively positioned products and services to meet client needs and grow the business.

We are extremely gratified with our success in achieving our new status, and Canadian seniors will benefit from lower interest rates on reverse mortgages as a result of HomEquity Bank's diversified sources of funding and lower cost of borrowing. With reverse mortgage interest rates already at an all-time low, we recently announced a further reduction in rates to as low as 4.95%.

In establishing HomEquity Bank we have demonstrated that a company with a trusted brand, high-demand products and strong customer and partner relationships can forge ahead and achieve significant milestones. Our established corporate culture, well-defined business philosophy and innovative, capable team have all played a major role, not only in our success in the past but throughout the recent transition process. Undoubtedly, they will continue to play a vital role in our future growth.

During the last two years HOMEQ has operated in an environment of extreme uncertainty. Starting in late 2008, we were forced to take actions to reduce the level of new mortgage originations by up to 50% in order to conserve cash. With the anticipation of the imminent launch of HomEquity Bank, in Q3 2009 we reversed many of those actions in order to restore our previous growth rate. The result was that originations in Q3 2009 of \$29.5 million were the highest achieved since Q3 2008 and were 78% of that achieved in Q3 2008. We are excited with our ability to resume the rates of growth that we are capable of.

Spread percentage in the quarter of 3.20% was 16 basis points higher than Q3 2008, and was the highest achieved since Q1 2008. The Canadian debt capital markets have recently been more consistent with historic experience than has been the case since Q3 2007. In particular, the difference between the Prime Rate and the rate on Government of Canada Treasury Bills, on which mortgage rates have in the past been based, and the rate on Bankers' Acceptances, on which HOMEQ's debt and hedging instruments are based, have returned to historical norms after deviating significantly over the last two years.

This quarter marks the first period in which our financial statements and management discussion and analysis have been prepared as a financial institution rather than as an income trust. The relevant disclosure and pertinent measures are consistent with financial industry practice in this regard. The significant change in the corporate structure from an income trust to a taxable entity, and the relevant change in presentation will make comparison to prior year periods somewhat inconsistent for the forthcoming year.

We are introducing the concept of adjusted net income and adjusted return on equity in our management discussion and analysis for the first time. We believe that these measures are relevant in understanding the true economics and performance of the entity in its new form. In particular, they remove the quarterly variations in income caused by changes in the unrealized mark to market value of our derivatives and also the recent costs of converting from an income trust and establishing HomEquity Bank.

Net loss for the quarter was \$0.2 million, adjusted net income was \$2.1 million and adjusted return on equity (annualized) was 9.7%. In Q3 2008, net income, adjusted net income, and adjusted return on equity (annualized) were \$3.5 million, \$1.3 million and 5.7% respectively.

Subsequent to the end of the quarter, HomEquity Bank's subsidiary CHIP Mortgage Trust successfully issued \$150 million of medium term notes at favourable rates, and the proceeds were used to repay an equivalent



amount of medium term notes that matured on November 1, 2009. In addition, HomEquity Bank issued \$10 million of subordinated medium term notes due October 31, 2014. The proceeds were used to repurchase an equivalent amount of subordinated medium term notes maturing in November 2012. The new subordinated notes qualify as Tier 2 B Capital of HomEquity Bank thus increasing its regulatory capital. The pro-forma total capital ratio of HomEquity Bank at September 30, 2009, including the impact of these notes, would have been in excess of 17% and its assets to capital multiple would have been 11.3 times. The successful completion of both of these transactions ensures our liquidity and capital positions as we begin the next stage of our corporate life as a bank.

Over the last two years we have proven the soundness of our business model and have been able to withstand the effects of extremely uncertain economic conditions well beyond our control. Our immediate goal is to build on the tremendous achievement of becoming a bank and to return to the growth rate we enjoyed prior to the financial crisis.

Thank you to all our shareholders for your support over the past two years.

Sincerely,

A handwritten signature in black ink, appearing to read "P. Lebel".

Pierre Lebel  
Chairman, Board of Directors

A handwritten signature in black ink, appearing to read "S. K. Ranson".

Steven K. Ranson  
President & Chief Executive Officer

November 5, 2009



## **MANAGEMENT DISCUSSION AND ANALYSIS**

The following management discussion and analysis (“MD&A”) of HOMEQ Corporation (HOMEQ Corp) reflects the continuation of Home Equity Income Trust (the Trust) subsequent to the court approved plan of arrangement where the Trust converted to a corporation on June 30, 2009 (the Conversion). HOMEQ Corp and the Trust are together referred to as “HOMEQ” or the “Company”.

Effective June 30, 2009, all of the outstanding trust units of the Trust were exchanged for common shares of HOMEQ Corp on a one-for-one basis. All references to “shares” refer collectively to the common shares subsequent to Conversion and to 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. Since the Conversion, HOMEQ has ceased reporting on matters specifically relevant to Income Trusts.

HOMEQ Corp has the same financial year end, December 31, as the Trust and continues the business of the Trust. For the financial year ending December 31, 2009, its first financial year after the effective date of the Conversion, HOMEQ Corp will file audited consolidated financial statements, including a comparison to the results of the Trust for the financial year ended December 31, 2008.

The MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the period ended September 30, 2009 included herein and the MD&A and audited annual consolidated financial statements of the Trust for the year ended December 31, 2008. These are available on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A has been prepared based on information available as at November 5, 2009. All amounts are stated in Canadian dollars and have been primarily derived from the HOMEQ’s annual or interim consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles (GAAP). HOMEQ Corp’s Audit Committee reviewed this document, and prior to its release, the Company’s Board of Directors approved this document, on the Audit Committee’s recommendation.

On October 13, 2009, HOMEQ’s wholly owned operating subsidiary Canadian Home Income Plan Corporation (“CHIP”) received its Letters Patent and Order to Commence as a federally regulated Schedule I bank, HomEquity Bank, from the Minister of Finance. The continuance as a bank is a strategic initiative that will allow access to additional cost-effective and reliable sources of funding as detailed later in the MD&A. Unless indicated otherwise, CHIP and HomEquity Bank are collectively referred to as HomEquity.

The management discussion and analysis is dated November 5, 2009.

## **CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

*HOMEQ Corporation from time to time makes written and verbal forward-looking statements about business objectives, operations, performance, and financial condition, including, in particular, the forecast of anticipated dividend policy and the likelihood of HOMEQ’s success in developing and expanding its business. These may be included in HOMEQ’s or its predecessor’s Annual Reports, quarterly reports, regulatory filings, reports to shareholders, press releases, presentations and other communications.*

*These forward-looking statements are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond the control of HOMEQ. Actual results may differ materially from those expressed or implied by such forward-looking statements including but not limited to risks related to capital markets and additional funding requirements, fluctuating interest rates, asset quality and rates of default as well as those factors discussed under the heading “Business Risks” herein and in HOMEQ’s documents filed on SEDAR. HOMEQ does not undertake to update any forward-looking statement, whether written or verbal, that may be made from time to time.*



## **CORPORATE OVERVIEW**

HOMEQ is a national provider of reverse mortgages to homeowners aged 60 and over, Canada's fastest growing demographic segment. HomEquity originates reverse mortgages under the CHIP Home Income Plan brand. HomEquity's predecessor, Canadian Home Income Plan Corporation, has been the main underwriter of reverse mortgages in Canada since pioneering the concept in 1986. The objective of HOMEQ is to generate stable profits and cash flow primarily from the spread between the interest earned on the mortgage portfolio and the interest paid on the debt and deposits used to fund the portfolio.

HOMEQ Corp is publicly traded on the Toronto Stock Exchange (TSX) under the symbol HEQ and has the following direct and indirect subsidiaries:

- HomEquity originates and finances reverse mortgages and also provides mortgage administration services on the reverse mortgage portfolio.
- CHIP Mortgage Trust (CMT), a wholly owned subsidiary of HomEquity, finances a segment of the reverse mortgages originated by HomEquity by issuing short-term and medium-term debt. Senior debt is rated 'R1-high' and 'AAA' and subordinated debt is rated 'BBB' by DBRS Limited (DBRS).

The discussion of HOMEQ's operations in the MD&A and financial statements consolidates the activities of these subsidiaries.

A reverse mortgage is a type of residential mortgage that permits qualifying homeowners to convert a portion of their home equity into cash on a tax-free basis while remaining in the home. Customers are not required to repay any principal or interest on such mortgage until the loan becomes due.

Each reverse mortgage is secured by a specific residential property, is a registered first mortgage and contains standard contractual mortgage terms, conditions and default remedies. The loan becomes due on the earlier of (i) the time the home is sold, (ii) the time the home is permanently vacated by the mortgagors (as both spouses are typically mortgagors), (iii) 120 days following the death of the last surviving mortgagor, and (iv) demand for repayment after the occurrence of an event of default (including failure to pay property taxes, maintain insurance or keep the house in proper repair).

Homeowners may remain in the home as long as they wish or are able, provided they are not in default. When the loan becomes due, the reverse mortgage is usually repaid from the proceeds of the sale of the home or the mortgagors' estate and, if the home is sold, any excess value of the home remains with the homeowner or the homeowner's estate. The right of the Company to receive principal and interest when due under the reverse mortgage is limited to the realized value of the property at such time and HOMEQ has no additional recourse to the mortgagors or their estates.

HOMEQ is the primary provider of reverse mortgages in Canada through its distribution and referral network. The referral network includes all the major Canadian Banks as well as credit unions, mortgage brokers, investment and financial planning firms.



## **NON-GAAP MEASURES**

HOMEQ uses a number of financial measures to assess its performance. Some measures are calculated in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), such as net interest income. Other measures are not defined by GAAP and do not have standardized meanings or similar measures used by other companies. HOMEQ believes that the non-GAAP items provide the reader with additional understanding of how management views HOMEQ's performance.

Non-GAAP measures used in the MD&A include the following:

### **Yield**

Yield is a measure that presents interest earned on the mortgage portfolio as a percentage of the mortgage portfolio value.

### **Cost of funds**

Cost of funds is a measure that presents the interest paid on the debt used to fund the mortgage portfolio as a percentage of the aggregate value of debt.

### **Spread Income**

Spread income is the difference in dollars between interest earned on the mortgage portfolio and interest paid on the debt used to fund the portfolio.

### **Spread Percentage**

Spread percentage is a measure that presents spread income as a percentage calculated as the difference between the yield earned on the mortgage portfolio and the cost of funds of the debt funding the mortgages.

### **Tier 1 and Total Capital Ratios**

The capital ratios provided in this MD&A are those of the Company's wholly owned subsidiary, HomEquity Bank. The calculations are in accordance with the guidelines issued by the Office of the Superintendent of Financial Institutions ("OSFI").

### **Adjusted Net Income**

To arrive at adjusted net income, HOMEQ removes certain items from reported net income which management believes are not indicative of the underlying business performance.

### **Adjusted Shareholders' Equity**

To arrive at adjusted shareholders' equity, HOMEQ removes certain items from reported equity which Management believes are not indicative of the underlying capital structure.

### **Return on Equity (Annualized) and Adjusted Return on Equity (Annualized)**

Return on equity (annualized) is a measure that presents net income earned in the current quarter multiplied by a factor of four and reflected as a percentage of average shareholders' equity. Adjusted return on equity is calculated as adjusted net income divided by the average adjusted shareholders' equity.

### **Efficiency ratio**

The efficiency ratio is derived by dividing non-interest expenses by the sum of net interest income and non-interest income. In general, a lower efficiency ratio is associated with a more efficient cost structure.

### **Loan-to-Value**

Loan-to-Value or LTV measures the outstanding mortgage balance as a percentage of the appraised value of the property.



## FINANCIAL RESULTS

### Financial Overview

Reverse mortgages are long term assets and earn interest over a multi-year period. Under GAAP, interest income is recognized in the period it is accrued despite not being received in cash. Other than sales commissions, which are deferred and amortized over the period the mortgages are expected to earn interest, origination costs such as marketing, origination salaries and benefits and the share of overhead expenses applicable to new mortgage originations are expensed under GAAP in the period incurred. This has the effect of reducing net income during periods of growth, but benefiting HOMEQ in the longer term.

The change in HOMEQ's corporate structure from an income trust to a taxable entity, and the relevant significant change in financial presentation will make comparison to prior year periods somewhat inconsistent for the forthcoming year.

The table below provides a summary of results of the past nine quarters of operations.

(\$ thousands, except per share amounts)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Interest income	13,797	15,080	14,846	14,945	15,030	14,725	13,104	12,514	11,920
Interest expense	8,062	10,047	9,768	10,075	10,154	9,473	8,492	7,201	6,268
Net interest income	5,735	5,033	5,078	4,870	4,876	5,252	4,612	5,313	5,652
Provision for credit losses	—	54	—	—	—	(157)	—	—	(1,741)
Non interest income	202	205	182	271	279	311	222	199	255
Net interest income and other income	5,937	5,292	5,260	5,141	5,155	5,406	4,834	5,512	4,166
Non interest expenses	3,205	3,251	3,337	2,864	3,247	3,102	3,104	3,086	3,095
Income before undernoted items	2,732	2,041	1,923	2,277	1,908	2,304	1,730	2,426	1,071
Less:									
Unrealized (gain) loss on derivative instruments	(3,423)	(4,427)	(14,306)	6,360	(1,671)	(17,746)	(2,271)	5,384	1,595
Current income tax expense (recovery)	(70)	21	—	2	—	(2)	—	—	973
Future income tax expense (recovery)	1,073	145	3,184	(1,282)	63	4,277	910	2,108	(1,300)
Net income (loss)	5,152	6,302	13,045	(2,803)	3,516	15,775	3,091	(5,066)	(197)
Per share	0.37	0.45	0.93	(0.20)	0.25	1.12	0.22	(0.36)	(0.01)
Average number of shares outstanding	13,872	13,918	13,981	14,061	14,113	14,124	14,153	14,213	14,229

### Adjusted Net Income and Return on Equity

The table below details the adjustments between net income and adjusted net income for the past nine quarters of operations. In calculating adjusted net income, HOMEQ removes certain items from reported net income as it believes that these items are not indicative of the underlying business performance. In particular, as further discussed under "Derivatives" later in the MD&A, derivatives are normally held to maturity and thus any unrealized gains or losses are timing differences and will be zero at maturity. In addition, costs related to the Conversion and the adjustment to the provision for credit losses in Q3 2009 are not considered recurring items. HOMEQ has calculated notional taxes for prior quarters when it was an income trust using the current period tax rate of 33%.



(\$ thousands, except per share amounts)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Net Income (loss) before tax	6,155	6,468	16,229	(4,083)	3,579	20,050	4,001	(2,958)	(524)
Add (deduct)									
Unrealized (gain) loss on derivatives	(3,423)	(4,427)	(14,306)	6,360	(1,671)	(17,746)	(2,271)	5,384	1,595
Conversion costs	—	—	—	—	—	—	522	524	65
Adjustment to provision for credit losses	—	—	—	—	—	—	—	—	1,741
Adjusted net income before tax	2,732	2,041	1,923	2,277	1,908	2,304	2,252	2,950	2,877
Notional taxes	(902)	(674)	(635)	(751)	(630)	(760)	(743)	(974)	—
Tax provision as reported less tax effect of above items	—	—	—	—	—	—	—	—	(791)
Adjusted net income	1,830	1,367	1,288	1,526	1,278	1,544	1,509	1,976	2,086
Per share	0.13	0.10	0.09	0.11	0.09	0.11	0.11	0.14	0.15
Average number of shares outstanding	13,872	13,918	13,981	14,061	14,113	14,124	14,153	14,213	14,229

Similarly, management adjusts shareholders' equity for items it believes are not indicative of the underlying capital structure in order to arrive at adjusted shareholders' equity used to determine adjusted return on equity. Adjusted return on equity is calculated as adjusted net income divided by the average adjusted shareholders' equity. The table below details the adjustments between shareholders' equity and adjusted shareholders' equity for the past nine quarters.

(\$ thousands)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Shareholders' equity	90,798	93,912	103,779	97,774	97,798	110,724	110,890	102,547	102,486
Add (deduct)									
Derivative instruments, net	2,538	(948)	(12,085)	(7,044)	(8,630)	(22,119)	(23,231)	(17,344)	(16,271)
Adjusted shareholders' equity	93,336	92,964	91,694	90,730	89,168	88,605	87,659	85,203	86,215
Adjusted return on equity (annualized)	7.8%	5.9%	5.6%	6.7%	5.7%	6.9%	6.8%	9.1%	9.7%

A discussion of various elements impacting net income is included below. Where applicable, further details are discussed later in the MD&A.

### Net Interest Income

Net interest income is derived mainly from the spread between the interest earned on the mortgage portfolio and the interest paid on the debt to fund the portfolio, and increased by \$0.8 million or 15.9% in Q3 2009 over Q3 2008. For the quarter, spread percentage of 3.20% was 16 basis points higher than Q3 2008 and three basis points higher than Q2 2009. The improvement in spread percentage reflects that the Canadian debt capital markets have recently been more consistent with historic experience than has been the case since Q3 2007. In particular, the difference between the Prime Rate and the rate on T-Bills, on which mortgage rates have in the past been based, and the rate on BAs, on which HOMEQ's debt and hedging instruments are based, have returned to historical norms after deviating significantly over the last two years.



### **Provision for Credit Losses**

HOMEQ increased its provision for credit losses in Q3 2009, resulting in a non cash-flow reduction in interest income in the quarter of \$1.7 million following which the total provision will be \$2.1 million, equivalent to 0.26% of the total value of the mortgage portfolio. The increase follows 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, which is discussed in detail later in the MD&A, included a review of general real estate conditions and trends and their potential impact on the portfolio.

### **Non-Interest Income**

Non interest income comprised of mortgage closing fees, net of costs and administration fees, was \$0.3 million in Q3 2009, 8.6% lower than Q3 2008 due mainly to the reduced number of mortgages originated while the company waited to receive its bank charter.

### **Non-Interest Expenses**

In order to conserve cash resources prior to HomeEquity receiving its bank Charter, HOMEQ has operated at a reduced level of marketing spend since Q3 2008 and has managed overhead expenses to 2008 levels. As a result, total non-interest expenses of \$3.1 million were \$0.2 million or 4.7% lower in Q3 2009 compared to Q3 2008. Excluding \$0.1 million of expenses incurred in the quarter relating to the bank launch and \$0.2 million of capital tax since the conversion to a corporate structure on June 30 2009, non-interest expenses were lower by \$0.4 million, or 12.5%. HOMEQ's efficiency ratio for Q3 2009 was 52.4%, an improvement from 63.0% in Q3 2008.

For the nine months ended September 2009 total non-interest expenses of \$9.3 million were \$0.2 million or 1.7% lower than 2008 as the Company managed its overhead costs while working through the process to obtain the bank charter. The cost of the Conversion and the continuation of CHIP as a federally-regulated, Schedule I Canadian bank is \$2.5 million, of which \$1.4 million has been capitalized and \$1.1 million has been expensed. Excluding Conversion costs of \$1.1 million, \$0.1 million for the bank launch and \$0.2 million of capital tax not previously incurred, non-interest expenses for the nine months ended September 2009 were \$1.6 million or 16.5% lower than the same period of 2008. The efficiency ratio for the nine months ending September 30, 2009 was 57.1% an improvement from 60.7% in the same period of 2008.

### **Derivatives**

Under GAAP, derivatives are valued at fair market value with changes in fair value recognized in the current period's statement of income. HOMEQ's derivative portfolio is substantially weighted to receive fixed rates. Therefore the fair market value of the derivatives will move in an opposite direction to changes in the underlying interest rates and the related interest rate curve (the Curve) used to value the derivatives. As rates decrease or the Curve flattens the fair value of the derivative portfolio increases. As the rates increase or the Curve steepens, the fair value will decrease. In addition, as the derivative contracts approach maturity, the fair value will reduce. In Q3 2009 the fair value of the derivatives declined by \$1.6 million mainly due to the reduction in remaining term of the derivatives. There was minimal impact from rates which have remained relatively flat since June 30, 2009.

HOMEQ's derivatives are generally neither held for resale nor traded. For derivatives that are not subject to hedge accounting, HOMEQ believes that there is an asymmetry in the recognition methods of derivatives at fair market value, and assets and liabilities at amortized cost. This has resulted in net income volatility not indicative of the business. As both derivatives and medium term debt are normally held to maturity, any unrealized gains or losses are timing differences and will be zero at maturity.



## Taxes

With the conversion to a corporate structure on June 30 2009, HOMEQ is now subject to income tax on its taxable income and has recorded a net tax recovery of \$327 of current and future taxes in the third quarter. Prior to the Conversion, HOMEQ distributed all of its taxable income to its unitholders and was not subject to corporate taxes.

Future income taxes are accounted for under the asset and liability method. Under this method of tax allocation, future tax assets and liabilities are determined based on differences between the financial reporting and tax basis 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 recorded in the consolidated financial statements to the extent that realization of such benefits is more likely than not.

Included in its tax provision, HOMEQ recorded a future income tax non-cash recovery of \$1.3 million to earnings during Q3 2009. The future tax asset and liability reflect the temporary differences between the financial reporting and tax basis of the derivatives, mortgage reserves and mortgage premiums as of September 30, 2009.

## Net Income (loss) and Adjusted Net Income

For the third quarter of 2009 HOMEQ reported a net loss of \$0.2 million or \$0.01 per share and adjusted net income of \$2.1 million or \$0.15 per share. Adjusted net income was \$0.8 million or 63.2% higher than Q3 2008 mainly due to increases in net interest income and reduced non-interest expenses.

## Portfolio Growth

HOMEQ intends to generate stable profits and cash flow by profitably increasing the size of its mortgage portfolio. The mortgage portfolio at the end of Q3 2009 was \$837.0 million, an increase of \$38.9 million or 4.9% over Q3 2008. The following table shows the growth in the mortgage portfolio on a quarterly basis for the past nine quarters.

(\$ millions)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Opening mortgage balance (1)	655.0	678.7	707.8	737.7	767.5	798.2	814.2	825.7	832.9
Originations	34.4	33.9	28.2	39.0	37.8	24.6	14.7	22.7	29.5
Accrued interest	14.3	14.9	15.2	15.2	15.3	15.2	14.1	13.6	12.9
Repayments of principal	(17.4)	(13.2)	(9.5)	(16.4)	(15.2)	(15.4)	(11.2)	(20.0)	(26.1)
Repayments of accrued interest	(7.6)	(6.5)	(4.0)	(8.0)	(7.2)	(8.4)	(6.1)	(9.1)	(12.2)
Ending mortgage balance (1)	678.7	707.8	737.7	767.5	798.2	814.2	825.7	832.9	837.0
# of origination transactions (2)	380	373	313	400	470	390	252	356	446
Loan to value of originations	30%	32%	31%	32%	30%	27%	28%	28%	29%
Total repayments as % of opening balance	3.8%	2.9%	1.9%	3.3%	2.9%	3.0%	2.1%	3.5%	4.6%
Trailing 4 quarters:									
Originations	118.2	127.3	129.9	135.5	138.9	129.6	116.1	99.8	91.5
# of origination transactions (2)	1,373	1,427	1,443	1,466	1,556	1,573	1,512	1,468	1,444
Average value (\$000's)	86.1	89.2	90.0	92.4	89.3	82.4	76.8	68.0	63.4
Total repayments	(86.8)	(87.6)	(82.7)	(82.6)	(80.0)	(84.1)	(87.9)	(92.6)	(108.5)

(1) Excluding unamortized purchase price premiums, origination fees, deferred commissions and allowance for credit losses

(2) # of transactions includes new clients and additional borrowing from existing clients

Commencing in Q4, 2008, HOMEQ took specific actions to conserve its cash resources. Steps were taken to reduce the average mortgage amount for new customers, marketing activity was scaled back, overhead expenditure was closely monitored and sales territories were rationalized. As anticipated, these steps caused originations to be reduced by 40% to 50% in late 2008 and early 2009 and resulted in the loan to value on new originations dropping to 29% from a quarterly average of above 30%.



In Q3 2009, with the anticipation of the imminent continuation of HomeEquity, interest rates and mortgage closing costs were gradually reduced to allow average mortgage amounts to revert to historic norms. Originations in Q3 of \$29.5 million were the highest achieved since Q3 2008 and were 78% of that achieved in Q3, 2008.

The number of origination transactions in Q3 2009 decreased by 5.1% and the average value per transaction on a trailing four quarters basis decreased 29.0% to \$63,400 from Q3 2008 due to the mix of new mortgages and additional borrowing from existing clients. In the opinion of HOMEQ, there was no undue concentration in originations by source, region, age group or property type.

Accrued interest in Q3 2009 of \$12.9 million decreased 15.7% from \$15.3 million in Q3 2008 mainly due to the 164 basis point reduction in yield earned on the mortgage portfolio. The impact of the reduction in the yield was partially offset by the 4.9% growth in the mortgage portfolio from Q3 2008

Total repayments of principal and interest of \$38.3 million in Q3 2009 were \$15.9 million or 71.0% higher than Q3 2008. Repayments in the quarter were higher than recent quarters reflecting increased housing market activity. As a percentage of the opening mortgage balance, total repayments were higher than historical experience. Short-term fluctuations in the level of originations and repayments will have an impact on the total portfolio balance in the future. There is no apparent reason to believe that the increased level of repayments in the quarter reflects a long term trend.

### **Portfolio Quality**

The loan-to-value ratio ("LTV") measures the outstanding mortgage balance as a percentage of the appraised value of the property. A lower LTV together with information on the past performance of the mortgage indicates the probability that the proceeds realized on the disposition of the home will be sufficient to pay out the outstanding mortgage balance on maturity. Once a mortgage has been originated, typically its LTV increases over time. Each property in the mortgage portfolio is reappraised at least every five years.

HOMEQ's policy is to cease accruing interest income from any mortgage where the loan to value exceeds 83%. To ensure that these loans are reported as accurately as possible, each mortgage with a loan to value in excess of 80% is reappraised at least once per year. At September 30, 2009, 11 loans had a loan to value greater than 83% having a balance of \$1.3 million, net of a \$0.2 million specific allowance. The appraised value of the property securing the mortgages is \$1.6 million before disposition costs. There were five mortgages with a loan-to-value greater than 83% at September 30, 2008.

HOMEQ continually monitors and reassesses its underwriting policies, procedures and methodology, paying close attention to, amongst others, real estate trends, interest rate environments and occupancy experience. 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 7.5% or more;
- A rate of future property appreciation is assumed for the life of the mortgage in comparison with the Canadian 20 year average. The average rate of assumed appreciation used in the initial underwriting of the mortgages currently in the portfolio is approximately 1.60%;
- Each mortgage originated is limited in maximum dollar amount and to no more than 55% loan-to-value ratio.

The loan-to-value ratio of the \$29.5 million of new mortgages originated in Q3 2009 was 29% in comparison to 30% in Q3, 2008. For the entire mortgage portfolio, the most recently appraised value of the underlying properties was approximately \$2.3 billion, for a loan-to-value ratio of approximately 36% at September 30, 2009, comparable to that of September 30, 2008.

In the underwriting process, there is an inherent risk that expected occupancy term ("EOT"), interest rate and property appreciation experienced over the life of a mortgage might vary from the assumed factors used in



underwriting the mortgage. In addition, the value of a mortgage may increase unexpectedly as a result of charges being applied to the mortgage during the course of its life. Charges applied to the mortgage can include fire insurance, property taxes, property maintenance and legal fees which the client has not paid. HOMEQ covers these charges in order to retain its registered mortgage in first position.

In recognition of the above, HOMEQ has developed a loan provisioning policy based on a risk management process that:

- Utilizes an anticipatory approach to measuring and reporting risk and the probability of loss;
- Calculates a general allowance that estimates the potential loss within the portfolio in an amount closely approximating the present value of projected future cash flow shortfalls; and
- Adequately discloses general allowances.

HOMEQ's loan provisioning methodology is reviewed and assessed periodically and is updated to take into account both current circumstances and evolution of the portfolio and business. During the current quarter a significant review was undertaken, having last been undertaken comprehensively approximately five years ago. The most recent findings indicate that the portfolio remains strong with a low loan-to-value however, other qualitative aspects are becoming evident as the portfolio matures and have now been addressed.

As a result, HOMEQ's loan provisioning policy has been updated to incorporate allowances required to identify the following:

- Mortgages with a current value greater than the current expected realizable value of the property;
- Mortgages with a LTV that may be inaccurate because;
  - a) The value of a property may have fallen since the last appraisal (up to five years prior) resulting in the expected realizable value of the property becoming less than the value of the mortgage;
  - b) Re-appraisals are conducted on either a desk top or drive-by basis which may not adequately recognize internal and structural damage or regional issues that could have a negative effect on the value of the property.
- Mortgages that have exhibited characteristics indicating a greater likelihood of exceeding the expected realizable value of the relevant property during the expected life of the mortgage. This situation can occur when the interest rates and/or property appreciation and/or charges applied against the mortgage experienced since funding are different from the underwriting assumptions;
- Mortgages that have already exceeded their current EOT and thus are indicating a payment trend significantly different from the EOT expectations.

A general allowance has been established in accordance with the updated loan provisioning methodology referred to above, relating to probable losses in an amount closely approximating the present value of projected future cash flow shortfalls on mortgages whose loan-to-value ratios are still below 83%. The allowance for credit losses has been increased to \$2.1 million from \$0.4 million at September 30, 2008 and equates to 0.26% of the mortgage balance. The increase in the quarter is a result of updating the policy and is not expected to recur in the future. The adjustment has therefore been removed from adjusted net income.



## Spread

HOMEQ's net interest income is derived from the spread between the interest earned on the mortgage portfolio and the interest paid on the debt to fund the portfolio. The yield on mortgages has historically been based on Prime and Government of Canada Treasury Bills (T-Bill) rates whereas the cost of debt is primarily based on the rate of Bankers Acceptances (BAs).

Commencing in August 2007, a reduction in market liquidity resulted in an increase in HOMEQ's marginal borrowing costs. In addition, the difference between the rate on T-Bills and the rate on BAs rose to levels higher than historical norms. This situation continued throughout 2008 and contributed to a reduction of spread income and spread percentage

Management took steps to offset the ongoing impact on spread income of higher borrowing costs by raising the interest rate charged for new mortgages. In addition, in Q2 2008 the pricing methodology was changed to a posted rate derived from HOMEQ's average cost of borrowing as opposed to a fixed spread above the T-Bill rate as had previously been the case. This methodology will enable HOMEQ in the future to change the rates on all mortgages in the portfolio for strategic purposes to offset systemic changes in borrowing costs.

During 2009, the difference between T-Bills and BAs is once again at historical norms, which has helped to restore spread percentage to higher rates. In addition, mortgages under the new pricing methodology have grown to approximately 15% of the total mortgage portfolio at September 30, 2009.

Interest rate risk resulting from timing differences between the interest reset dates on the mortgages and interest reset dates on HOMEQ's debt is managed through the use of derivative instruments such as interest rate swaps and forward rate agreements. Derivative instruments are entered into with Schedule 1 Canadian chartered banks to reduce counterparty risk. The objective of HOMEQ's hedging practices is to maintain a relatively stable spread between interest earned on the mortgages and interest paid on the highly rated debt used to fund them.

The Bank of Canada benchmark interest rate has declined significantly since the beginning of the credit crisis. The corresponding decreases to the Prime Rate and interest rates on T-Bills and BAs resulted in reductions to HOMEQ's yield and cost of funds. The interest rate reset in August 2009 was at lower underlying benchmark rates than in August 2008 therefore the yield on HOMEQ's mortgages and its cost of funds were lower than in 2008.

Interest income earned on the mortgage portfolio in Q3 2009 was \$12.9 million, a decrease of \$2.4 million or 15.9% from Q3 2008 due primarily to the lower interest rate environment. The average yield earned on the mortgage portfolio of 6.13% was 164 basis points lower than Q3 2008. The reduced yield was partially offset by the 6.6% increase in the quarterly average mortgage portfolio from September 30, 2008.

Correspondingly, interest expense on the debt portfolio, was \$6.3 million, a decrease of \$3.9 million or 38.3% from Q3 2008 due to a 179 basis point decrease in the average interest rate on the debt to 2.94%.

The spread percentage in Q3 2009 of 3.20% was 16 basis points higher than Q3 2008 and was the highest achieved since Q1 2008.

HOMEQ has elected under CICA's Section 3865 – *Hedges* to apply hedge accounting for interest rate swaps having a notional amount of \$159.0 million to hedge \$159.0 million of the \$165.0 million series 2008-1 fixed rate medium-term debt maturing in May 2011. The objective of these hedges is to protect against changes in the fair value of the fixed rate medium-term debt due to changes in the underlying benchmark interest rate. The hedges are effective at September 30, 2009.



Spread income and spread percentage for the prior nine quarters are shown below.

(\$ thousands)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Mortgage interest income (1)	14,345	15,040	15,199	15,214	15,302	15,036	14,177	13,595	12,877
Average mortgage balance (2) (4)	666,433	693,790	721,258	752,014	781,435	805,422	820,375	829,554	832,866
Average mortgage yield – annualized (%)	8.54%	8.60%	8.45%	8.11%	7.77%	7.41%	7.01%	6.57%	6.13%
Interest expense	8,062	10,047	9,768	10,075	10,154	9,474	8,492	7,201	6,268
Average debt balance (3) (4)	651,936	738,094	755,397	804,337	851,007	850,102	848,448	847,809	846,418
Cost of funds – annualized (%)	4.92%	5.39%	5.19%	5.02%	4.73%	4.42%	4.06%	3.41%	2.94%
Spread (\$)	6,283	4,993	5,431	5,139	5,148	5,562	5,685	6,394	6,609
Spread (%)	3.62%	3.21%	3.27%	3.09%	3.04%	2.99%	2.95%	3.17%	3.20%

(1) Excluding early repayment fees and amortization of purchase price premiums and deferred commissions

(2) Excluding unamortized purchase price premiums, origination fees and commissions

(3) Reflects the principal portion of debt

(4) Calculated on the average of the month end balances during the period

### Mortgage Origination Cost

HOMEQ's objective is to maintain mortgage origination costs, to no more than 10% of the value of mortgages originated, and to focus on improving sales and marketing efficiencies in order to reduce this percentage over time.

As referred to previously, over the past 2 years HOMEQ took specific actions to conserve its cash resources resulting in a reduction in the rate of originations. As a result, originations in Q3 2009 of \$29.5 million, while significantly higher than the prior 3 quarters were lower than the level of originations in Q3 2008. Total origination costs of \$2.6 million were \$0.7 million or 21.8% lower than Q3 2008. The origination cost percentage of 8.9% was the same as Q3 2008. The trailing four quarter origination cost percentage was slightly higher than target at 10.8%.

The following table provides the details of the calculation for the past nine quarters.

(\$ thousands)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Mortgage originations	34,442	33,794	28,235	39,019	37,814	24,554	14,680	22,690	29,460
Origination expenses									
Commissions	951	1,669	1,153	1,278	1,400	1,230	856	943	1,166
Direct origination expenses									
Origination salaries and benefits	172	196	198	195	198	189	201	193	191
Marketing	970	1,020	1,059	865	1,097	774	428	356	581
	1,142	1,216	1,257	1,060	1,295	963	629	549	772
Origination overhead expenses									
Salaries and benefits	1,136	1,271	1,055	1,041	1,057	1,233	1,082	1,077	1,106
Office	255	263	308	248	288	266	264	283	283
Subtotal	1,391	1,534	1,363	1,289	1,345	1,499	1,346	1,360	1,389
50% inclusion	696	767	681	645	673	749	673	680	695
Total origination cost	2,789	3,652	3,091	2,983	3,368	2,942	2,158	2,172	2,633
Origination cost (%)									
Current quarter	8.1%	10.8%	10.9%	7.7%	8.9%	12.0%	14.7%	9.6%	8.9%
Trailing four quarter	9.1%	9.2%	9.5%	9.2%	9.4%	9.6%	9.8%	10.6%	10.8%



Commissions of \$1.2 million decreased \$0.2 million or 16.7% over Q3 2008 while mortgage originations decreased 22.1%. The average commission rate, while significantly lower than in the past 3 quarters, was still higher than that of Q3 2008 during which originations were at a near record high.

In accordance with measures to conserve cash available for mortgage originations, marketing spend remained at a reduced level in the quarter, 47.0% lower than Q3 2008.

Offsetting total origination costs, HOMEQ collects a flat fee per mortgage from clients to cover the legal and other costs of completing the transaction. For Q3 2009 HOMEQ recognized \$0.2 million of revenue, 21.3% lower than Q3 2008 reflecting the 5.1% lower number of transactions completed in the quarter.

### Mortgage Administration Expense

Cost effective administration of its mortgages is an important objective of HOMEQ, and management has taken steps to offset the recent impact of lower originations and increased cost of funds by actively managing its administrative costs. In Q3 2009, the administration costs, net of \$0.1 million of expenses for the bank launch and \$0.2 million of capital tax expense were \$1.3 million, similar to Q3 2008 in comparison with growth in the average mortgage portfolio of \$51.5 million or 6.6%. As a percentage of the average mortgage portfolio, mortgage administration expenses were 0.64% in Q3 2009, similar to Q3 2008 and 0.64% on a trailing four quarter basis compared to 0.67% for the period ended September 30, 2008.

On a quarterly basis, mortgage administration expenses may fluctuate slightly, however, operational efficiencies and economies of scale are reducing administrative expenses as a percentage of the average mortgage portfolio. The following table provides the details of the calculation for the past nine quarters.

(\$ thousands)	2007		2008				2009		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Average mortgage balance	666,433	693,790	721,296	752,014	781,368	805,422	820,375	829,554	832,866
Administration expenses									
Mortgage servicing and administration	78	71	73	65	66	64	75	67	88
Origination overhead expenses	696	767	681	645	673	749	673	680	695
Professional services	449	258	405	276	379	417	878	981	502
Amortization of capital assets	65	67	77	81	76	69	60	64	66
Business and capital taxes	-	-	-	-	-	-	-	-	215
Other	80	106	161	93	86	93	116	65	63
Less:									
Conversion costs	-	-	-	-	-	-	(522)	(524)	(65)
Mortgage administration fees	(45)	(39)	(21)	(37)	(39)	(31)	(25)	(36)	(66)
<b>Total administration expenses</b>	<b>1,323</b>	<b>1,230</b>	<b>1,376</b>	<b>1,123</b>	<b>1,241</b>	<b>1,361</b>	<b>1,255</b>	<b>1,297</b>	<b>1,498</b>
Administration expense (%)									
Annualized	0.79%	0.71%	0.75%	0.59%	0.63%	0.67%	0.61%	0.63%	0.72%
Trailing four quarters	0.81%	0.79%	0.77%	0.71%	0.67%	0.67%	0.63%	0.64%	0.66%



## CASH FLOW AND LIQUIDITY

The objective of liquidity management is to ensure that the amount of liquidity available is sufficient to meet HOMEQ's financial obligations when they are due in order to support the orderly continuation of operations. Senior management is responsible for managing the various funding sources, and to ensure that adequate funds are available for future growth at an appropriate cost. Liquidity management ensures availability of funds to meet anticipated maturities of existing sources of funds and to finance growth in the asset portfolio. The liquidity management process takes account of operating liquidity, uncertainties surrounding cashflows, the quality of liquid assets and the availability of liquidity lines and funding facilities.

An intricacy of HOMEQ is the deferred nature of its income streams. HOMEQ earns and accrues interest on a monthly basis, yet interest income is not received in cash until mortgages are repaid. Whereas net accrual of interest on mortgages (accrual of interest on mortgages net of repayments of accrued interest) is deemed an operating activity in accordance with GAAP, it results in growth in the mortgage portfolio, equivalent to new originations, and is effectively an investing activity. Pursuant to the covenants in CMT's trust indenture and the capital treatment of HomEquity Bank's assets, HOMEQ is able to finance substantially all of the growth in its mortgage portfolio (net accrual of interest plus originations net of mortgage principal repayments) with debt and deposits.

HOMEQ finances its portfolio of mortgages with deposits, medium term notes, subordinated debt, and to the extent necessary to maintain its regulatory capital and debt rating, equity. By maintaining a diversified source of financing it is able to mitigate its liquidity risk. The mix of funding in place is based on several factors including cost and availability at any point in time.

Primary sources of funding are as follows:

1. Deposits – HOMEQ, through its subsidiary HomEquity, accepts deposits from the public by issuing Guaranteed Investment Certificates ("GICs") with terms up to five years. GICs provide a reliable and stable source of funding that can be matched against anticipated reverse mortgage cash-flows.

Payment of principal and interest on HomEquity's GICs is eligible to be guaranteed to the holder by the Canadian Deposit Insurance Corporation in an amount up to \$100,000. Deposits are sourced exclusively through deposit agents who are members of the Federation of Canadian Independent Deposit Brokers ("FCIDB") or the Investment Industry Regulatory Organization of Canada ("IIROC"). HomEquity has longstanding relationships with the largest Schedule 1 Banks through the mortgage origination partnership agreements which have been in place for many years. The majority of its deposit requirements come from affiliated deposit agents of some of these banks.

2. Medium Term Notes – HOMEQ, through its subsidiary CMT has the option of raising funds through the issuance of Medium Term Notes.

DBRS has issued a AAA rating on the senior medium term debt and BBB rating on the subordinated debt. As a result of these superior ratings, CMT has historically had access to the capital markets to finance new mortgages on cost-effective terms. Pursuant to the terms of its indenture and with the consent of the rating agency rating its debt, CMT is permitted to operate with a maximum senior debt-to-mortgage ratio of 95% when its senior rated debt consists only of medium term notes. Including senior and subordinated debt, it is permitted to operate with a maximum total debt-to-mortgage ratio of 98%. CMT must also maintain minimum cash on hand equivalent to at least 2% of the CMT mortgage portfolio value. During the year, CMT operated within these covenants. At September 30, 2009, the senior debt-to-mortgage ratio was 89.5% and the total debt-to-mortgage ratio was 96.6%.

In order to mitigate the refinancing risk of existing Medium Term Notes, 70% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2031 to 2033. Any Medium Term Notes Issued in the future will also have extended legal maturities.

As discussed earlier in the MD&A, the portfolio of reverse mortgages has a loan to value of 36% and is secured by residential real estate. As a result, HOMEQ can reasonably expect to recover the full recorded



value of most mortgages. HOMEQ's portfolio of approximately 7,000 reverse mortgages is diversified by location, property type, date of origination and age of borrower. As supported by prior experience, between 2% and 5% of the mortgage portfolio is repaid each quarter, providing a predictable source of cash flow.

Historically HOMEQ has used cash flows from operating activities to fund its operations and dividends, and the excess of those cash flows coupled with borrowings under its debt programs have been used to fund growth in the mortgage portfolio.

### Liquid Assets

HOMEQ holds liquid assets ("Regulatory Liquid Assets" or "RLA") determined in accordance with its liquidity management policy and invested in the form of cash and bank deposits, treasury bills, bankers' acceptances, government bonds and debentures. The credit quality of these assets is such as they are easily marketable and can be readily converted to cash and thus can be used to fulfill cash requirements should the need arise.

The table below summarizes the liquid assets held at September 30, 2009

(\$ thousands)	September 30, 2009
Cash and non-interest bearing deposits with regulated financial institutions	6,921
Treasury bills issued or guaranteed by Canada	6,999
Treasury bills issued or guaranteed by Provinces	3,999
Corporate notes	5,700
Cash and cash equivalents	23,619
Interest bearing deposits with regulated financial institutions	17,148
Total liquid assets	40,767

### Medium Term Notes

Total principal amount of outstanding debt at September 30, 2009 of \$845.3 million is \$5.4 million lower than September 30, 2008 due to repayments. The remaining notes have a bullet payment requirement at their respective expected final payment dates.

The table below summarizes the timing of the expected final payments of the debt at September 30, 2009. 70% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2031 to 2033

(\$ thousands)	Less than 1 year	More than 1 year and 2 years or less	More than 2 years and 5 years or less	More than 5 years	September 30, 2009	December 31, 2008
Medium-Term Debt	150,000	400,000	235,267	—	785,267	789,186
Subordinated Debt	—	—	60,000	—	60,000	60,000
Total	150,000	400,000	295,267	—	845,267	849,186

The expected final payment date of the \$150 million due in less than one year was November 1, 2009 and was repaid by issuing a one-year floating rate note to mature October 26, 2010. The interest on the new note is the 3-month BA rate plus 140 basis points.

### Deposits

HOMEQ commenced issuing deposits when HomeEquity received its letters patent from the Minister of Finance on October 13, 2009. GICs are issued in various terms in accordance with anticipated cash flows from mortgage repayments. As at September 30, 2009, no deposits had yet been issued.



## CAPITAL

### Equity

On June 30, 2009 the Conversion of the trust structure was completed, whereby the Trust and its subsidiaries became subsidiaries of HOMEQ. The outstanding units of the Trust were exchanged for common shares of HOMEQ on a one-for-one basis.

HOMEQ has two long-term incentive plans; a Restricted Share Plan (RSP) for management and a Deferred Share Plan (DSP) for Directors. 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.

The DSP allows the Directors to defer a portion of their cash compensation and receive the equivalent amount in shares of the Company. On retiring from the Board, a Director will receive all deferred shares accumulated in the plan. HOMEQ Corp intends to settle the restricted and deferred shares in voting shares of the Company upon vesting and retirement respectively. Until such time, restricted and deferred shares do not trade on the TSX, have no voting rights and cannot be sold or liquidated early.

The table below summarizes HOMEQ's share activity for the period ended September 30, 2009.

	Voting	Management Restricted Share Plan	Directors' Deferred Share Plan	Total number of shares
Balance, December 31, 2008	13,953,592	79,696	90,261	14,123,549
Restricted shares redeemed	53,247	(53,247)	—	—
Restricted share grants, net	—	55,000	—	55,000
Deferred shares earned	—	—	50,178	50,178
Balance, September 30, 2009	14,006,839	81,449	140,439	14,228,727

Periodically, as required, HOMEQ may issue additional shares to manage its leverage as the mortgage portfolio grows.

### Capital Management

Capital is the fundamental building block which enables HOMEQ to support its lending and borrowing operations. The amount of capital required in relation to the size of the HOMEQ's operations is determined by regulation and by the judgement of senior management and the Board.

The overall objective of capital management is to ensure that HOMEQ has sufficient capital to maintain its operations based on current activities and expected business developments in the future. At the same time, HOMEQ must invest its capital to provide a return to shareholders commensurate with the risk of the business and comparable to other financial institutions.

The regulatory capital requirements of HomeEquity are determined in accordance with OSFI *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. There are two capital standards addressed in HomeEquity's capital management policy. These are the risk based capital ratio and the assets to capital multiple.

In the determination of its capital levels, HomeEquity has implemented an Internal Capital Adequacy Assessment Process ("ICAAP") supported further by an Economic Capital Assessment which are both based on HOMEQ's assessment of the business risks of HomeEquity. As a result of this process, HOMEQ has



established the capital ratios of HomEquity and has developed a contingency plan to be enacted on the occurrence of pre-determined events.

HOMEQ intends to maintain strong capital levels through the retention of earnings, the management of its risk-weighted asset mix and by maintaining effective access to a variety of sources of additional capital should the need arise.

The table below summarizes HOMEQ's pro-forma capital measures (relating solely to HomEquity) as at September 30, 2009 prior to receiving its bank license on October 13, 2009.

(\$ thousands)	September 30, 2009
Risk weighted assets	
Credit risk	429,063
Off balance sheet exposure	7,346
Operational risk	39,531
Total risk-weighted assets	475,940
Tier 1 capital	
Shareholders' equity	77,307
Total	77,307
Tier 2 capital	—
Total	—
Regulatory capital to risk weighted assets	
Tier 1 capital	16.2%
Tier 2 capital	—
Total capital	16.2%
Total Assets	962,759
Assets to capital multiple	12.5x

Subsequent to receiving its bank Charter, HomEquity issued \$10 million of subordinated debt which qualifies as Tier 2 B capital. The total capital ratio inclusive of this debt would be in excess of 17% and the assets to capital multiple would be 11.3x.

### Production capacity

Given the nature of its business, HOMEQ does not require significant investment in infrastructure, facilities or equipment. Limited capital investment is made on an ongoing basis to upgrade the information technology platform, to maintain the office environment and to provide the sales force with appropriate tools and equipment to carry out their functions. In the near term, future capital expenditure on the existing business is expected to continue on the basis experienced over the prior years.



## **FINANCIAL INSTRUMENTS**

As reflected in the Note 2 to the consolidated financial statements commencing on page 36 of the 2008 Annual Report, in the normal course of business, HOMEQ uses derivative instruments such as interest rate swaps and forward rate agreements effectively matching the interest term of its debt 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 and changes in shareholders' equity. Fair market values of the derivative instruments are determined using the period end interest rate curves compared to the rates in the derivative contract. Realized amounts receivable or payable on derivatives are accrued and recorded as adjustments to interest expense in the consolidated statements of income and changes in shareholders' equity.

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

## **BUSINESS RISKS**

HOMEQ's business strategies and operations expose it to a range of risks that could adversely affect its business, financial condition and operating results. HOMEQ has adopted a risk management framework ("RMF") methodology. The RMF uses a systematic and proactive approach, identifying high priority risks which are continuously reviewed and assessed such that appropriate action can be taken to mitigate those risks over time.

In accordance with the RMF, HOMEQ 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. HOMEQ has created an Operating Risk Management Committee in order to satisfy the above and assist the Board of Directors in fulfilling its responsibilities.

Detailed below are the areas of risk that HOMEQ has identified and deemed to be its primary areas of exposure.

### **Underwriting Risk**

In underwriting new reverse mortgages, HOMEQ uses a proprietary lending model to estimate the timing of mortgage repayment based on the age and sex of the borrower. This information, along with information on the type of the property and its location, is used to determine the amount to be lent. The initial mortgage amount is usually between 28% and 33% of the value of the house, substantially less than the 80% ratio commonly applied for a conventional bank mortgage.

The actual performance of each loan is reviewed on a monthly basis and compared to its expected performance over this time. Based on this exercise, underwriting inputs are refined if deemed appropriate and implemented on a go forward basis. In addition, the model is frequently stress tested using various scenarios. There is a risk in every case that a mortgage is funded in an amount that may result in the full amount of interest and principle not being recovered when the mortgage is due.

The following factors can result in the mortgage not being fully recoverable:

- **Property Risk**

One of the assumptions made at the time a reverse mortgage is underwritten concerns the rate of future price appreciation for the underlying property. A risk exists that the property might not appreciate in accordance with underwriting forecasts. The average rate of assumed appreciation used in the initial underwriting of the existing mortgage portfolio is approximately 1.5% per annum. According to data available from the Canadian



Real Estate Association, over the past 20 years the rate of appreciation for residential real estate in Canada has averaged greater than 4.0% per annum. HOMEQ currently uses a rate lower than the 20 year Canadian average as the future appreciation rate. In addition, the initial appraised value of every property is discounted, generally by between 7.5% and 30%, depending on the province, location, and property type.

- **Occupancy Risk**

HOMEQ makes assumptions as to when borrowers will cease occupying their homes. To the extent that borrowers remain in their homes longer than expected, there is a risk that the amount owing on the reverse mortgage at the time the borrower moves or dies will exceed the value of property securing the reverse mortgage, thus resulting in a loss. The EOT for a borrower is determined based on a combination of industry standard mortality data and HOMEQ's proprietary data on the mobility of its clients at the 75% probability. This formula is closely monitored and compared to actual experience on an ongoing basis.

- **Interest Rate Risk**

An increasing interest rate environment could also result in a mortgage eventually compounding to a value greater than the value of the underlying property. For this reason, when an initial loan amount is determined, interest rates in the future are assumed to be at least 2% higher than the rate at the initial term.

### **Spread Interest Risk**

HOMEQ's net interest income is 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. Spread interest rate risk is the exposure or potential impact to HOMEQ's earnings and financial condition of changes in interest rates, resulting either from changes in the shape of the yield curve, absolute changes in interest rates across the yield curve or the quality of the assets on which interest is earned. The risk arises when assets and liabilities have mismatched re-pricing dates or are referenced to different underlying instruments.

Risks considered within the broader category of Spread Interest Risk include:

- **Pricing/Mismatch Risk**

This occurs when there are timing differences between:

- The interest reset dates on HOMEQ's assets and interest reset dates on its debt; and,
- The maturity dates of HOMEQ's assets and maturity dates on its debt.

Pricing risk resulting from timing differences between the interest reset dates on the mortgages and interest reset dates on HOMEQ's debt is managed through a matching process. Derivative instruments such as interest rate swaps and forward rate agreements are used to match the proportion of mortgages maturing in a period with a proportion of debt maturing in the same period. Derivative instruments are entered into with Schedule 1 Canadian chartered banks to reduce counterparty risk.

The objective of HOMEQ's hedging practices is to maintain a relatively stable spread between interest earned on the mortgages and interest paid on the debt used to fund them. HOMEQ has internal policies (interest rate risk management policy) regarding the extent of mismatch that it is prepared to accept and has quantified the potential risk involved.

- **Basis Risk**

Situations occur in which the difference between the Prime Rate and the rate on Government of Canada Treasury Bills, on which mortgage rates for a section of the Bank's mortgages are based, and the rate on Bankers' Acceptances, on which a section of the Bank's debt and hedging instruments are based, can deviate from historical norms. This situation can result in a reduction of spread.



#### ▪ **Cost of Debt Risk**

Circumstances in the capital markets can result in an increase in the cost of debt used by HOMEQ to fund new mortgages or to replace maturing debt. Depending on the interest rate environment in existence at the time, HOMEQ may not be in a position to pass the increased costs on to customers which could result in a decrease in spread. The extent of this risk is quantified based on the extent of new debt issued in a year and various scenarios of increased price.

#### **Leverage and Refinancing**

HOMEQ, in its normal course of business, is projected to have significant debt service obligations under its indebtedness. The degree to which HOMEQ is leveraged could have important consequences, on (i) HOMEQ's ability to obtain additional financing; (ii) the extent of the cash flow from reverse mortgages that will be dedicated to the payment of interest on its indebtedness; (iv) the risk that the cash flow from HOMEQ's reverse mortgages is not sufficient to repay any indebtedness on maturity, exposing HOMEQ to refinancing risk. HOMEQ mitigates these risks by having a diversified source of funding, by issuing highly rated debt, by using a syndicate of several dealers to issue debt and by staggering the maturities of its debt obligations. Changes in general market conditions, fluctuations in markets for debt securities and other factors beyond the control of HOMEQ may affect its ability to successfully issue debt as and when required.

#### **Derivative Related risk**

Derivative instruments have either no or an insignificant market value at inception. They obtain value, increase or decrease, as relevant interest 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 HOMEQ does not hold or use any derivative contracts for reasons other than for hedging purposes. No derivative contracts are held for speculative trading purposes.

#### **Restrictive Covenants**

HOMEQ's indirect subsidiary CMT's trust indenture contains covenants that place restrictions on, among other things, its ability to incur additional indebtedness, to create liens or other encumbrances and to sell or otherwise dispose of significant assets or consolidate with another entity. A failure to comply with the obligations in the indenture could result in an event of default, which if not cured or waived, could permit acceleration of the relevant indebtedness. If the indebtedness were to be accelerated, there can be no assurance that the assets of HOMEQ would be sufficient to repay in full that indebtedness.

#### **Reliance on Relationships with Financial Institutions**

HOMEQ has developed an extensive referral network in the broader financial service community, including distribution agreements with the largest Canadian banks. There can be no assurance that this referral network will be maintained. Furthermore, there is no assurance that any new distribution agreements entered into by HOMEQ will have terms similar to those contained in current arrangements with the banks. The termination or alteration of the referral network and distribution arrangements may adversely affect HOMEQ's ability to continue originating reverse mortgages, and its growth may be adversely affected as a result.

#### **Access to Capital Markets**

Periodically, as required, HOMEQ may issue additional equity to manage its leverage as the mortgage portfolio grows. Changes in general market conditions, fluctuations in markets for equity securities and other factors beyond the control of HOMEQ may affect its ability to successfully issue additional equity as and when required.



## CONTROLS AND PROCEDURES

### Changes in Internal Controls over Financial Reporting

During the quarter the final pieces were put in place to ensure the successful launch of HomeEquity. This included the build-out of operating, control and compliance platforms to encompass the additional requirements of a deposit taking federally regulated financial institution.

There have been no other significant changes in HOMEQ's internal controls over financial reporting during the quarter ended September 30, 2009, that have materially affected, or are reasonably likely to materially affect, HOMEQ's internal control over financial reporting.

## ACCOUNTING POLICIES AND ESTIMATES

### Changes in Significant Accounting Policies

#### ▪ Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

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 CICA's Emerging Issues Committee released *EIC-173 Abstract, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*. The EIC requires the inclusion of credit risk of the counterparty and HOMEQ in determining the fair value of derivative instruments for periods after January 20, 2009. The EIC requires retrospective adoption without restatement of prior periods. HOMEQ adopted the accounting treatment in the first quarter of 2009.

#### ▪ Goodwill, Intangible Assets and Financial Statement Concepts

Effective January 1, 2009, the accounting and disclosure requirements of the CICA's new accounting standard, *Section 3064, Goodwill and Intangible Assets*, was adopted. The 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 impact of these standards is that certain items previously included in prepaid expenses which were deferred and amortized, will be expensed as period costs when incurred.

### Critical Accounting Estimates

The significant accounting policies are outlined in Note 2 to the consolidated financial statements commencing on page 36 of the 2008 Annual Report. The estimates listed below are considered critical because they refer to material amounts and require management to make estimates that involve uncertainty.

The specific allowance has been established to cover estimated losses when there is no longer reasonable assurance that all interest and principal would be recovered should a mortgage be immediately repaid. The specific allowances are determined on an individual mortgage basis and reflect the amount required to reduce the carrying value of a mortgage to its current estimated realizable value.

The general allowances reflect management's best estimate of probable losses in an amount closely approximating the present value of projected future cash flow shortfalls in HOMEQ's mortgage portfolio as at the balance sheet date. In order to assess the likelihood of loss, management takes into consideration a range of information including amongst others, recent loss experience, real estate trends, interest rate environments, occupancy experience and the evolution of the portfolio and business.

During the current quarter a significant review was undertaken, to assess the adequacy of existing general allowances, having last been undertaken approximately five years ago. The most recent findings indicate that the portfolio remains strong with a low loan to value however, other qualitative aspects are becoming evident as the portfolio matures and accordingly the loan provisioning methodologies have been updated as discussed earlier in the MD&A.



HOMEQ also uses estimates to determine the amortization of the commissions, purchase price premiums and origination fees paid on the acquisition of reverse mortgages. The estimates are based on the projected lives of the mortgages for which the premiums and fees were paid. The methodology attempts to match the amortization of these amounts over the period that the mortgages earn interest income. The projected lives of the mortgages are reassessed on an annual basis.

**Future Accounting and Reporting Changes**

▪ **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 amendments will be effective for the Company's 2009 annual consolidated financial statements

▪ **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 HOMEQ, effective for fiscal years beginning on or after January 1, 2011.

Accordingly, HOMEQ 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.

**IFRS Transition Plan**

HOMEQ has developed a comprehensive IFRS implementation plan and established an implementation team to prepare for this transition. The transition team has completed the identification of the key areas where changes to current accounting policies may be required. The team is currently performing detailed analyses of IFRS requirements for these key areas to identify changes that may be necessary to HOMEQ's current accounting policies.

The table below summarizes the expected timing of activities related to HOMEQ's transition to IFRS.

Identification of key areas for which changes to accounting policies may be required.	Complete
Detailed analysis of all relevant IFRS requirements and identification of areas requiring accounting policy changes or those with accounting policy alternatives.	In progress, continuing through 2009
Assessment of first-time adoption (IFRS 1) requirements and alternatives.	In progress, continuing through 2009
Final determination of changes to accounting policies and choices to be made with respect to first-time adoption alternatives	Q4 2009 – Q2 2010
Resolution of the accounting policy change implications on information technology, internal controls and contractual arrangements	Q4 2009 – Q2 2010
Management and employee education and training	Throughout the transition process
Quantification of the financial statement impact of changes in accounting policies	Throughout 2010

**Impact of Adopting IFRS on the Organization**

The Board of Directors and Audit Committee are regularly updated on the progress of the IFRS implementation plan, and with information regarding the potential for changes to significant accounting policies. As part of the implementation plan, HOMEQ's employees that are involved in the preparation of



financial statements are receiving training on the relevant aspects of IFRS and the potential for changes to accounting policies.

As part of its analysis of potential changes to significant accounting policies, the implementation team is assessing what changes may be required to its accounting systems and business processes. HOMEQ has identified that changes may be required to the systems, processes and documentation required to apply hedge accounting for its interest rate swaps, and is currently working with its third party vendor to ensure the appropriate changes are available on a timely basis. To date, the other changes to systems and process that have been identified are minimal and HOMEQ believes the systems and processes can accommodate the necessary changes.

HOMEQ is in the process of identifying any contractual arrangements that may be impacted by potential changes to significant accounting policies.

#### Impact of Adopting IFRS on HOMEQ's Financial Statements

The key areas that HOMEQ has identified with the most potential for changes to accounting policies include the following:

- Financial Instruments Presentation & Disclosure
- Financial Instruments Recognition & Measurement
- Impairment of Assets (assessment methodology for Loans & Goodwill)
- Share-based payments
- Income Taxes

HOMEQ is in the process of performing detailed analysis of IFRS for these key areas to identify differences to HOMEQ's current accounting policies and determine whether changes will be required. This is not intended to be complete list of areas where the adoption of IFRS will require a change in accounting policies, but to highlight the areas identified to have the most potential for significant changes.

The International Accounting Standards Board (IASB) has a number of ongoing projects, the outcome of which may have a significant effect on the changes required to HOMEQ's accounting policies on adoption of IFRS. Of particular significance to HOMEQ is the current IASB projects related to financial instruments.

#### **First-time adoption of IFRS**

The adoption of IFRS requires the application of IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS as effective at the end of its first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

HOMEQ has identified the following relevant optional exemptions that it may apply in its preparation of an opening IFRS statement of financial position as at January 1, 2010, HOMEQ's "Transition Date":

- To apply IFRS 2 Share-based Payments only to equity instruments that were issued after November 7, 2002 and had not vested by the Transition Date.
- To apply IFRS 3 *Business Combinations* prospectively from the Transition Date, therefore not restating business combinations that took place prior to the Transition Date.
- To apply the transition provisions of IFRIC 14 *Determining whether an Arrangement Contains a Lease*, therefore determining if arrangements existing at the Transition Date contain a lease based on the circumstances existing at that date.

As the analysis of its accounting policies under IFRS continues, HOMEQ may decide to apply other optional exemptions contained in IFRS 1.

IFRS 1 does not permit changes to estimates that have been made previously. Accordingly, estimates used in the preparation of HOMEQ's opening IFRS statement of financial position as at the Transition Date will be



consistent with those made under current Canadian GAAP. If necessary, estimates will be adjusted to reflect any difference in accounting policy.

### **Subsequent Disclosures**

Further disclosures of the IFRS transition process are expected as follows:

- HOMEQ's MD&A for the year ended December 31, 2009 will include an update on the progress of the transition plan, and further details regarding the impact of adopting IFRS on significant accounting policies and key elements of the financial statements.
- HOMEQ's MD&A for the 2010 interim periods and the year ended December 31, 2010 will include updates on the progress of the transition plan, and, to the extent known, information regarding the impact of adopting IFRS on key line items in the annual financial statements.
- HOMEQ's first financial statements prepared in accordance with IFRS will be the interim financial statements for the three months ending March 31, 2011, which will include notes disclosing transitional information and disclosure of new accounting policies under IFRS. The interim financial statements for the three months ending March 31, 2011 will also include 2010 financial statements for the comparative period, adjusted to comply with IFRS, and HOMEQ's transition date IFRS statement of financial position (as at January 1, 2010).

### **OUTLOOK**

HOMEQ's goal is to continue to be Canada's leading provider of reverse mortgages. Market awareness of both HOMEQ and its product has increased, and sources of referral cover a widening array of financial institutions. In addition, HOMEQ is benefiting from a preference of seniors to remain in their homes as long as possible, and from the demographic trend of a rising seniors population.

Starting in the third quarter of 2007, volatility in the capital markets resulted in a decrease in availability and a resultant increase in the cost of both commercial paper and medium term notes, and the difference between the rate on T-Bills and BAs rose to levels higher than historical norms. As a result of the increased costs of capital, spread percentage in recent quarters has been lower than the historical range.

Management has taken steps to offset the ongoing impact of these circumstances by changing the pricing methodology to a posted rate derived from HOMEQ's average cost of borrowing as opposed to a mark-up over the T-Bill rate as has previously been the case. In addition, during the last two quarters the Canadian debt capital markets have been more consistent with historic experience than has been the case since Q3 2007. In particular, the difference between T-Bills and BAs have returned to historical norms. While we remain cautiously optimistic, it is not possible to determine if current market conditions will persist.

By obtaining chartered bank status, significant benefits are anticipated in the following areas:

- Retail deposits represent a stable and cost-effective source of funds that will diversify the wholesale funding strategy previously used;
- Access to additional cost-effective and reliable sources of funding will enable HomEquity to meet the growing financial needs of Canadian seniors, allowing it to increase annual originations and the resulting value of its portfolio of reverse mortgages;
- Access to cost-effective sources of funding will improve margins and enable HomEquity to offer lower consumer pricing;
- HomEquity will benefit from the efficiency of being federally regulated. This will elevate reverse mortgage supervision to a consistent national standard, and in so doing will raise awareness and greater understanding of a solution that meets the specific financial needs of a growing segment of the population.



Over the next several quarters, the impact of achieving bank status will begin to be felt. In particular, the availability of reliable sources of funding will enable HOMEQ to resume concerted marketing and sales efforts, with a goal of originations resuming the levels and rates of growth experienced in recent years. Spread percentage in the ensuing months is expected to continue to benefit from the return of the T-Bill and BA correlation. Higher levels of originations will also have the effect of improving HOMEQ's origination cost efficiency.

As discussed in detail earlier in the MD&A, an increase in the general allowance of \$1.7 was made during the quarter following an assessment of statistical and qualitative analyses of the underwriting performance of each mortgage as well as changes in the characteristics of the portfolio. The recent assessment and revised provisioning methodology was extremely comprehensive, and accordingly the general allowance is anticipated to remain consistent for the foreseeable future.

As a result of HomeEquity becoming a regulated entity, its overhead structure has been expanded. Several new positions, computer software and hardware, and an internal audit function have been added. The cost of this added infrastructure will initially have a negative impact on profit but should eventually be absorbed by the improved profitability resulting from an increase in the portfolio size.

#### **ADDITIONAL INFORMATION**

Additional information regarding HOMEQ including the Trust's Annual Information Form is available on SEDAR at [www.sedar.com](http://www.sedar.com).

November 5, 2009

**HOMEQ CORPORATION**  
**Interim Consolidated Balance Sheets (unaudited)**

(in thousands of dollars)	September 30 2009 \$	December 31 2008 \$	September 30 2008 \$
<b>ASSETS</b>			
<b>Cash resources (note 3)</b>			
Cash and cash equivalents	23,619	23,569	41,619
Interest bearing deposits with regulated financial institutions	17,148	17,963	29,884
	<b>40,767</b>	<b>41,532</b>	<b>71,503</b>
<b>Securities (note 4)</b>			
Held-for-trading	—	24,502	19,384
<b>Loans (notes 5 and 15)</b>			
Residential reverse mortgages	890,684	868,971	853,026
Allowance for credit losses	(2,149)	(408)	(251)
	<b>888,535</b>	<b>868,563</b>	<b>852,775</b>
<b>Other</b>			
Property and equipment, net of accumulated amortization	860	656	725
Goodwill	19,109	19,109	19,109
Prepaid expenses and other assets	1,509	825	1,116
Future income tax assets (note 6)	682	77	97
Derivative instruments (note 14)	33,434	44,680	13,174
	<b>55,594</b>	<b>65,347</b>	<b>34,221</b>
	<b>984,896</b>	<b>999,944</b>	<b>977,883</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
<b>Other</b>			
Dividends payable	—	1,228	1,612
Future income tax liabilities (note 6)	15,414	13,090	8,833
Income taxes payable	973	—	—
Accounts payable and accrued liabilities	2,613	2,248	1,588
Derivative instruments (note 14)	3,570	7,950	1,795
	<b>22,570</b>	<b>24,516</b>	<b>13,828</b>
Medium-term debt (notes 7, 13 and 15)	799,592	804,297	805,903
Subordinated debt (notes 8, 13 and 15)	60,248	60,407	60,354
	<b>882,410</b>	<b>889,220</b>	<b>880,085</b>
<b>Shareholders' equity / Unitholders' equity</b>			
Common shares (notes 1 and 12)	102,683	110,724	97,798
Deficit	(197)	—	—
	<b>102,486</b>	<b>110,724</b>	<b>97,798</b>
	<b>984,896</b>	<b>999,944</b>	<b>977,883</b>

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

**HOMEQ CORPORATION**  
**Interim Consolidated Statements of Income (unaudited)**

	For the three months ended			For the nine months ended	
	September 30 2009 \$	June 30 2009 \$	September 30 2008 \$	September 30 2009 \$	September 30 2008 \$
(in thousands of dollars)					
<b>Interest income</b>					
Mortgage interest (note 5.5)	11,887	12,437	14,231	37,271	42,637
Securities	14	50	583	167	933
Deposits with regulated financial institutions	19	27	216	100	1,252
	<b>11,920</b>	<b>12,514</b>	<b>15,030</b>	<b>37,538</b>	<b>44,822</b>
<b>Interest expense</b>					
Medium-term debt	5,190	6,112	9,438	18,657	25,738
Subordinated debt	783	794	423	2,419	2,207
Amortization of debt issue costs	295	295	293	885	819
Commercial paper and liquidity line	—	—	—	—	1,233
	<b>6,268</b>	<b>7,201</b>	<b>10,154</b>	<b>21,961</b>	<b>29,997</b>
<b>Net interest income</b>	<b>5,652</b>	<b>5,313</b>	<b>4,876</b>	<b>15,577</b>	<b>14,825</b>
Provision for credit losses (notes 2 and 5.4)	(1,741)	—	—	(1,741)	—
<b>Net interest income after provision for credit losses</b>	<b>3,911</b>	<b>5,313</b>	<b>4,876</b>	<b>13,836</b>	<b>14,825</b>
<b>Non-interest income</b>					
Mortgage closing fees, net of costs	189	163	240	549	635
Mortgage administration fees	66	36	39	127	97
	<b>255</b>	<b>199</b>	<b>279</b>	<b>676</b>	<b>732</b>
<b>Net interest income and other income</b>	<b>4,166</b>	<b>5,512</b>	<b>5,155</b>	<b>14,512</b>	<b>15,557</b>
<b>Non-interest expenses</b>					
Salaries and benefits (note 9)	1,341	1,314	1,299	3,985	3,875
Selling, general and administration (note 10)	1,688	1,708	1,872	5,110	5,340
Amortization of property and equipment	66	64	76	190	234
	<b>3,095</b>	<b>3,086</b>	<b>3,247</b>	<b>9,285</b>	<b>9,449</b>
<b>Income before under noted item</b>	<b>1,071</b>	<b>2,426</b>	<b>1,908</b>	<b>5,227</b>	<b>6,108</b>
Unrealized losses (gains) on derivative instruments (note 14)	1,595	5,384	(1,671)	4,708	(9,617)
<b>Income (loss) before income taxes</b>	<b>(524)</b>	<b>(2,958)</b>	<b>3,579</b>	<b>519</b>	<b>15,725</b>
Current income tax expense	973	—	—	973	2
Future income tax expense (recovery) (note 6)	(1,300)	2,108	63	1,718	1,965
<b>Net income (loss) and total comprehensive income (loss)</b>	<b>(197)</b>	<b>(5,066)</b>	<b>3,516</b>	<b>(2,172)</b>	<b>13,758</b>
<b>Average number of common shares outstanding (note 1)</b>	<b>14,229</b>	<b>14,213</b>	<b>14,113</b>	<b>14,207</b>	<b>14,052</b>
<b>Basic and diluted earnings (loss) per share (note 1)</b>	<b>(0.014)</b>	<b>(0.356)</b>	<b>0.249</b>	<b>(0.153)</b>	<b>0.979</b>

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

**HOMEQ CORPORATION**
**Interim Consolidated Statements of Changes in Shareholders' Equity (unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2009 \$	2008 \$	2009 \$	2008 \$
(in thousands of dollars)				
<b>Common shares</b>				
Balance at beginning of period	102,547	—	—	—
Conversion from Trust Units (note 1)	—	—	102,547	—
Issued during the period	136	—	136	—
Balance at end of period	102,683	—	102,683	—
<b>Unitholders' equity</b>				
Balance at beginning of period	—	97,774	110,724	93,912
Issued during the period	—	318	238	1,496
Transition adjustment on adoption of financial instrument standard (note 2)	—	—	(484)	—
Net income (loss) for the period	—	3,516	(1,975)	13,758
Dividends declared	—	(3,810)	(5,956)	(11,368)
Conversion to Common shares (note 1)	—	—	(102,547)	—
Balance at end of period	—	97,798	—	97,798
<b>Deficit</b>				
Balance at beginning of period	—	—	—	—
Net income (loss) for the period	(197)	—	(197)	—
Dividends declared	—	—	—	—
Balance at end of period	(197)	—	(197)	—
<b>Total Shareholders' equity / Unitholders' equity (note 1)</b>	<b>102,486</b>	<b>97,798</b>	<b>102,486</b>	<b>97,798</b>

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

**HOMEQ CORPORATION**  
**Interim Consolidated Statements of Cash Flows (unaudited)**

	For the three months ended		For the nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2009	2008	2009	2008
(in thousands of dollars)	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Net income (loss)	(197)	3,516	(2,172)	13,758
Adjust for non-cash items				
Amortization				
Purchase price premiums and origination fees	841	939	2,635	2,785
Deferred commissions	499	395	1,425	1,087
Debt issue costs	295	293	885	819
Property and equipment	66	76	190	234
Increase in provision for credit losses	1,741	—	1,741	—
Compensation expense related to long-term incentive plans	136	142	377	327
Future income tax expense (recovery)	(1,300)	63	1,718	1,965
Unrealized losses (gains) on derivative instruments	1,595	(1,671)	4,708	(9,617)
	<b>3,676</b>	<b>3,753</b>	<b>11,507</b>	<b>11,358</b>
Changes in non-cash working capital				
Accrual of interest payable on debt and derivatives	321	2,459	(155)	5,883
Accrual of interest on mortgages	(12,875)	(15,302)	(40,648)	(45,716)
Repayments of accrued interest	12,135	7,147	27,404	19,262
Other (note 11)	911	182	329	(1,642)
	<b>492</b>	<b>(5,514)</b>	<b>(13,070)</b>	<b>(22,213)</b>
Cash provided by (used in) operating activities	<b>4,168</b>	<b>(1,761)</b>	<b>(1,563)</b>	<b>(10,855)</b>
<b>INVESTING ACTIVITIES</b>				
Mortgages originated	(29,460)	(37,814)	(66,831)	(105,068)
Mortgage principal repayments	26,076	15,235	57,267	41,133
Commissions	(1,166)	(1,400)	(2,965)	(3,830)
Decrease in securities, net	10,296	54,823	24,502	(19,384)
Purchase of property and equipment	(124)	(10)	(394)	(211)
Cash provided by (used in) investing activities	<b>5,622</b>	<b>30,834</b>	<b>11,579</b>	<b>(87,360)</b>
<b>FINANCING ACTIVITIES</b>				
Repayments of commercial paper, net	—	—	—	(76,075)
Gross proceeds of medium-term debt	—	—	—	165,000
Repayment of medium-term debt	(2,364)	(760)	(3,920)	(1,082)
Capitalized debt issue costs	—	(37)	—	(706)
Dividends	—	(3,765)	(6,861)	(11,274)
Proceeds from shares issued under dividend reinvestment plan	—	175	—	1,169
Cash (used in) provided by financing activities	<b>(2,364)</b>	<b>(4,387)</b>	<b>(10,781)</b>	<b>77,032</b>
<b>Net increase (decrease) in cash and cash equivalents, during the period</b>	<b>7,426</b>	<b>24,686</b>	<b>(765)</b>	<b>(21,183)</b>
Cash and cash equivalents, beginning of period	<b>33,341</b>	<b>46,817</b>	<b>41,532</b>	<b>92,686</b>
<b>Cash and cash equivalents, end of period (note 3)</b>	<b>40,767</b>	<b>71,503</b>	<b>40,767</b>	<b>71,503</b>
<b>Supplemental cash flow information:</b>				
Interest paid	5,652	6,502	21,231	23,128
Taxes paid	—	—	—	2

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

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

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### 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 invests in reverse mortgages originated by its wholly owned subsidiary Canadian Home Income Plan Corporation.

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 will continue 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 the common shares subsequent to Conversion and to 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 interim consolidated financial statements of the Company have been prepared using the continuity of interest in the assets, liabilities and operations of the Trust.

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and should be read together with the Trust's audited annual consolidated financial statements and accompanying notes included in the Trust's Annual Report for the year ended December 31, 2008. The preparation of these unaudited interim consolidated financial statements is based on accounting policies and practices consistent with those used in the preparation of the audited annual consolidated financial statements, except as described below.

### 2. CHANGES IN ACCOUNTING POLICIES

#### Goodwill, Intangible Assets and Financial Statement Concepts

Effective January 1, 2009 the Canadian Institute of Chartered Accountants' ("CICA") 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.

#### 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. This EIC 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 shareholders' equity by \$484 for the period ended September 30, 2009. The adjustment is related solely to the recognition of credit risk on the fair value of derivative instruments as at December 31, 2008.

#### Income taxes

Future income taxes are determined using the asset and 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 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. 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

## HOMEQ CORPORATION

### Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

#### 2. CHANGES IN ACCOUNTING POLICIES (continued)

mortgage loan outstanding and the most recently appraised value of the underlying property. The Company has both general and specific 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.

##### General Allowances

The Company's general allowance methodology is reviewed and assessed periodically and is updated to take into account both current circumstances and evolution of the portfolio and business. During the three months ended September 30, 2009 a 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.

During the three and nine months ended September 30, 2009 the increase in the general allowance resulted in a decrease in net income and a decrease in shareholders equity by \$1,741. This is considered a change in accounting estimate and is applied prospectively. Consequently, comparative periods are not restated. Previously, the increase or decrease in the general allowance was included in mortgage interest and is now presented separately as the provision for credit losses.

#### 3. CASH RESOURCES

For the purposes of the consolidated statement of cash flows, cash and cash equivalent balances have less than 90 days to maturity from the date of acquisition. Cash and cash equivalents consist of cash, government and provincial securities, deposits with regulated financial institutions and corporate notes and are carried at fair value.

	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$
Cash and non-interest bearing deposits with regulated financial institutions	6,921	6,087	2,591
Treasury bills issued or guaranteed by Canada	6,999	—	—
Treasury bills issued or guaranteed by Provinces	3,999	10,988	—
Corporate notes	5,700	6,494	39,028
Cash and cash equivalents	23,619	23,569	41,619
Interest bearing deposits with regulated financial institutions	17,148	17,963	29,884
Total Cash Resources	40,767	41,532	71,503

#### 4. SECURITIES

Securities balances have more than 90 days to maturity from the date of acquisition and consist of government and provincial securities and corporate notes. Securities are designated as held-for-trading and are carried at fair value. For the period ended December 31, 2008 the yield on these investments ranges between 1.13% and 2.98% with a weighted average rate of 1.96% (September 30, 2008 – 2.97%).

	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$
Treasury bills issued or guaranteed by Canada	—	13,458	4,985
Treasury bills issued or guaranteed by Provinces	—	1,495	—
Other debt securities	—	9,549	14,399
	—	24,502	19,384

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

### 5. LOANS

#### 5.1 Residential reverse mortgages

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

	September 30 2009	December 31 2008	September 30 2008
Mortgage principal plus accrued interest	\$ 837,003	\$ 814,195	\$ 798,162
Mortgage purchase price premiums, net of accumulated amortization	34,379	36,839	37,673
Mortgage origination fees, net of accumulated amortization	2,364	2,538	2,596
Deferred commissions, net of accumulated amortization	16,938	15,399	14,595
	<b>890,684</b>	<b>868,971</b>	<b>853,026</b>

#### 5.2 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.

Province	September 30 2009	December 31 2008	September 30 2008	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$	%	%	%
Ontario	349,581	348,891	343,857	41.8	42.9	43.1
British Columbia	302,474	296,758	292,408	36.1	36.4	36.6
Alberta	101,154	94,274	90,671	12.1	11.6	11.4
Quebec	50,607	44,606	42,954	6.0	5.5	5.4
Other	33,187	29,666	28,272	4.0	3.6	3.5
	<b>837,003</b>	<b>814,195</b>	<b>798,162</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Loan-to-value	September 30 2009	December 31 2008	September 30 2008	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$	%	%	%
Less than 30.0%	174,025	171,280	168,340	20.8	21.0	21.1
30.1% - 40.0%	235,231	225,849	222,342	28.1	27.7	27.9
40.1% - 50.0%	230,371	226,884	218,851	27.5	27.9	27.4
50.1% - 60.0%	127,453	130,057	126,243	15.2	16.0	15.8
60.1% - 70.0%	59,359	53,018	58,159	7.1	6.5	7.3
Greater than 70.1%	10,564	7,107	4,227	1.3	0.9	0.5
	<b>837,003</b>	<b>814,195</b>	<b>798,162</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

#### 5.3 Impaired Loans

The following table shows residential reverse mortgages with a loan-to-value ratio of greater than 83% and the appraised value of those underlying properties.

	September 30 2009	December 31 2008	September 30 2008
Gross amount of impaired loans	\$ 1,535	\$ 720	\$ 599
Specific allowance	(224)	(164)	(148)
	<b>1,311</b>	<b>556</b>	<b>451</b>
Appraised value of underlying properties	<b>1,580</b>	<b>670</b>	<b>543</b>

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

### 5. LOANS (continued)

#### 5.4 Allowances for Credit Losses

	For the three month period			For the nine month period	
	September 30 2009	ended June 30 2009	September 30 2008	ended September 30 2009	September 30 2008
	\$	\$	\$	\$	\$
<b>Specific allowances</b>					
Balance , beginning of period	(181)	(141)	(82)	(164)	(46)
Provision for credit losses	(43)	(42)	(73)	(130)	(102)
Write-offs	—	—	—	70	—
Recoveries	—	2	7	—	—
Balance , end of period	(224)	(181)	(148)	(224)	(148)
<b>General allowances</b>					
Balance , beginning of period	(408)	(408)	(251)	(408)	(251)
Provision for credit losses	(1,741)	—	—	(1,741)	—
Balance, end of period	(2,149)	(408)	(251)	(2,149)	(251)
	(2,373)	(589)	(399)	(2,373)	(399)

#### 5.5 Mortgage interest

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

	For the three month period			For the nine month period	
	September 30 2009	ended June 30 2009	September 30 2008	ended September 30 2009	September 30 2008
	\$	\$	\$	\$	\$
Interest income	12,920	13,635	15,368	40,709	45,818
Early repayment fees	351	214	263	682	793
Increase in specific allowances	(43)	(40)	(66)	(60)	(102)
Less:					
Amortization of deferred commissions	(499)	(473)	(395)	(1,425)	(1,087)
Amortization of purchase price premiums and origination costs	(842)	(899)	(939)	(2,635)	(2,785)
	11,887	12,437	14,231	37,271	42,637

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

### 6. FUTURE INCOME TAXES

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

Future Income Tax Assets	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$
Property and equipment	27	39	39
Non-capital losses	—	38	58
Allowance for credit losses	655	—	—
	682	77	97

As at September 30, 2009, all of the Company's subsidiaries non-capital losses have been fully utilized.

Future Income Tax Liabilities	September 30 2009	December 31 2008	September 30 2008
	\$	\$	\$
Mortgages	8,480	6,839	6,839
Derivative instruments	6,906	6,251	1,994
Debt issue costs	28	—	—
	15,414	13,090	8,833

At September 30, 2009, the Company's estimates of the effective tax rate on reversing temporary differences by tax year are presented in the table below:

	September 30 2009	December 31 2008	September 30 2008
	%	%	%
2009	33.0	—	—
2010	32.0	—	—
2011	30.5	29.5	29.5
2012 and thereafter	29.0	28.0	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. In June 2007, legislation was enacted imposing additional income taxes upon publicly traded income trusts, to commence on January 1, 2011. Consequently the Trust estimated the effective tax rate on reversing temporary differences in 2011, 2012 and thereafter. As a result of the Conversion, the Company is taxable in 2009 and has accordingly estimated rates for 2009 and 2010.

The Company's future income tax provision relates to temporary differences at September 30, 2009. At September 30, 2008 the future income tax provision related to the impact of the taxes estimated to be paid by the Trust from January 1, 2011. The reconciliation of statutory and effective rates of tax is as follows:

	For the three months ended,			For the nine months ended,	
	September 30 2009	June 30 2009	September 30 2008	September 30 2009	September 30 2008
Statutory rate	33.0%	33.0%	33.5%	33.0%	33.5%
	\$	\$	\$	\$	\$
Income (loss) before taxes	(524)	(2,958)	3,579	519	15,725
Tax expense (recovery) calculated at statutory rate	(173)	(976)	1,199	171	5,268
Increase (decrease) in income taxes due to:					
Income distributed to unitholders	—	994	(1,243)	(340)	(5,207)
Impact of the Conversion and tax rate changes	(72)	2,099	85	2,944	1,935
Other	(82)	(9)	22	(84)	(29)
Income tax provision (recovery)	(327)	2,108	63	2,691	1,967

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

### 7. MEDIUM-TERM DEBT

The following table summarizes the medium-term debt outstanding as at September 30, 2009.

Series	Expected final payment	Interest basis	Interest rate at September 30, 2009	Fair market value September 30, 2009	September 30, 2009	December 31, 2008	September 30, 2008
				\$	\$	\$	\$
2007-1	Nov 1, 2009	Fixed rate	5.407%	150,040	150,000	150,000	150,000
2005-1	Nov 1, 2010	Fixed rate	4.296%	112,287	110,000	110,000	110,000
2007-3	May 2, 2011	Fixed rate	5.613%	129,716	125,000	125,000	125,000
2008-1	May 16, 2011	Fixed rate	5.764%	170,843	165,000	165,000	165,000
2006-3	Aug 1, 2012	Fixed rate	4.542%	114,484	115,000	115,000	115,000
2006-1	Feb 1, 2013	Fixed rate	4.637%	102,950	105,000	105,000	105,000
2007-2	Apr 15, 2013	Floating rate (1)	1.603%	14,741	15,267	19,186	20,671
				<b>795,061</b>	<b>785,267</b>	789,186	790,671
					<b>13,533</b>	8,722	13,572
					—	1,251	3,332
					<b>(4,527)</b>	(1,053)	—
					<b>(1,368)</b>	(2,169)	(2,427)
					<b>6,687</b>	8,360	755
					<b>799,592</b>	804,297	805,903

(1) Rate is reset each May 1<sup>st</sup> and November 1<sup>st</sup> 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, 2007-1, 2007-3 and 2008-1 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%, 2007-1 – 2.00%, 2007-3 – 3.00% and 2008-1 – 4.00% until legal maturity. The series 2007-1 notes were repaid on November 1, 2009 (See note 17). The legal maturity dates of these notes range from August 1, 2031 to May 16, 2033. Fair value of medium-term debt is determined using average quoted market rates provided to the Company by capital market dealers.

### 8. SUBORDINATED DEBT

The following table summarizes the subordinated debt outstanding as at September 30, 2009.

Series	Expected final payment	Interest basis	Interest rate September 30, 2009	Fair market value September 30, 2009	September 30, 2009	December 31, 2008	September 30, 2008
				\$	\$	\$	\$
2007-1B	Nov 1, 2012	Fixed rate	6.663%	19,568	20,000	20,000	20,000
2007-2B	Apr 15, 2013	Fixed rate	7.582%	20,032	20,000	20,000	20,000
2006-2B	Aug 1, 2013	Fixed rate	5.803%	18,632	20,000	20,000	20,000
				<b>58,232</b>	<b>60,000</b>	60,000	60,000
					<b>873</b>	830	871
					<b>(356)</b>	(70)	(136)
					<b>(269)</b>	(353)	(381)
					<b>60,248</b>	60,407	60,354

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%, 2007-1B – 3.50% until legal maturity. The series 2007-1B notes were repaid on November 1, 2009 (See note 17). 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. Fair value of subordinated debt is determined using average quoted market rates provided to the Company by capital market dealers.

**HOMEQ CORPORATION****Notes to Interim Consolidated Financial Statements - (unaudited)**

(in thousands of dollars except per share amounts)

**September 30, 2009****9. SALARIES AND BENEFITS**

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

	For the three month period ended			For the nine month period ended	
	September 30 2009	June 30 2009	September 30 2008	September 30 2009	September 30 2008
Mortgage origination	\$ 191	\$ 193	\$ 198	\$ 585	\$ 591
Mortgage servicing and administration	44	44	44	135	131
Overhead	1,106	1,077	1,057	3,265	3,153
	<b>1,341</b>	<b>1,314</b>	<b>1,299</b>	<b>3,985</b>	<b>3,875</b>

**10. SELLING, GENERAL AND ADMINISTRATION**

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

	For the three month period ended			For the nine month period ended	
	September 30 2009	June 30 2009	September 30 2008	September 30 2009	September 30 2008
Marketing	\$ 581	\$ 356	\$ 1,097	\$ 1,365	\$ 3,020
Professional services	502	981	379	2,361	1,061
Office expenses	283	283	288	830	845
Other	63	65	86	244	341
Business and capital taxes	215	—	—	215	—
Mortgage servicing and administration	44	23	22	95	73
	<b>1,688</b>	<b>1,708</b>	<b>1,872</b>	<b>5,110</b>	<b>5,340</b>

**11. CONSOLIDATED STATEMENTS OF CASH FLOW**

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
Prepaid expenses	\$ (467)	\$ 89	\$ (684)	\$ (26)
Income taxes payable	973	—	973	—
Accounts payable and accrued liabilities	405	93	40	(1,616)
	<b>911</b>	<b>182</b>	<b>329</b>	<b>(1,642)</b>

## HOMEQ CORPORATION

### Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

#### 12. 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 September 30, 2009 is as follows:

##### Share Capital

###### Authorized:

An unlimited number of common shares

	For the three months ended September 30, 2009		For the nine months ended September 30, 2009	
	Number of shares	Amount \$	Number of shares	Amount \$
<b>Issued:</b>				
Balance, beginning of period	14,215,433	102,547	—	—
Conversion from Trust units – June 30, 2009	—	—	14,215,433	102,547
Shares earned and granted under the long-term incentive plans (1)	13,294	136	13,294	136
<b>Balance, end of period (2)</b>	<b>14,228,727</b>	<b>102,683</b>	<b>14,228,727</b>	<b>102,683</b>

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

(2) Includes 81,449 restricted shares issued under the Restricted Share Plan and 140,439 deferred shares issued under the Deferred Share Plan.

Trust Units	December 31, 2008		September 30, 2008	
	Number of units	Proceeds \$	Number of units	Proceeds \$
Balance, beginning of period	13,933,047		13,933,047	
Units issued under distribution reinvestment plan	148,456	1,169	139,071	1,169
Units earned and granted under the long-term incentive plans (1)	42,046	443	41,946	327
<b>Balance, end of period</b>	<b>14,123,549</b>	<b>1,612</b>	<b>14,114,064</b>	<b>1,496</b>

The Trust had two long-term incentive plans; a Restricted Unit Plan (RUP) for management and a Deferred Unit Plan (DUP) for Trustees. The entitlements to units under these plans has been 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 Restricted Share Plan (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 September 30, 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.

The non-employee Directors may elect to receive their compensation in whole or in part in the form of deferred shares under the Deferred Share Plan (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 September 30, 2009, the Directors have earned 140,439 shares under the DSP.

For the three month period ending September 30, 2009, Directors fees and executive compensation expense under the long-term incentive plans was \$136 (September 30, 2008 - \$142).

The Company intends to settle the restricted and deferred shares in real 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.

## HOMEQ CORPORATION

### Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

September 30, 2009

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#### 13. 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 have consisted of cash and cash equivalents, securities, senior debt, consisting of medium-term notes, access to credit facilities, 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 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 two percent of its mortgage portfolio value. At September 30, 2009, the senior debt-to-mortgage ratio was 89.5%, the total debt-to-mortgage ratio was 96.6% and CMT held more than the required amount of cash. The Company closely monitors business performance to manage compliance with these covenants.

Subsequent to the period ended September 30, 2009 the Company's subsidiary, Canadian Home Income Plan Corporation received its Letters Patent and Order to Commence as a federally regulated Schedule I bank from the Minister of Finance (See note 15). The bank is called HomEquity Bank (Banque HomEquity). As a chartered bank, HomEquity Bank will have access to retail deposits sourced through deposit brokers, which will become 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. There are two capital standards addressed in HomEquity Bank's capital management policy. These are the risk based capital ratio and the assets to capital multiple. The Company has implemented appropriate 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.

The total capital managed at September 30, 2009 was approximately \$1.0 billion (December 31, 2008, \$1.1 billion; September 30, 2008, \$1.1 billion).

#### 14. DERIVATIVE INSTRUMENTS

In the normal course of business, the Company enters into interest rate derivative contracts to manage the portfolio's 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.

##### 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 statement of income.

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

(in thousands of dollars except per share amounts)

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### 14. DERIVATIVE INSTRUMENTS (continued)

#### 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 September 30, 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	September 30, 2009		
	Weighted average rate	Notional principal	Fair values
<b>Receive fixed</b>		\$	\$
Swaps	4.231%	800,000	33,166
<b>Pay fixed</b>			
Swaps	1.528%	25,000	268
<b>ASSETS</b>		<b>825,000</b>	<b>33,434</b>
<b>Receive fixed</b>			
Forward Rate Agreements	0.435%	20,000	1
<b>Pay fixed</b>			
Swaps	3.191%	126,000	3,559
Forward Rate Agreements	1.169%	10,000	10
<b>LIABILITIES</b>		<b>156,000</b>	<b>3,570</b>

Interest rate contracts	Weighted average rate		Notional principal		Fair values	
	December 31, 2008	September 30, 2008	December 31, 2008	September 30, 2008	December 31, 2008	September 30, 2008
<b>Receive fixed</b>		\$	\$	\$	\$	\$
Swaps	4.223%	4.230%	815,000	822,000	44,511	13,170
Forward Rate Agreements	2.764%	—	40,000	—	169	—
<b>Pay fixed</b>						
Swaps	—	3.296%	—	10,000	—	1
Forward Rate Agreements	—	3.230%	—	5,000	—	3
<b>ASSETS</b>			<b>855,000</b>	<b>837,000</b>	<b>44,680</b>	<b>13,174</b>
<b>Receive fixed</b>						
Forward Rate Agreements	—	2.697%	—	35,000	—	25
<b>Pay fixed</b>						
Swaps	3.904%	4.154%	127,000	124,000	7,465	1,764
Forward Rate Agreements	2.283%	3.410%	136,000	6,000	485	6
<b>LIABILITIES</b>			<b>263,000</b>	<b>165,000</b>	<b>7,950</b>	<b>1,795</b>

# HOMEQ CORPORATION

## Notes to Interim Consolidated Financial Statements - (unaudited)

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### 14. DERIVATIVE INSTRUMENTS (continued)

#### Maturity Terms

The following table summarizes the notional principal and fair value by term to maturity of derivative instruments outstanding as at September 30, 2009. Maturity dates range from November 2009 to May 2014.

	Remaining term to maturity			September 30 2009	December 31 2008	September 30 2008
	Within 1 year	1 to 3 years	3 to 5 years			
<b>Notional principal</b>	\$	\$	\$	\$	\$	\$
Swaps	150,000	545,000	130,000	<b>825,000</b>	815,000	832,000
Forward rate agreements	—	—	—	—	40,000	5,000
<b>Derivative assets</b>	<b>150,000</b>	<b>545,000</b>	<b>130,000</b>	<b>825,000</b>	855,000	837,000
Swaps	7,000	86,000	33,000	<b>126,000</b>	127,000	124,000
Forward rate agreements	30,000	—	—	<b>30,000</b>	136,000	41,000
<b>Derivative liabilities</b>	<b>37,000</b>	<b>86,000</b>	<b>33,000</b>	<b>156,000</b>	263,000	165,000
<b>Fair Values</b>						
Swaps	264	24,523	8,647	<b>33,434</b>	44,511	13,170
Forward rate agreements	—	—	—	—	169	4
<b>Derivative assets</b>	<b>264</b>	<b>24,523</b>	<b>8,647</b>	<b>33,434</b>	44,680	13,174
Swaps	72	1,859	1,628	<b>3,559</b>	7,465	1,764
Forward rate agreements	11	—	—	<b>11</b>	485	31
<b>Derivative liabilities</b>	<b>83</b>	<b>1,859</b>	<b>1,628</b>	<b>3,570</b>	7,950	1,795

#### 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 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 (gains) losses 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.

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 Company elected under Section 3865 – *Hedges* to apply hedge accounting for these interest rate swaps.

The hedges are effective at September 30, 2009. The fair value of these swaps is positive \$5,992 at September 30, 2009 (September 30, 2008 – positive \$755) and is recorded as derivative instruments asset on the balance sheet. For the three and nine months ended September 30, 2009, the Company has recorded a loss of \$952 (September 30, 2008 –\$2,281) and \$2,308 (September 30, 2008 –\$755) respectively of changes in fair value of the derivatives to unrealized losses (gains) on derivative instruments in the consolidated statements of income. The carrying value of the fixed-rate medium-term debt has been adjusted by the same amount with a corresponding gain (2008 – gain) to unrealized losses (gains) on derivative instruments in the consolidated statements of income (See Note 7). For the three and nine months ended September 30, 2009, a loss of \$152 (September 30, 2008 – nil) and \$695 (September 30, 2008 – nil) respectively 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

# HOMEQ CORPORATION

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### 15. FINANCIAL INSTRUMENTS – FINANCIAL RISKS

derivative contracts presented in the summary table above. The Company's exposure to risks arising from other financial instruments is disclosed in Note 15.

#### Credit Risk

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 an appraised value of \$2.3 billion.

#### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations when they are due. 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.

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

	Within 1 year	More than 1 year and 2 years or less	More than 2 years and 5 years or less	September 30, 2009 Total	December 31, 2008 Total	September 30, 2008 Total
	\$	\$	\$	\$	\$	\$
Interest payable on medium-term debt	13,533	—	—	13,533	8,722	13,572
Interest payable on subordinated debt	873	—	—	873	830	871
Interest payable on derivative instruments	—	—	—	—	1,251	3,332
Debt principal (1)						
Medium-Term Debt	150,000	400,000	235,267	785,267	789,186	790,671
Subordinated Debt	—	—	60,000	60,000	60,000	60,000
<b>Total</b>	<b>164,406</b>	<b>400,000</b>	<b>295,267</b>	<b>859,673</b>	<b>859,989</b>	<b>868,446</b>

(1) Certain tranches of debt have refinancing terms upon their expected final payment dates. See notes 7 and 8.

#### 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 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 85 percent 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' Acceptances rates. Historically, changes in interest rates do not impact each benchmark rate equally which may result in a reduction in spread. The following sensitivity analysis shows the annualized impact of a 100 basis point change on each of the underlying benchmark rates individually on the current mortgage and debt portfolios respectively.

	Interest Income	Interest Expense
	\$	\$
100 basis point increase	8,370	8,453
100 basis point decrease	(8,370)	(8,453)

These sensitivities are hypothetical and should be used with caution.

## HOMEQ CORPORATION

### Notes to Interim Consolidated Financial Statements - (unaudited)

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#### 16. FUTURE CHANGES IN ACCOUNTING POLICIES

##### International Financial Reporting Standards

The CICA will transition Canadian GAAP for publicly accountable entities to International Financial Reporting Standards (IFRS). The Company's consolidated financial statements will be prepared in accordance with IFRS for the fiscal year commencing January 1, 2011. The impact of the transition to IFRS on the Company's consolidated financial statements is not yet determinable.

##### 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 amendments will be effective for the Company's 2009 annual consolidated financial statements.

#### 17. SUBSEQUENT EVENTS

On October 13, 2009 the Company's subsidiary, Canadian Home Income Plan Corporation received its Letters Patent and Order to Commence as a federally regulated Schedule I bank from the Minister of Finance. The bank is called HomEquity Bank (Banque HomEquity). As a chartered bank, HomEquity Bank will have access to retail deposits sourced through deposit brokers.

Income tax rules that apply to chartered banks for purposes of computing taxable income earned in the year in a province differ from the rules that apply for general corporations. If the allocation for chartered banks were applied to the Company's subsidiary Canadian Home Income Plan, at September 30, 2009 current tax payable would decrease by \$34 and the net future tax liability would decrease by \$671.

On October 14, 2009 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 October 23, 2009 and was paid on October 28, 2009.

On October 26, 2009 the Company's subsidiary, CHIP Mortgage Trust ("CMT"), concluded the sale of \$150,000 of senior medium term notes (the "Notes") for net proceeds of \$149,775. The Notes have a coupon of the three month banker's acceptance rate plus 1.40%, are rated AAA by DBRS Limited and have an expected final payment date of October 26, 2010. They are unconditionally guaranteed by the Company. CMT has filed with the securities commissions and other similar regulatory authorities in each of the provinces of Canada, a pricing supplement to the short form base shelf prospectus of CMT dated November 23, 2007. Under the prospectus, CMT may issue up to a total of \$750 million of medium term notes from time to time over the 25 months following the date of the prospectus. At September 30, 2009 there was \$418 million remaining under this prospectus. Proceeds of the Notes were used to repay the \$150,000 series 2007-1 fixed rate medium-term debt on November 1, 2009 (See Note 7).

On October 23, 2009 the Company's subsidiary, HomEquity Bank, concluded the sale of \$10,000 subordinated medium term notes (the "Subordinated Notes") due October 31, 2014. The proceeds of the Subordinated Notes were used to repay an equivalent amount of Series 2007-1B subordinated medium term notes issued by HomEquity Bank's wholly owned subsidiary, CMT, in 2007 (See note 8). The Notes constitute subordinated indebtedness within the meaning of the Bank Act (Canada) and qualify as Tier 2 B Capital of HomEquity Bank. They have a coupon of 9.71% and are unrated.

#### 18. COMPARATIVE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

## **CORPORATE INFORMATION**

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### **STOCK LISTING**

The shares of HOMEQ Corporation  
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For further information, please contact:

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or

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