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**CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

**For the three and nine month period  
ended**

**September 30, 2011**

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## Interim Consolidated Balance Sheets (unaudited)

As at

(in thousands of Canadian dollars)

### ASSETS

#### Cash resources (note 4)

Cash and cash equivalents

Interest bearing deposits with banks

#### Securities (note 5)

#### Loans (note 6)

Residential reverse mortgages

Allowance for credit losses

#### Other

Derivative instruments (note 17)

Computer hardware and other property, net

Goodwill and other intangible assets (note 7)

Deferred income tax assets (note 8)

Income taxes receivable

Prepaid expenses and other assets

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Liabilities

#### Deposits (notes 9, 16 and 17)

Payable on a fixed date

#### Other

Derivative instruments (note 17)

Deferred income tax liabilities (note 8)

Dividends payable

Accounts payable and accrued liabilities

Medium-term debt (notes 10, 16 and 17)

Subordinated debt (notes 11, 16 and 17)

Unsecured subordinated debt (notes 12, 16 and 17)

Bank term loan (notes 13, 16 and 17)

#### Shareholders' equity

Common shares (note 14)

Contributed surplus (note 15)

Deficit

	September 30 2011 \$	December 31 2010 \$
	<b>32,014</b>	66,074
	—	11,994
	<b>32,014</b>	78,068
	<b>2,996</b>	—
	<b>1,186,064</b>	1,064,640
	<b>(3,318)</b>	(3,185)
	<b>1,182,746</b>	1,061,455
	<b>33,064</b>	15,264
	<b>504</b>	540
	<b>19,805</b>	19,807
	<b>4,701</b>	4,985
	<b>272</b>	1,306
	<b>1,148</b>	1,170
	<b>59,494</b>	43,072
	<b>1,277,250</b>	1,182,595
	<b>557,226</b>	367,643
	<b>557,226</b>	367,643
	<b>1,212</b>	2,093
	<b>10,070</b>	10,914
	<b>996</b>	988
	<b>10,943</b>	7,988
	<b>23,221</b>	21,983
	<b>527,994</b>	626,298
	<b>40,298</b>	40,308
	<b>20,903</b>	19,724
	<b>10,605</b>	9,726
	<b>599,800</b>	696,056
	<b>1,180,247</b>	1,085,682
	<b>104,676</b>	103,844
	<b>86</b>	31
	<b>(7,759)</b>	(6,962)
	<b>97,003</b>	96,913
	<b>1,277,250</b>	1,182,595

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



## Interim Consolidated Statements of Operations (unaudited)

	For the three month period ended		For the nine month period ended	
	September 30 2011	September 30 2010	September 30 2011	September 30 2010
	\$	\$	\$	\$
<i>(in thousands of Canadian dollars)</i>				
<b>Interest income</b>				
Mortgage interest (note 6)	14,409	12,495	41,693	35,109
Securities	28	28	183	39
Deposits with banks	82	119	442	188
	<b>14,519</b>	<b>12,642</b>	<b>42,318</b>	<b>35,336</b>
<b>Interest expense</b>				
Deposits	3,195	1,368	8,413	2,740
Medium-term debt	3,354	4,217	11,874	12,857
Subordinated debt	613	611	1,852	1,389
Unsecured subordinated debt	427	363	1,283	856
Bank term loan	196	14	585	14
	<b>7,785</b>	<b>6,573</b>	<b>24,007</b>	<b>17,856</b>
<b>Net interest income</b>	<b>6,734</b>	<b>6,069</b>	<b>18,311</b>	<b>17,480</b>
Provision for credit losses, net of recoveries (note 6)	254	135	385	486
<b>Net interest income after provision for credit losses</b>	<b>6,480</b>	<b>5,934</b>	<b>17,926</b>	<b>16,994</b>
<b>Non-interest income</b>				
Mortgage administration fees	37	29	103	85
	<b>37</b>	<b>29</b>	<b>103</b>	<b>85</b>
<b>Net interest income and non-interest income</b>	<b>6,517</b>	<b>5,963</b>	<b>18,029</b>	<b>17,079</b>
<b>Non-interest expenses</b>				
Salaries and benefits (note 20)	1,730	1,756	4,993	4,909
Selling, general and administration (note 21)	1,646	1,823	5,458	5,219
Amortization of intangible assets	54	38	153	126
Amortization of computer hardware and other property	60	48	178	150
	<b>3,490</b>	<b>3,665</b>	<b>10,782</b>	<b>10,404</b>
<b>Income before undernoted item</b>	<b>3,027</b>	<b>2,298</b>	<b>7,247</b>	<b>6,675</b>
Unrealized losses on derivative instruments (note 17)	584	1,372	3,871	7,159
<b>Income (loss) before income taxes</b>	<b>2,443</b>	<b>926</b>	<b>3,376</b>	<b>(484)</b>
Current income tax expense	728	864	1,693	2,771
Deferred income tax recovery	(4)	(527)	(562)	(2,584)
<b>Provision for income taxes</b>	<b>724</b>	<b>337</b>	<b>1,131</b>	<b>187</b>
<b>Net income (loss) and total comprehensive income (loss)</b>	<b>1,719</b>	<b>589</b>	<b>2,245</b>	<b>(671)</b>
<b>Average number of common shares outstanding</b>	<b>14,535</b>	<b>14,348</b>	<b>14,491</b>	<b>14,306</b>
<b>Basic and diluted earnings (loss) per share</b>	<b>\$0.12</b>	<b>\$0.04</b>	<b>\$0.15</b>	<b>\$(0.05)</b>

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

## Interim Consolidated Statements of Changes in Equity (unaudited)

*(in thousands of Canadian dollars)*

### Common shares (note 14)

	For the three month period ended		For the nine month period ended	
	September 30 2011 \$	September 30 2010 \$	September 30 2011 \$	September 30 2010 \$
Balance, beginning of period	104,386	103,216	103,844	102,892
Issued during the period	290	266	832	590
Balance, end of period	104,676	103,482	104,676	103,482

### Contributed surplus (note 15)

Balance, beginning of period	66	6	31	—
Amortization of fair value of employee stock options	20	13	55	19
Employee stock options exercised	—	—	—	—
Balance, end of period	86	19	86	19

### Deficit

Balance, beginning of period (note 17)	(8,461)	(5,510)	(6,962)	(2,286)
Net income (loss) for the period	1,719	589	2,245	(671)
Dividends declared	(1,017)	(988)	(3,042)	(2,952)
Balance, end of period	(7,759)	(5,909)	(7,759)	(5,909)

### Total Shareholders' equity

	97,003	97,592	97,003	97,592
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The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## Interim Consolidated Statements of Cash Flows (unaudited)

(in thousands of Canadian dollars)

### OPERATING ACTIVITIES

	For the three month period ended		For the nine month period ended	
	September 30 2011 \$	September 30 2010 \$	September 30 2011 \$	September 30 2010 \$
Net income (loss) for the period	1,719	589	2,245	(671)
Adjustments for non-cash items				
Amortization				
Purchase price premiums and origination fees	889	826	2,544	2,524
Deferred origination commissions and mortgage fees and costs	569	741	1,641	2,110
Deferred deposit commissions	296	104	781	216
Debt issue costs	146	318	594	1,264
Intangible assets	54	38	153	126
Computer hardware and other property	60	48	178	150
Increase in provision for credit losses	254	135	385	486
Compensation expense related to long-term incentive plans	155	108	429	314
Deferred income tax recovery	(4)	(527)	(562)	(2,584)
Unrealized losses on derivative instruments	584	1,372	3,871	7,159
	<b>4,722</b>	<b>3,752</b>	<b>12,259</b>	<b>11,094</b>
Changes in non-cash working capital				
Accrual of interest payable on debt and derivatives	(2,184)	2,870	(744)	1,481
Accrual of interest on mortgages	(15,652)	(13,493)	(45,121)	(38,179)
Repayments of accrued interest on mortgages	9,320	8,162	27,668	23,898
Other (note 22)	2,328	1,119	4,358	(110)
	<b>(6,188)</b>	<b>(1,342)</b>	<b>(13,839)</b>	<b>(12,910)</b>
Cash provided by (used in) operating activities	<b>(1,466)</b>	<b>2,410</b>	<b>(1,580)</b>	<b>(1,816)</b>

### INVESTING ACTIVITIES

Mortgages originated	(54,538)	(52,037)	(168,103)	(158,297)
Purchase of mortgage portfolio	—	—	(3,732)	—
Mortgage principal repayments	21,623	18,322	66,196	53,208
Origination commissions and deferred mortgage fees and costs	(922)	(1,275)	(2,769)	(3,712)
Increase in securities, net	2,988	10,487	(2,996)	12,192
Decrease (increase) in interest bearing deposits with banks, net	9,992	(11,003)	11,994	(2,519)
Purchase of intangible assets	(58)	—	(151)	—
Purchase of computer hardware and other property	(43)	(6)	(142)	(32)
Cash used in investing activities	<b>(20,958)</b>	<b>(35,512)</b>	<b>(99,703)</b>	<b>(99,160)</b>

### FINANCING ACTIVITIES

Increase in deposits, net	33,081	94,408	180,343	216,128
Gross proceeds from medium-term debt	—	—	175,000	125,000
Repayment of medium-term debt	(912)	(1,178)	(284,697)	(4,653)
Repurchase of medium-term debt	—	—	—	(136,506)
Repurchase of subordinated debt	—	—	—	(10,000)
Gross proceeds from unsecured subordinated debt	—	10,000	—	10,000
Gross proceeds from bank term loan	—	10,000	—	10,000
Increase in debt issue costs	—	(240)	(847)	(1,018)
Proceeds from shares issued under dividend reinvestment plan	156	166	458	292
Dividends	(1,015)	(985)	(3,034)	(2,945)
Cash provided by financing activities	<b>31,310</b>	<b>112,171</b>	<b>67,223</b>	<b>206,298</b>

### Net increase (decrease) in cash and cash equivalents, during the period

Cash and cash equivalents, beginning of period	23,128	40,769	66,074	14,516
<b>Cash and cash equivalents, end of period (note 4)</b>	<b>32,014</b>	<b>119,838</b>	<b>32,014</b>	<b>119,838</b>

### Supplemental cash flow information:

Interest paid	6,127	2,016	13,065	12,371
Income taxes paid	539	1,919	659	4,813

Amounts paid for interest and taxes are included in cash flows from operating activities in the consolidated statements of cash flows.

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



# Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

## 1. CORPORATE INFORMATION

HOMEQ Corporation (the Company) is a public holding company traded on the Toronto Stock Exchange. The Company was incorporated on March 10, 2009 under the laws of the Province of Ontario and is domiciled in Canada with its registered and principal business offices located at 45 St. Clair Ave. West, Suite 600, Toronto, Ontario. 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). 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.

The Company operates primarily through its federally regulated subsidiary, HomeEquity Bank (formerly Canadian Home Income Plan Corporation), which originates and administers reverse mortgages and offers guaranteed investment certificate deposits. The Company is the ultimate parent of the group.

These condensed interim consolidated financial statements for the period ended September 30, 2011 were authorized for issuance by the Board of Directors of the Company on November 4, 2011. The Board of Directors has the power to amend the financial statements after their issuance only in the case of discovery of an error.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Statement of compliance

These condensed interim consolidated financial statements have been prepared to comply with International Accounting Standard 34, *Interim Financial Reporting* (IAS 34) as issued by the International Accounting Standards Board (IASB) using accounting policies consistent with International Financial Reporting Standards (IFRS). The accounting policies have been selected to be consistent with IFRS expected to be effective on December 31, 2011, the Company's first annual IFRS reporting date and were consistently applied to all periods presented unless otherwise noted.

These condensed interim consolidated financial statements should be read in conjunction with the Company's audited annual financial statements as at and for the year ended December 31, 2010 as set out in the 2010 Annual Report on pages 40 through 68 and the Company's interim consolidated financial statements as at and for the period ended March 31, 2011 as set out in the 2011 First Quarter report on pages 27 through 61 and in consideration of the IFRS transition disclosures in Notes 24 and 27 of these financial statements.

### Basis of presentation

These condensed interim consolidated financial statements have been prepared on a historical cost basis, except for the following:

#### Derivative financial instruments and available-for-sale financial assets

Financial assets designated as available-for-sale as well as derivative financial instruments and those financial assets classified or designated at fair value through profit and loss are measured at fair value.

#### Assets and liabilities designated as part of an effective and designated hedging relationship

Assets and liabilities that are designated as hedging instruments in effective fair value hedge relationships are measured at fair value.

### Basis of consolidation

These condensed interim consolidated financial statements reflect the financial position and results of operations of the Company consolidated with the financial position and results of operations of its subsidiaries. The Company's principal subsidiary is HomeEquity Bank. All of the Company's subsidiaries are directly or indirectly wholly owned.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. All intra-company transactions and balances are eliminated in full.



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

#### Critical accounting estimates

The preparation of these condensed interim consolidated financial statements requires management to apply judgment when making estimates and assumptions that affect the reported amounts recognized in the condensed interim financial statements.

#### Allowance for credit losses

The specific and general allowances for credit losses are maintained at a level that is considered adequate to absorb incurred credit-related losses to the mortgage loan portfolio. The determination of the allowances requires management to make estimates when assessing whether or not there is reasonable assurance of the collection of the full amount of principal and interest. Significant judgment is involved in estimating factors such as the expected realizable value of properties and the expected term of the mortgages.

At September 30, 2011, the specific and general allowances for credit losses were \$423 and \$2,895, respectively. The use of different estimates and assumptions could have a significant effect on the measurement of the allowance for credit losses.

#### Fair value of financial instruments

Where possible, the fair value of publicly traded financial instruments is based on quoted market prices. The fair value for a substantial majority of financial instruments is based on quoted market prices or valuation models that use observable market inputs such as interest rate yield curves. Valuation models incorporate prevailing market rates and may require estimates for economic risks and projected cash flows.

At September 30, 2011, the fair value of the derivative instrument assets was \$33,064 and the fair value of the derivative instrument liabilities was \$1,212. The fair value adjustments to deposits, medium-term debt, unsecured subordinated debt and bank term loan subject to hedge accounting were increases of \$7,998, \$17,013, \$431 and \$356 respectively. The use of different estimates and assumptions could have a significant effect on the determination of the fair value of financial instruments and the application of hedge accounting.

#### Amortization of purchase price premiums and transaction costs

In the application of the effective interest rate method to measure amortized cost, purchase price premiums, mortgage origination fees and transaction costs are included in the carrying value of the mortgages and deferred and expensed over the estimated period that mortgages earn interest.

The amounts, net of accumulated amortization, of purchase price premium, mortgage origination fees and transaction costs included in the carrying value of the mortgages at September 30, 2011 were \$28,103, \$1,898 and \$16,840 respectively. The use of different estimates and assumptions related to the expected lives of the mortgages could have a significant effect on the measurement of deferred purchase price premiums and transaction costs included in the carrying value of the mortgages.

#### Income taxes

The Company measures income taxes payable and deferred income tax assets and liabilities at each reporting date. The actual amount of income taxes only becomes final upon filing and acceptance of the tax return by the relevant authorities, which usually occurs subsequent to the issuance of the financial statements. Related carrying amounts at September 30, 2011 were income taxes receivable of \$272, deferred tax assets of \$4,701 and deferred tax liabilities of \$10,070.

Additionally, estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions before they expire against future taxable income. The assessment is based upon existing tax laws and estimates of future taxable income. The use of different estimates and assumptions could have a significant effect on the measurement of the deferred income tax assets.

#### Valuation of goodwill and other intangible assets

Goodwill and the bank license costs are tested for impairment annually by comparing their carrying amount, together with the carrying amount of associated assets, to the recoverable amount. Recoverable amount is defined as the higher of the fair value less costs to sell and the value in use. The determination of recoverable amount requires management to make estimates of forecasted cash flows, growth rates and discount rates. These estimates include assumptions regarding such factors as market risk, credit risk and operational risk.

The carrying value of the goodwill and the bank license costs at September 30, 2011 were \$19,109 and \$427 respectively. The use of different estimates and assumptions could lead to different results in impairment testing, and have a significant effect on the measurement of goodwill and other intangible assets.

## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

#### Critical judgments in applying accounting policies

In the preparation of these condensed interim consolidated financial statements, management has made judgments, aside from those that involve estimates, in the process of applying the accounting policies. These judgments can have an effect on the amounts recognized in the financial statements.

#### Valuation of goodwill and other intangible assets

For the purposes of impairment testing, goodwill and the bank license costs are allocated to the associated cash generating units, or group of cash generating units. Management is required to make judgments regarding the appropriate allocation of goodwill and other intangible assets for impairment testing. Different conclusions on the appropriate allocation could lead to different results of the impairment testing, and have a significant effect on the measurement of goodwill and other intangible assets.

#### Income taxes

The measurement of income taxes payable and deferred income tax assets and liabilities requires management to make judgments in the interpretation and application of the relevant tax laws. The actual amount of income taxes only becomes final upon filing and acceptance of the tax return by the relevant authorities, which occurs subsequent to the issuance of the financial statements.

### 4. CASH RESOURCES

Included in cash and cash equivalents are securities with maturities of less than 90 days from the date of acquisition. For the nine month period ended September 30, 2011, the yield earned on these investments ranged between 0.95% and 1.23% (September 30, 2010 – ranged between 0.17% and 1.01%) with a weighted average rate of 1.06% (September 30, 2010 – 0.51%).

	September 30 2011	December 31 2010
	\$	\$
Cash and non-interest bearing deposits with banks	29,016	48,881
Treasury bills issued or guaranteed by provinces	—	15,993
Corporate notes	2,998	1,200
Cash and cash equivalents	32,014	66,074
Interest-bearing deposits with banks	—	11,994
Total cash resources	32,014	78,068

### 5. SECURITIES

For the nine month period ended September 30, 2011, the yield earned on investments ranged between 1.30% and 1.35% with a weighted average rate of 1.32% (September 30, 2010 – 0.43%).

	Remaining term to maturity			September 30 2011	December 31 2010
	Within 1 year	1 to 5 years	Over 5 years		
	\$	\$	\$	\$	\$
Treasury bills issued or guaranteed by provinces	2,996	—	—	2,996	—
Other debt securities	—	—	—	—	—
	2,996	—	—	2,996	—



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 6. LOANS

#### Residential reverse mortgages

	September 30 2011 \$	December 31 2010 \$
Mortgage principal plus accrued interest	1,139,223	1,016,383
Mortgage purchase price premiums, net of accumulated amortization	28,103	30,398
Mortgage origination fees, net of accumulated amortization	1,898	2,072
Deferred commissions and mortgage fees and costs, net of accumulated amortization	16,840	15,787
	<b>1,186,064</b>	<b>1,064,640</b>

#### Geographic region and loan-to-value

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

Province	September 30 2011 \$	December 31 2010 \$	September 30 2011 %	December 31 2010 %
	Ontario	429,977	401,230	37.8
British Columbia	410,513	365,637	36.0	36.0
Alberta	142,425	123,560	12.5	12.1
Quebec	99,415	79,133	8.7	7.8
Other	56,893	46,823	5.0	4.6
	<b>1,139,223</b>	<b>1,016,383</b>	<b>100.0</b>	<b>100.0</b>

Loan-to-value	September 30 2011 \$	December 31 2010 \$	September 30 2011 %	December 31 2010 %
	Less than 30.0%	195,752	193,444	17.2
30.1% - 40.0%	326,439	287,219	28.6	28.3
40.1% - 50.0%	340,329	294,324	29.9	29.0
50.1% - 60.0%	195,469	165,976	17.2	16.3
60.1% - 70.0%	64,980	61,926	5.7	6.1
Greater than 70.1%	16,254	13,494	1.4	1.3
	<b>1,139,223</b>	<b>1,016,383</b>	<b>100.0</b>	<b>100.0</b>

#### Impaired loans

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

	September 30 2011 \$	December 31 2010 \$
Mortgage principal plus accrued interest	2,667	3,901
Specific allowance	(423)	(638)
	<b>2,244</b>	<b>3,263</b>
Appraised value of underlying properties	<b>2,732</b>	<b>4,008</b>



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 6. LOANS (continued)

#### Allowance for credit losses

	For the three month period ended		For the nine month period ended	
	September 30	September 30	September 30	September 30
	2011	2010	2011	2010
	\$	\$	\$	\$
<b>Specific allowances</b>				
Balance, beginning of period	(318)	(420)	(638)	(263)
Provision for credit losses	(63)	(109)	(218)	(365)
Write-offs	—	28	252	68
Recoveries	(42)	49	181	108
Balance, end of period	(423)	(452)	(423)	(452)
<b>General allowances</b>				
Balance, beginning of period	(2,746)	(2,343)	(2,547)	(2,149)
Provision for credit losses	(149)	(103)	(348)	(297)
Balance, end of period	(2,895)	(2,446)	(2,895)	(2,446)
<b>Total allowances</b>	<b>(3,318)</b>	<b>(2,898)</b>	<b>(3,318)</b>	<b>(2,898)</b>

#### Mortgage interest

	For the three month period ended		For the nine month period ended	
	September 30	September 30	September 30	September 30
	2011	2010	2011	2010
	\$	\$	\$	\$
Interest income	15,652	13,493	45,121	38,179
Early repayment fees	215	298	757	796
	15,867	13,791	45,878	38,975
Less:				
Amortization of deferred commissions and mortgage fees and costs, net	(569)	(470)	(1,641)	(1,342)
Amortization of purchase price premiums and origination costs	(889)	(826)	(2,544)	(2,524)
	(1,458)	(1,296)	(4,185)	(3,866)
	14,409	12,495	41,693	35,109

## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 7. GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets consist of the following:

	September 30 2011 \$	December 31 2010 \$
Goodwill	19,109	19,109
Bank license costs	427	427
Software – amortized	269	271
	<b>19,805</b>	<b>19,807</b>

During the three month and nine month period ended September 30, 2011, amortization of \$54 and \$153 respectively, was recognized for software (September 30, 2010 \$38 and \$126 respectively).

### 8. INCOME TAXES

#### Components of deferred income tax balances

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

	September 30 2011 \$	December 31 2010 \$
<b>Deferred income tax assets</b>		
Non-capital losses	127	85
Mortgages	3,615	3,920
Allowance for credit losses	741	654
Debt issue and deferred costs	218	326
	<b>4,701</b>	<b>4,985</b>
<b>Deferred income tax liabilities</b>		
Computer hardware and other property	59	98
Mortgages	8,447	8,276
Derivative instruments	1,556	2,536
Debt issue and deferred costs	8	4
	<b>10,070</b>	<b>10,914</b>

### 9. DEPOSITS

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

	Maturity term			September 30 2011 \$	December 31 2010 \$
	Within 1 year \$	2 to 3 years \$	4 to 5 years \$		
Individuals	186,178	238,811	124,239	549,228	368,105
Adjustment in carrying value of hedged deposits (note 17)	127	3,602	4,269	7,998	(462)
	<b>186,305</b>	<b>242,413</b>	<b>128,508</b>	<b>557,226</b>	<b>367,643</b>
<b>Fair value of deposits (1)</b>	<b>186,877</b>	<b>244,663</b>	<b>131,366</b>	<b>562,906</b>	<b>373,759</b>
<b>Effective interest rate</b>	<b>1.88%</b>	<b>2.59%</b>	<b>3.27%</b>	<b>2.51%</b>	<b>2.44%</b>

(1) Management determines fair value of deposits by discounting the contractual cash flows using the market interest rates currently offered for deposits with similar terms.



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### 10. MEDIUM-TERM DEBT

Series	Expected final payment	Interest basis	Interest rate	Fair value	September 30 2011	December 31 2010
				\$	\$	\$
2008-1	May 16, 2011	Fixed rate	—	—	—	161,800
2007-3	May 2, 2011	Fixed rate	5.613%	—	—	119,000
2006-3	Aug 1, 2012	Fixed rate	4.542%	<b>102,438</b>	<b>100,200</b>	100,200
2006-1	Feb 1, 2013	Fixed rate	4.637%	<b>108,809</b>	<b>105,000</b>	105,000
2007-2	Aug 31, 2012	Floating rate (1)	2.401%	<b>4,186</b>	<b>4,183</b>	8,080
2010-1	Aug 4, 2015	Fixed rate	4.490%	<b>133,876</b>	<b>125,000</b>	125,000
2011-1	Feb 1, 2016	Fixed rate	3.973%	<b>183,646</b>	<b>175,000</b>	—
				<b>532,955</b>	<b>509,383</b>	619,080
Interest payable					<b>3,626</b>	8,229
Interest payable on derivative instruments					<b>164</b>	—
Interest receivable on derivative instruments					<b>(769)</b>	(4,250)
Debt issue costs, net of accumulated amortization					<b>(1,423)</b>	(1,072)
Adjustment in carrying value of hedged debt (note 17)					<b>17,013</b>	4,311
					<b>527,994</b>	626,298

(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, 2010-1 and 2011-1 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%, 2010-1 – 3.00% and 2011-1 – 3.00% until legal maturity. The legal maturity dates of these notes range from August 1, 2031 to February 1, 2036. Management determines the fair value of medium-term debt using average quoted market rates based on expected final payment dates, provided to the Company by capital markets dealers.

During the year ended December 31, 2010, the Company repurchased \$3,200 of series 2008-1. During the nine month period ended September 30, 2011, the Company redeemed the remaining series 2008-1 medium-term notes which had an expected final payment date of May 16, 2011. For the nine month period ended September 30, 2011 included in medium-term debt interest expense is a net cost of \$1,704 related to these transactions which consist of a loss of \$1,633 on the redemption and \$71 of accelerated recognition of unamortized debt issue costs. There were no repurchases during the three month period ended September 30, 2011.

During the nine month period ended September 30, 2010, the Company repaid all of the series 2007-3 medium-term notes for a cash consideration of \$122,319, consisting of principal and accrued interest. There were no repayments during the three month period ended September 30, 2011.

On January 25, 2011, the Company concluded the sale of \$175,000 of series 2011-1 medium-term notes. The notes have a coupon of 3.97% and have an expected final payment date of February 1, 2016. The Company entered into an interest rate swap to hedge the interest rate on the notes. On a swapped basis, the interest rate of the notes is approximately 138 basis points over the corresponding Bankers' Acceptance rate. The Company incurred costs of \$847 related to this transaction, which are deferred and amortized over the term of the debt on an effective interest rate method and are included in interest expense in the interim consolidated statements of operations.



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### 11. SUBORDINATED DEBT

Series	Expected final payment	Interest basis	Interest rate	Fair value	September 30 2011	December 31 2010
				\$	\$	\$
2007-1B	Nov 1, 2012	Fixed rate	6.663%	10,201	10,000	10,000
2007-2B	Aug 31, 2012	Fixed rate	7.582%	20,487	20,000	20,000
2006-2B	Aug 1, 2013	Fixed rate	5.803%	10,123	10,000	10,000
				40,811	40,000	40,000
Interest payable					499	477
Interest receivable on derivative instruments					(143)	(57)
Debt issue costs, net of accumulated amortization					(58)	(112)
					40,298	40,308

The Company has a best efforts obligation to refinance the series 2006-2B and 2007-1B notes on their respective expected final payment dates. If a note remains outstanding after the expected final payment date, the interest will become the one-month Bankers' Acceptance rate plus the following spreads calculated and payable monthly: 2006-2B – 1.75% and 2007-1B – 3.50% until legal maturity. The legal maturity dates of these notes range from August 1, 2031 to November 1, 2032. The series 2007-2B note is repayable after the 2007-2 medium-term note is repaid in full. Management determines the fair value of subordinated debt using average quoted market rates based on expected final payment dates, provided to the Company by capital market dealers.

### 12. UNSECURED SUBORDINATED DEBT

Maturity	Interest basis	Interest rate	Fair value	September 30 2011	December 31 2010
			\$	\$	\$
Oct 31, 2014	Fixed rate	9.713%	10,463	10,000	10,000
May 31, 2016	Fixed rate	8.600%	10,101	10,000	10,000
			20,564	20,000	20,000
Interest payable				696	238
Interest receivable on derivative instruments				(41)	(11)
Debt issue costs, net of accumulated amortization				(183)	(225)
Adjustments in carrying value of hedged debt (note 17)				431	(278)
				20,903	19,724

Management determines the fair value of the unsecured subordinated debt using quoted market rates provided to the Company by a capital market dealer.

### 13. BANK TERM LOAN

Maturity	Interest basis	Interest rate	Fair value	September 30 2011	December 31 2010
			\$	\$	\$
May 31, 2016	Fixed rate	8.210%	10,211	10,000	10,000
Interest payable				278	71
Interest receivable on derivative instruments				(29)	(21)
Adjustment in carrying value of hedged debt (note 17)				356	(324)
				10,605	9,726

During the year ended December 31, 2010, the Company entered into a non-revolving term loan for \$10,000 maturing on May 31, 2016 with a coupon of 8.21%. The proceeds of the loan were used to invest in unsecured subordinated debt issued by HomeEquity Bank, constituting subordinated indebtedness within the meaning of the *Bank Act* (Canada) and qualifying as Tier 2 B Capital. The Company has provided a promissory note, a general security agreement, and a pledge of all investments made in HomeEquity Bank including the unsecured subordinated debt and all of the issued and outstanding shares in the capital of HomeEquity Bank. Management determines the fair value of the term loan using quoted market rates provided to the Company by a capital markets dealer.



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### 14. SHARE CAPITAL

A summary of the changes to the Company's share capital is as follows:

**Authorized:** An unlimited number of common shares

Common shares	Number of shares	Amount \$
<b>Balance, January 1, 2010</b>	14,239,041	102,892
Shares issued under Dividend Re-investment Plan	110,953	480
Shares earned and granted under the long-term incentive plans (1)	40,396	472
<b>Balance, December 31, 2010</b>	14,390,390	103,844
Shares issued under Dividend Re-investment Plan	20,049	129
Shares earned and granted under the long-term incentive plans (1)	52,529	136
<b>Balance, March 31, 2011 (2)</b>	14,462,968	104,109
Shares issued under Dividend Re-investment Plan	24,478	173
Shares earned and granted under the long-term incentive plans (1)	12,397	104
<b>Balance, June 30, 2011 (2)</b>	<b>14,499,843</b>	<b>104,386</b>
Shares issued under Dividend Re-investment Plan	22,513	156
Shares earned and granted under the long-term incentive plans (1)	13,045	134
<b>Balance, September 30, 2011 (2)</b>	<b>14,535,401</b>	<b>104,676</b>

(1) Includes re-invested dividends and vested, unvested and cancelled shares.

(2) Includes 73,814 restricted shares issued under the Restricted Share Plan and 236,906 deferred shares issued under the Deferred Share Plan.

The Company has three long-term incentive plans: a Restricted Share Plan (RSP) for management, a Deferred Share Plan (DSP) for Directors and an Option and Share Appreciation Rights Plan for management.

A restricted share granted through the RSP entitles the holder to receive, on the vesting date, a share plus the amount of dividends that would have been paid on the shares respectively if the share had been issued on the date of grant. Subject to the achievement of performance conditions, if any, restricted shares vest equally over three years and the total cost of the grant is recognized over the vesting period. As at September 30, 2011, 254,703 restricted shares were issued since the inception of the plan and 73,814 shares remain within the plan, none of which have vested. For the nine month period ended September 30, 2011, 38,268 restricted shares were issued (September 30, 2010 – 29,700).

The non-employee Directors may elect to receive their compensation in whole or in part in the form of deferred shares under the DSP in lieu of cash compensation. On retiring from the Board, a Director will receive all deferred shares accumulated in the plan. The maximum number of shares that may be issued under the DSP is limited to 500,000. As at September 30, 2011, the Directors have earned 236,902 shares under the DSP. For the nine month period ended September 30, 2011, 39,703 deferred shares were issued (September 30, 2010 – 33,976).

For the three and nine month period ended September 30, 2011, Directors' fees and executive compensation expense under the long-term incentive plans was \$135 and \$374 respectively (September 30, 2010 – \$101 and \$303 respectively). The Company intends to settle the restricted and deferred shares in shares of the Company upon vesting and retirement, respectively. Until such time, these shares do not trade on the Toronto Stock Exchange, have no voting rights and cannot be sold or liquidated early.

The Option and Share Appreciation Rights Plan was established to reinforce the alignment of interests between key executives and shareholders, reward achievement of shareholder value creation and provide competitive compensation opportunities to enable the Company to attract, retain and motivate leaders that are critical to the long-term success of the Company. A summary of the Company's Option and Share Appreciation Rights Plan and related information is described in Note 15.

The Company has an optional Dividend Reinvestment Plan (the Plan) for shareholders. The Plan allows eligible Canadian shareholders to elect to have their cash dividends from the Company automatically reinvested in additional shares. Shareholders who participate in the Plan will receive a further bonus of shares equal in value to 4% of each dividend that was reinvested.



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### 15. OPTION AND SHARE APPRECIATION RIGHTS PLAN

Stock options vest equally over three years and have a maximum term of seven years from the date of grant. Options under the Plan are granted at the closing price of the Company's common shares on the business day prior to the date of the grant. A summary of the Plan and related information is as follows:

	Stock options	Weighted average exercise price \$
<b>Outstanding, January 1, 2010</b>	—	—
Granted	82,000	7.21
Exercised	—	—
Forfeited	—	—
<b>Outstanding, December 31, 2010</b>	82,000	7.21
<b>Exercisable, end of period</b>	—	—
Granted	<b>88,100</b>	<b>7.20</b>
Exercised	—	—
Forfeited	—	—
<b>Outstanding, September 30, 2011</b>	<b>170,100</b>	<b>7.20</b>
<b>Exercisable, end of period</b>	<b>27,333</b>	<b>7.21</b>

The Company expenses the fair value of stock options that are expected to vest over the vesting period using the Black-Scholes option pricing model to estimate fair value for each option at the date of grant. The weighted average fair value of options granted and principal assumptions used in applying the Black-Scholes option pricing model were as follows:

	2011	2010
<b>Weighted average fair value</b>	<b>\$1.16</b>	\$0.89
Weighted average of key assumptions:		
Exercise price	<b>\$7.20</b>	\$7.21
Risk-free interest rate	<b>2.61%</b>	3.07%
Dividend yield	<b>3.89%</b>	4.12%
Volatility factor	<b>25.6%</b>	20.0%
Expected life in years	<b>4.5 years</b>	4.5 years

For the three and nine month period ended September 30, 2011, the Company has recorded share-based compensation expense of \$20 and \$55 respectively (September 30, 2010 – \$7 and \$11 respectively) related to grants of options under the Option and Share Appreciation Rights Plan. This amount is included in salaries and benefits in the interim consolidated statements of operations and in contributed surplus on the interim consolidated balance sheets.

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### 16. CAPITAL MANAGEMENT

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

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

The Company's subsidiary, HomEquity Bank, has access to retail deposits sourced through deposit brokers, which are 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) – Simpler 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: risk-based capital ratios and assets-to-capital multiple. The Company has implemented policies and procedures to monitor compliance with regulatory capital requirements. HomEquity Bank has implemented an Internal Capital Adequacy Assessment Process which is based on the Company's assessment of the business risks of HomEquity Bank.

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

	September 30 2011	December 31 2010 (Canadian GAAP)(4)
	\$	\$
Shareholders' equity per HomEquity Bank's consolidated balance sheets	76,089	75,494
Deductions	414	341
<b>Tier 1 capital</b>	<b>75,675</b>	<b>75,153</b>
Book value of unsecured subordinated debt	30,000	30,000
Less: accumulated amortization for capital adequacy purposes	8,000	4,000
<b>Tier 2 capital</b>	<b>22,000</b>	<b>26,000</b>
<b>Total regulatory capital</b>	<b>97,675</b>	<b>101,153</b>
Credit risk	560,962	518,689
Off-balance sheet exposure	7,304	3,463
Operational risk	42,712	41,001
<b>Total risk-weighted assets</b>	<b>610,978</b>	<b>563,153</b>
<b>Capital ratios</b>		
Tier 1 Capital Ratio (1)	12.4%	13.3%
Total Capital Ratio (2)	16.0%	18.0%
Assets-to-Capital Multiple (3)	12.9x	11.5x

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

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

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

(4) Regulatory capital and calculations as at December 31, 2010 are based on Canadian GAAP balances.

During the three and nine month period ended September 30, 2011, HomEquity Bank complied with the OSFI guideline related to capital ratios and the assets-to-capital multiple. Both the Tier 1 and Total Capital Ratios remain above OSFI's stated minimum capital ratios of 7% and 10%, respectively, for a well capitalized financial institution. HomEquity Bank's Assets-to-Capital Multiple remains below the maximum permitted by OSFI. The IFRS transition adjustments described in Note 24 did not have a significant impact on HomEquity Bank's capital ratios and assets-to-capital multiple as at December 31, 2010.

HomEquity Bank's wholly owned subsidiary, CHIP Mortgage Trust's (CMT) borrowings are subject to debt-to-mortgage covenants. The covenants are: a maximum senior debt-to-mortgage ratio of 93% when it has commercial paper outstanding, a maximum of 95% when its senior rated debt consists only of medium-term notes, and a maximum total debt-to-mortgage ratio of 98%. CMT is also required to maintain minimum cash on hand equivalent to 2% of its mortgage portfolio value. At September 30, 2011, the senior debt-to-mortgage ratio was 69.1% (December 31, 2010 - 76.4%; September 30, 2010 - 90.2%), the total debt-to-mortgage ratio was 76.0% (December 31, 2010 - 82.8%; September 30, 2010 - 96.4%) and CMT held more than the required amount of cash. The Company closely monitors business performance to manage compliance with these covenants.



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### 17. DERIVATIVE INSTRUMENTS

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

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

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

#### Fair values

Fair values of the interest rate derivatives are determined using an internal valuation model with observable inputs. Changes in fair value resulting in unrealized gains or losses are recorded in the interim consolidated statements of operations.

#### 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 is 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, 2011. The floating rate for all instruments is based on the CDOR-BA rate for terms ranging from one to twelve months.

	Weighted average rate		Notional principal		Fair values	
	September 30 2011	December 31 2010	September 30 2011 \$	December 31 2010 \$	September 30 2011 \$	December 31 2010 \$
<b>Interest rate contracts</b>						
<b>Receive fixed</b>						
Swaps	3.60%	4.00%	799,700	685,000	33,064	15,199
Forward rate agreements	—	1.69%	—	30,000	—	24
<b>Pay fixed</b>						
Swaps	—	1.45%	—	75,000	—	41
<b>ASSETS</b>			<b>799,700</b>	<b>790,000</b>	<b>33,064</b>	<b>15,264</b>
<b>Receive fixed</b>						
Swaps	—	2.43%	—	120,500	—	1,051
<b>Pay fixed</b>						
Swaps	1.69%	2.79%	239,500	64,500	1,175	1,039
Forward rate agreements	1.27%	1.40%	100,000	75,000	37	3
<b>LIABILITIES</b>			<b>339,500</b>	<b>260,000</b>	<b>1,212</b>	<b>2,093</b>



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### 17. 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, 2011. Maturity dates range from November 2011 to May 2016.

	Remaining term to maturity				September 30 2011	December 31 2010
	Within 1 year	1 to 3 years	3 to 5 years	Over 5 years		
	\$	\$	\$	\$	\$	\$
<b>Notional principal</b>						
Swaps	108,700	282,000	409,000	—	799,700	760,000
Forward rate agreements	—	—	—	—	—	30,000
<b>Derivative assets</b>	<b>108,700</b>	<b>282,000</b>	<b>409,000</b>	<b>—</b>	<b>799,700</b>	<b>790,000</b>
Swaps	175,000	64,500	—	—	239,500	185,000
Forward rate agreements	100,000	—	—	—	100,000	75,000
<b>Derivative liabilities</b>	<b>275,000</b>	<b>64,500</b>	<b>—</b>	<b>—</b>	<b>339,500</b>	<b>260,000</b>
<b>Fair values</b>						
Swaps	2,185	8,207	22,672	—	33,064	15,240
Forward rate agreements	—	—	—	—	—	24
<b>Derivative assets</b>	<b>2,185</b>	<b>8,207</b>	<b>22,672</b>	<b>—</b>	<b>33,064</b>	<b>15,264</b>
Swaps	347	828	—	—	1,175	2,090
Forward rate agreements	37	—	—	—	37	3
<b>Derivative liabilities</b>	<b>384</b>	<b>828</b>	<b>—</b>	<b>—</b>	<b>1,212</b>	<b>2,093</b>

#### 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, deposits, unsecured subordinated debt and the bank term loan due to movements in market interest rates. Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded as unrealized losses (gains) on derivative instruments in the consolidated statements of operations, along with adjustments to the carrying value of the financial instruments that are attributable to the hedged risk. The Company has elected under IAS 39 *Financial Instruments: Recognition and Measurement*, to apply hedge accounting to the interest rate swaps detailed below. All hedging relationships to which the Company has chosen to apply hedge accounting are fair value hedges, used to protect against changes in the fair value of fixed-rate deposits and medium-term debt due to movements in interest rates.

#### Unrealized losses on derivative instruments

The following table summarizes the unrealized gains and losses on non-hedged and hedged derivative instruments which are included in unrealized losses on derivative instruments on the consolidated statements of operations.

	For the three month period ended		For the nine month period ended	
	September 30 2011	September 30 2010	September 30 2011	September 30 2010
	\$	\$	\$	\$
Non-hedged derivative instruments	680	1,708	4,100	7,097
Hedged derivative instruments	(96)	(336)	(229)	62
	<b>584</b>	<b>1,372</b>	<b>3,871</b>	<b>7,159</b>

The Company continuously evaluates and monitors the performance of hedged derivative instruments and the underlying calculations of hedge ineffectiveness. Following the review performed in Q3 of hedging relationships, an adjustment to hedge ineffectiveness was identified, as a result of a correction in the interest rate used in the calculation of the fair value of the hedged items in 2011. For the three month periods ended March 31, 2011 and June 30, 2011, the Company recorded \$3,134 (tax impact \$787) and \$1,086 (tax impact \$273), respectively, of adjustment restating the carrying value of the hedged items. The adjustment would have resulted in less hedge ineffectiveness being recorded in Q1 and Q2 than previously presented.



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### 17. DERIVATIVE INSTRUMENTS (continued)

#### Hedge accounting results (continued)

The adjustments to unrealized (gains) losses on derivative instruments on the consolidated statements of operations and the resulting account balances for periods ended March 31, 2011 and June 30, 2011 are as follows:

	For the three months March 31 2011 \$	For the three months June 30 2011 \$
Unrealized (gains) losses on derivative instruments previously presented	(1,240)	307
Adjustments to the carrying value of the hedged items	3,134	1,086
Unrealized (gains) losses on derivative instruments restated	1,894	1,393

As a result of the above adjustments, the accumulated deficit as at March 31, 2011 and June 30, 2011 are \$8,821 and \$8,461 respectively.

#### Medium-term debt

During the nine month period ended September 30, 2011, the Company entered into interest rate swaps having a notional amount of \$175,000 to hedge the series 2011-1 fixed-rate medium-term debt issued during the period. As at September 30, 2011, the Company also has interest rate swaps having a notional amount of \$300,000 that hedge series 2010-1 and series 2011-1. The fair value of these swaps is recorded as derivative instrument assets on the consolidated balance sheets. The hedges were effective on September 30, 2011. During the three month and nine month period ended September 30, 2011, the Company recorded a hedge ineffectiveness gain of \$217 and \$1,242 respectively (September 30, 2010 – gain of \$228 and loss of \$194 respectively), which is included in unrealized (gains) losses on derivative instruments on the consolidated statements of operations.

#### Deposits

During the nine month period ended September 30, 2011, the Company entered into interest rate swaps having a notional amount of \$116,000 to hedge \$116,000 of deposits issued during the period. As at September 30, 2011 the Company also has interest rate swaps having a notional amount of \$263,500 that hedge deposits. The fair value of these swaps is recorded as derivative instruments assets on the consolidated balance sheets. The hedges were effective on September 30, 2011. During the three and nine month period ended September 30, 2011, the Company recorded a hedge ineffectiveness loss of \$233 and \$734 respectively (September 30, 2010 – gain of \$62 and \$85 respectively), which is included in unrealized (gains) losses on derivative instruments on the consolidated statements of operations.

#### Unsecured subordinated debt

At September 30, 2011, the Company has interest rate swaps having a notional amount of \$10,000 to hedge \$10,000 of unsecured subordinated debt. The fair value of these swaps is recorded as derivative instruments assets on the consolidated balance sheets. The hedges were effective on September 30, 2011. During the three and nine month period ended September 30, 2011, the Company recorded a hedge ineffectiveness gain of \$58 and \$158 respectively (September 30, 2010 gain of \$58), which is included in unrealized (gains) losses on derivative instruments on the consolidated statements of operations.

#### Bank term loan

At September 30, 2011, the Company has interest rate swaps having a notional amount of \$10,000 to hedge \$10,000 of the bank term loan. The fair value of this swap is recorded as derivative instruments assets on the consolidated balance sheets. The hedges were effective on September 30, 2011. During the three and nine month period ended September 30, 2011, the Company recorded a hedge ineffectiveness gain of \$54 and \$121 respectively (September 30, 2010 – loss of \$12), which is included in unrealized (gains) losses on derivative instruments on the consolidated statements of operations.

### 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.



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### 17. DERIVATIVE INSTRUMENTS (continued)

#### Derivative-related risks (continued)

##### 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 I Canadian chartered banks as counterparties. The maximum derivative credit exposure to the Company is the fair value of derivative contracts presented in the summary table below.

The Company's exposure to risks arising from other financial instruments is disclosed in Note 18.

September 30, 2011 Interest rate contracts	Notional principal	Replacement cost (1)	Credit risk equivalent (2)	Risk-weighted assets (3)	Fair value
	\$	\$	\$	\$	\$
Swaps					
Maturing within 1 year	108,700	2,185	2,185	437	2,185
Maturing in 1 to 3 years	282,000	8,207	9,617	1,923	8,207
Maturing in 3 to 5 years	409,000	22,672	24,717	4,943	22,672
	<b>799,700</b>	<b>33,064</b>	<b>36,519</b>	<b>7,303</b>	<b>33,064</b>
December 31, 2010 Interest rate contracts	Notional principal	Replacement cost (1)	Credit risk equivalent (2)	Risk-weighted assets (3)	Fair value
	\$	\$	\$	\$	\$
Swaps					
Maturing within 1 year	349,800	2,502	2,502	500	2,502
Maturing in 1 to 3 years	235,200	9,322	10,498	2,100	9,322
Maturing in 3 to 5 years	175,000	3,416	4,291	858	3,416
Forward rate agreements					
Maturing within 1 year	30,000	24	24	5	24
	<b>790,000</b>	<b>15,264</b>	<b>17,315</b>	<b>3,463</b>	<b>15,264</b>

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

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

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

### 18. FINANCIAL INSTRUMENTS – FINANCIAL RISKS

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

#### Credit risk (non-derivative)

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations in accordance with agreed terms. Credit risk on the Company's cash and cash equivalents is mitigated by maintaining cash balances at Schedule I 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 1.1%. 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.



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 18. FINANCIAL INSTRUMENTS – FINANCIAL RISKS (continued)

#### Interest rate risk

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

Interest rates on approximately 52% of the mortgage portfolio are based on the Government of Canada Treasury-bill and bond rates whereas interest rates on the debt and derivative instruments are based on the Bankers' Acceptance rates. Historically, changes in interest rates do not impact each benchmark rate equally, which may result in a variation in spread.

#### Liquidity risk

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

The following table summarizes the expected final payment dates of debt principal and interest payable, derivative instruments and deposit maturities on the consolidated balance sheets:

					September 30
	Within 1 year	1 to 3 years	4 to 5 years	Over 5 years	2011 Total
	\$	\$	\$	\$	\$
Deposits	186,305	242,413	128,508	—	557,226
Interest payable on medium-term debt	3,626	—	—	—	3,626
Interest payable on subordinated debt	499	—	—	—	499
Interest payable on unsecured subordinated debt	696	—	—	—	696
Interest payable on bank term loan	278	—	—	—	278
Derivative instruments	384	828	—	—	1,212
Interest payable on derivative instruments	164	—	—	—	164
Debt principal (1)					
Medium-term debt	104,383	105,000	300,000	—	509,383
Subordinated debt	20,000	20,000	—	—	40,000
Unsecured subordinated debt	—	—	20,000	—	20,000
Bank term loan	—	—	10,000	—	10,000
<b>Total</b>	<b>316,335</b>	<b>368,241</b>	<b>458,508</b>	<b>—</b>	<b>1,143,084</b>

  

					December 31
	Within 1 year	1 to 3 years	4 to 5 years	Over 5 years	2010 Total
	\$	\$	\$	\$	\$
Deposits	127,149	126,959	113,535	—	367,643
Interest payable on medium-term debt	8,229	—	—	—	8,229
Interest payable on subordinated debt	477	—	—	—	477
Interest payable on unsecured subordinated debt	238	—	—	—	238
Interest payable on bank term loan	71	—	—	—	71
Derivative instruments	278	1,021	611	183	2,093
Debt principal (1)					
Medium-term debt	280,800	213,280	125,000	—	619,080
Subordinated debt	—	40,000	—	—	40,000
Unsecured subordinated debt	—	—	10,000	10,000	20,000
Bank term loan	—	—	—	10,000	10,000
<b>Total</b>	<b>417,242</b>	<b>381,260</b>	<b>249,146</b>	<b>20,183</b>	<b>1,067,831</b>

(1) Certain tranches of debt have refinancing terms upon their expected final payment dates. See Notes 10 and 11.



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 18. FINANCIAL INSTRUMENTS – FINANCIAL RISKS (continued)

#### Interest rate sensitivity

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

The Company estimates that an annualized 100 basis point decrease in interest rates would increase net interest income after tax over the next twelve months by \$5. A 100 basis point increase in interest rates would decrease net income after tax over the next twelve months by a similar amount. These sensitivities are hypothetical and should be used with caution.

(in thousands except % amounts)						Non-interest	Total
	Floating	0 to 3	4 to 12	1 to 3	Over 3	rate sensitive	
September 30, 2011	\$	\$	\$	\$	\$	\$	\$
Total assets	297,516	208,350	444,852	168,460	88,118	69,954	1,277,250
Total liabilities and equity	—	66,722	244,352	368,241	458,508	139,427	1,277,250
Derivative instruments	—	(382,000)	(244,500)	229,000	397,500	—	—
Interest rate sensitivity gap	297,516	(240,372)	(44,000)	29,219	27,110	(69,473)	—
Cumulative gap	297,516	57,144	13,144	42,633	69,743	—	—
Cumulative gap as a percentage of total assets	23.3%	4.5%	1.0%	3.3%	5.4%	—	—
<b>December 31, 2010</b>							
Total assets	241,602	185,414	473,242	153,151	56,306	72,880	1,182,595
Total liabilities and equity	—	24,060	384,167	381,700	269,351	123,317	1,182,595
Derivative instruments	—	(415,000)	(79,200)	255,200	239,000	—	—
Interest rate sensitivity gap	241,602	(253,646)	9,875	26,651	25,955	(50,437)	—
Cumulative gap	241,602	(12,044)	(2,169)	24,482	50,437	—	—
Cumulative gap as a percentage of total assets	20.4%	(1.0%)	(0.2%)	2.1%	4.3%	—	—

## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 19. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value amounts are designed to approximate amounts at which financial instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act.

The Company uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value of financial instruments. The classifications are as follows: the use of quoted market prices for identical financial instruments (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3). The Company had no Level 1 or Level 3 financial instruments at September 30, 2011 and there have been no transfers between levels.

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

The following table summarizes the Level 2 financial assets and liabilities carried at fair value:

	September 30 2011 \$	December 31 2010 \$
<b>Financial assets</b>		
Cash resources (1)	32,014	78,068
Securities (1)	2,996	—
Derivative instruments (2)	33,064	15,264
<b>Financial assets carried at fair value</b>	<b>68,074</b>	<b>93,332</b>
<b>Financial liabilities</b>		
Derivative instruments (2)	1,212	2,093
<b>Financial liabilities carried at fair value</b>	<b>1,212</b>	<b>2,093</b>

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

- (1) Cash resources and securities are valued using internal models using observable market information as inputs (Level 2).
- (2) Fair value of derivative instruments is determined using an internal valuation model with observable inputs (Level 2).

### 20. SALARIES AND BENEFITS

	For the three month period ended		For the nine month period ended	
	September 30 2011 \$	September 30 2010 \$	September 30 2011 \$	September 30 2010 \$
Origination	322	270	978	768
Mortgage administration	72	55	201	155
Overhead	1,336	1,431	3,814	3,986
	<b>1,730</b>	<b>1,756</b>	<b>4,993</b>	<b>4,909</b>

### 21. SELLING, GENERAL AND ADMINISTRATION

	For the three month period ended		For the nine month period ended	
	September 30 2011 \$	September 30 2010 \$	September 30 2011 \$	September 30 2010 \$
Marketing	647	610	2,052	1,812
Professional services	485	640	1,694	1,697
Office expenses	328	365	1,053	1,028
Other	108	107	427	353
Business and capital taxes	8	56	40	191
Mortgage administration	70	45	192	138
	<b>1,646</b>	<b>1,823</b>	<b>5,458</b>	<b>5,219</b>



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 22. CONSOLIDATED STATEMENTS OF CASH FLOWS - OTHER

	For the three month period ended		For the nine month period ended	
	September 30	September 30	September 30	September 30
	2011	2010	2011	2010
Prepaid expenses and other assets	\$ 22	\$ 346	\$ 22	\$ 246
Income taxes payable	189	(1,202)	1,034	(2,189)
Accounts payable and accrued liabilities	2,117	1,975	3,302	1,833
	<b>2,328</b>	<b>1,119</b>	<b>4,358</b>	<b>(110)</b>

### 23. RELATED PARTY TRANSACTIONS

Related party transactions conducted in the normal course of operations are measured at the exchange value (the amount established and agreed to by the related parties). The only related party transactions during the three and nine month period ended September 30, 2011 were compensation transactions with the Company's Directors and key management.

Remuneration of Directors and key management:

	For the three month period ended		For the nine month period ended	
	September 30	September 30	September 30	September 30
	2011	2010	2011	2010
Salaries and benefits	\$ 659	\$ 735	\$ 1,892	\$ 2,061
Share-based payments	175	152	519	443
	<b>834</b>	<b>887</b>	<b>2,411</b>	<b>2,504</b>

During the nine month period ended September 30, 2011, Directors and key management were awarded restricted shares, deferred shares and share options:

Description	Date of grant	Number	Exercise price	Expiry
Restricted Share Plan	March 7, 2011	35,400	n/a	March 15, 2014
Deferred Share Plan	January 15, 2011	14,261	n/a	Upon retirement
Option and Share Appreciation Rights Plan	March 7, 2011	88,100	\$7.20	March 15, 2018



## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

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### 24. EXPLANATION OF TRANSITION TO IFRS

#### Overview

IFRS replaced Canadian GAAP for publicly accountable enterprises, effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company's condensed interim consolidated financial statements have been prepared in accordance IAS 34 using accounting policies consistent with IFRS.

The accounting policies have been selected to be consistent with IFRS expected to be effective on December 31, 2011, the Company's first annual IFRS reporting date. Previously, the Company prepared its interim and annual consolidated financial statements in accordance with Canadian GAAP.

The adoption of IFRS requires the application of IFRS 1, which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS effective at the end of an entity's first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

The Company has elected to apply the following optional exemptions in its preparation of its opening IFRS consolidated balance sheet as at January 1, 2010 (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 elect to designate certain existing financial instruments as available-for-sale as at the Transition Date.
- To apply the transition provisions of IFRIC 4 *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.

IFRS 1 contains a mandatory exception to retrospective treatment that does not permit retrospective designation of hedging relationships. In addition, the Company may not reflect a hedging relationship in its opening consolidated balance sheet that does not qualify for hedge accounting under IFRS. All of the Company's existing hedging relationships under Canadian GAAP qualified for hedge accounting under IFRS at January 1, 2010.

IFRS 1 does not permit changes to estimates that have been made previously. Estimates used in the preparation of the Company's opening IFRS consolidated balance sheet, and other comparative information restated to comply with IFRS, are consistent with those made previously under current Canadian GAAP.

#### Changes to accounting policies

The adoption of IFRS resulted in changes to the accounting policies as compared with the most recent annual consolidated financial statements prepared under Canadian GAAP. Accounting policies have been changed to be consistent with IFRS as is expected to be effective on December 31, 2011.

Significant changes to the Company's accounting policies on adoption of IFRS, and the effect on the Company's opening IFRS consolidated balance sheet are detailed in the Company's interim consolidated financial statements as at and for the period ended March 31, 2011 as set out in the 2011 First Quarter report on pages 27 through 61.

## Notes to Condensed Interim Consolidated Financial Statements

September 30, 2011

(in thousands of Canadian dollars except per share amounts)

### 24. EXPLANATION OF TRANSITION TO IFRS (continued)

#### Reconciliations of Canadian GAAP to IFRS

IFRS 1 requires an entity to reconcile equity, comprehensive income and cash flows for prior periods. The Company's adoption of IFRS did not have a material impact on the consolidated statement of cash flows. The following provides reconciliations of shareholders' equity and comprehensive income from Canadian GAAP to IFRS as at September 30, 2010 and for the three and nine month periods ended September 30, 2010 (Note 27):

#### Reconciliation of shareholders' equity

	<b>As at September 30 2010</b>
	<b>\$</b>
<b>Shareholders' equity under Canadian GAAP</b>	<b>98,564</b>
Differences increasing (decreasing) reported shareholders' equity	
Change in transaction costs (1)	(4,869)
Tax effect of change in transaction costs (2)	1,253
Deferred income tax asset on inter-group transfers (2)	2,644
Change in recognition of share-based compensation (3)	—
<b>Shareholders' equity under IFRS</b>	<b>97,592</b>

#### Reconciliation of comprehensive income

	<b>For the three month period September 30 2010</b>	<b>For the nine month period September 30 2010</b>
	<b>\$</b>	<b>\$</b>
<b>Net loss and total comprehensive loss under Canadian GAAP</b>	<b>796</b>	<b>(74)</b>
Differences increasing (decreasing) reported comprehensive income		
Change in transaction costs (4)	157	453
Salaries and benefits (5)	(270)	(768)
Deferred income tax expense (6)	(94)	(282)
<b>Net loss and total comprehensive loss under IFRS</b>	<b>589</b>	<b>(671)</b>

1. The effect of retrospective application of the change in accounting policy so that certain compensation costs related to the origination of mortgages are no longer included in the carrying value of the mortgages, but expensed as incurred.
2. The tax effect of the change in the accounting value of the mortgages resulting from the change in accounting policy described in footnote (1), together with the effect of the change in accounting policy to recognize deferred tax assets related to temporary differences arising from inter-group transfers.
3. The effect of the change in accounting policy to treat each tranche included in a grant of restricted shares as a separate grant.
4. The change in accounting policy so that certain compensation costs are no longer included in the carrying value of the mortgages in a lower amount to be amortized over the estimated period the mortgage will earn interest.
5. The change in accounting policy so that certain compensation costs are no longer included in the carrying value of the mortgages results in an increase in salaries and benefits expense.
6. The tax effect of the changes described in footnote (4) and (5), together with the effect of the change in accounting policy to recognize deferred tax assets related to temporary differences arising from inter-group transfers.

### 25. FUTURE ACCOUNTING CHANGES

#### IFRS 7 Financial Instruments: Disclosures

In October 2010, the IASB issued amendments to IFRS 7 regarding *Disclosures – Transfer of Financial Assets*, which are effective for annual periods beginning on or after July 1, 2011, with earlier application permitted. These amendments comprise additional disclosures on transfer transactions of financial assets and will not have an impact on the results of operations or financial position of the Company as they are only disclosure requirements.



## Notes to Condensed Interim Consolidated Financial Statements

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(in thousands of Canadian dollars except per share amounts)

### 25. FUTURE ACCOUNTING CHANGES (continued)

#### IFRS 9 *Financial Instruments*

In November 2009, the IASB issued, and subsequently revised in October 2010, IFRS 9 *Financial Instruments* (IFRS 9) as a first phase in its ongoing project to replace IAS 39. IFRS 9, which is to be applied retrospectively, is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. The IASB has announced a decision to release an exposure draft that proposes to defer the effective date to January 1, 2015.

IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. The standard also adds guidance on the classification and measurement of financial liabilities. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements.

#### IFRS 10 *Consolidated Financial Statements*

In May 2011, the IASB issued IFRS 10 *Consolidated Financial Statements* which replaces portions of IAS 27 *Consolidated and Separate Financial Statements* and interpretation SIC-12 *Consolidation — Special Purpose Entities*, effective for annual periods beginning on or after January 1, 2013. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. There will not be an impact on the results of operations or financial position of the Company as this standard does not change the entities consolidated as part of the Company's consolidated financial statements.

#### IFRS 11 *Joint Arrangements*

In May 2011, the IASB also issued IFRS 11 *Joint Arrangements*. Management does not believe that this standard is applicable to the Company's consolidated financial statements.

#### IFRS 12 *Disclosures of Interests of Other Entities*

In May 2011 the IASB issued IFRS 12 *Disclosure of Interests in Other Entities*, a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities, replacing existing disclosure requirements. This standard is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. Management is currently evaluating the potential impact that the adoption of IFRS 12 will have on the Company's consolidated financial statements.

#### IFRS 13 *Fair Value Measurement*

In May 2011, the IASB issued IFRS 13 *Fair Value Measurement* which is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. This standard does not impact when fair value is used, but rather establishes requirements on how to measure fair value. Management is currently evaluating the potential impact that the adoption of IFRS 13 will have on the Company's consolidated financial statements.

### 26. SUBSEQUENT EVENTS

On October 24, 2011 the Company's subsidiary, HomeEquity Bank, concluded the sale of \$10,000 Unsecured Subordinated Debt (the Notes) to an independent investor and \$1,000,000 to directors and officers of HOMEQ with an expected final payment date of October 31, 2016 and a coupon of 8.55%. The proceeds of the Notes will be used for regular operating purposes. The Notes constitute subordinated indebtedness within the meaning of the Bank Act (Canada). The Notes are unrated and qualify as Tier 2 B Capital of HomeEquity Bank.

On November 4, 2011, 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 is payable to shareholders of record at the close of business on December 29, 2011 and is payable on January 13, 2012.

### 27. COMPARATIVE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The following are reconciliations of consolidated balance sheets previously presented under Canadian GAAP to the amended consolidated balance sheets prepared under IFRS as at September 30, 2010 and December 31, 2010. Reconciliations of the consolidated statements of operations for the three and nine month period ended September 30, 2010 and the year ended December 31, 2010 are also presented (Note 24).



## Reconciliation of Consolidated Balance Sheet as at September 30, 2010

(in thousands of Canadian dollars)

	September 30 2010 (Canadian GAAP)	Adjustments	September 30 2010 (IFRS)
Note	\$	\$	\$
<b>ASSETS</b>			
<b>Cash resources</b>			
Cash and cash equivalents	119,838	—	119,838
Interest bearing deposits with banks	24,491	—	24,491
	<u>144,329</u>	<u>—</u>	<u>144,329</u>
<b>Loans</b>			
Residential reverse mortgages	1,038,337	(4,869)	1,033,468
Allowance for credit losses	(2,898)	—	(2,898)
	<u>1,035,439</u>	<u>(4,869)</u>	<u>1,030,570</u>
<b>Other</b>			
Derivative instruments	24,142	—	24,142
Computer hardware and other property, net	540	—	540
Goodwill and other intangible assets	19,831	—	19,831
Deferred income tax assets	938	3,897	4,835
Income taxes receivable	316	—	316
Prepaid expenses and other assets	723	—	723
	<u>46,490</u>	<u>3,897</u>	<u>50,387</u>
	<u>1,226,258</u>	<u>(972)</u>	<u>1,225,286</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
<b>Deposits</b>			
Payable on a fixed date	258,329	—	258,329
	<u>258,329</u>	<u>—</u>	<u>258,329</u>
<b>Other</b>			
Derivative instruments	1,499	—	1,499
Deferred income tax liabilities	10,020	—	10,020
Income taxes payable	—	—	—
Dividends payable	986	—	986
Accounts payable and accrued liabilities	5,772	—	5,772
	<u>18,277</u>	<u>—</u>	<u>18,277</u>
Medium-term debt	780,321	—	780,321
Subordinated debt	40,181	—	40,181
Unsecured subordinated debt	20,477	—	20,477
Bank term loan	10,109	—	10,109
	<u>851,088</u>	<u>—</u>	<u>851,088</u>
	<u>1,127,694</u>	<u>—</u>	<u>1,127,694</u>
<b>Shareholders' equity</b>			
Common shares	103,390	92	103,482
Contributed surplus	11	8	19
Deficit	(4,837)	(1,072)	(5,909)
	<u>98,564</u>	<u>(972)</u>	<u>97,592</u>
	<u>1,226,258</u>	<u>(972)</u>	<u>1,225,286</u>

## Reconciliation of Consolidated Balance Sheet as at December 31, 2010

(in thousands of Canadian dollars)

	December 31 2010 (Canadian GAAP)	Adjustments	December 31 2010 (IFRS)
Note	\$	\$	\$
<b>ASSETS</b>			
<b>Cash resources</b>			
Cash and cash equivalents	66,074	—	66,074
Interest bearing deposits with banks	11,994	—	11,994
	<u>78,068</u>	<u>—</u>	<u>78,068</u>
<b>Loans</b>			
Residential reverse mortgages	1,069,598	(4,958)	1,064,640
Allowance for credit losses	(3,185)	—	(3,185)
	<u>1,066,413</u>	<u>(4,958)</u>	<u>1,061,455</u>
<b>Other</b>			
Derivative instruments	15,264	—	15,264
Computer hardware and other property, net	540	—	540
Goodwill and other intangible assets	19,807	—	19,807
Deferred income tax assets	1,182	3,803	4,985
Income taxes receivable	1,306	—	1,306
Prepaid expenses and other assets	1,170	—	1,170
	<u>39,269</u>	<u>3,803</u>	<u>43,072</u>
	<u>1,183,750</u>	<u>(1,155)</u>	<u>1,182,595</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
<b>Deposits</b>			
Payable on a fixed date	367,643	—	367,643
	<u>367,643</u>	<u>—</u>	<u>367,643</u>
<b>Other</b>			
Derivative instruments	2,093	—	2,093
Deferred income tax liabilities	10,914	—	10,914
Dividends payable	988	—	988
Accounts payable and accrued liabilities	7,988	—	7,988
	<u>21,983</u>	<u>—</u>	<u>21,983</u>
Medium-term debt	626,298	—	626,298
Subordinated debt	40,308	—	40,308
Unsecured subordinated debt	19,724	—	19,724
Bank term loan	9,726	—	9,726
	<u>696,056</u>	<u>—</u>	<u>696,056</u>
	<u>1,085,682</u>	<u>—</u>	<u>1,085,682</u>
<b>Shareholders' equity</b>			
Common shares	103,754	90	103,844
Contributed surplus	18	13	31
Deficit	(5,704)	(1,258)	(6,962)
	<u>98,068</u>	<u>(1,155)</u>	<u>96,913</u>
	<u>1,183,750</u>	<u>(1,155)</u>	<u>1,182,595</u>

## Reconciliation of Consolidated Statement of Operations for the three month period ended September 30, 2010

(in thousands of Canadian dollars except per share amounts)

For the three month period ended	Note	September 30 2010 (Canadian GAAP) \$	Adjustments \$	September 30 2010 (IFRS) \$
<b>Interest income</b>				
Mortgage interest	24.4	12,338	157	12,495
Securities		28	—	28
Deposits with banks		119	—	119
		<u>12,485</u>	<u>157</u>	<u>12,642</u>
<b>Interest expense</b>				
Deposits		1,368	—	1,368
Medium-term debt		4,217	—	4,217
Subordinated debt		611	—	611
Unsecured subordinated debt		363	—	363
Bank term loan		14	—	14
		<u>6,573</u>	<u>—</u>	<u>6,573</u>
		<u>5,912</u>	<u>157</u>	<u>6,069</u>
Provision for credit losses		135	—	135
<b>Net interest income after provision for credit losses</b>		<u>5,777</u>	<u>157</u>	<u>5,934</u>
<b>Non-interest income</b>				
Mortgage administration fees		29	—	29
		<u>29</u>	<u>—</u>	<u>29</u>
<b>Net interest income and non-interest income</b>		<u>5,806</u>	<u>157</u>	<u>5,963</u>
<b>Non-interest expenses</b>				
Salaries and benefits	24.5	1,486	270	1,756
Selling, general and administration		1,823	—	1,823
Amortization of intangible assets		38	—	38
Amortization of computer hardware and other property		48	—	48
		<u>3,395</u>	<u>270</u>	<u>3,665</u>
<b>Income before under noted item</b>		<u>2,411</u>	<u>(113)</u>	<u>2,298</u>
Unrealized losses on derivative instruments		1,372	—	1,372
<b>Income (loss) before income taxes</b>		<u>1,039</u>	<u>(113)</u>	<u>926</u>
Current income tax expense		864	—	864
Deferred income tax recovery	24.6	(621)	94	(527)
<b>Provision for income taxes</b>		<u>243</u>	<u>94</u>	<u>337</u>
<b>Net income (loss) and total comprehensive income (loss)</b>		<u>796</u>	<u>(207)</u>	<u>589</u>
<b>Average number of common shares outstanding</b>		<u>14,348</u>		<u>14,348</u>
<b>Basic and diluted earnings (loss) per share</b>		<u>\$0.06</u>		<u>\$0.04</u>

## Reconciliation of Consolidated Statement of Operations for the nine month period ended September 30, 2010

(in thousands of Canadian dollars except per share amounts)

For the nine month period ended	Note	September 30 2010 (Canadian GAAP) \$	Adjustments \$	September 30 2010 (IFRS) \$
<b>Interest income</b>				
Mortgage interest	24.4	34,656	453	35,109
Securities		39	—	39
Deposits with banks		188	—	188
		<u>34,883</u>	<u>453</u>	<u>35,336</u>
<b>Interest expense</b>				
Deposits		2,740	—	2,740
Medium-term debt		12,857	—	12,857
Subordinated debt		1,389	—	1,389
Unsecured subordinated debt		856	—	856
Bank term loan		14	—	14
		<u>17,856</u>	<u>—</u>	<u>17,856</u>
<b>Net interest income</b>		<u>17,027</u>	<u>453</u>	<u>17,480</u>
Provision for credit losses		486	—	486
<b>Net interest income after provision for credit losses</b>		<u>16,541</u>	<u>453</u>	<u>16,994</u>
<b>Non-interest income</b>				
Mortgage administration fees		85	—	85
		<u>85</u>	<u>—</u>	<u>85</u>
<b>Net interest income and non-interest income</b>		<u>16,626</u>	<u>453</u>	<u>17,079</u>
<b>Non-interest expenses</b>				
Salaries and benefits	24.5	4,141	768	4,909
Selling, general and administration		5,219	—	5,219
Amortization of intangible assets		126	—	126
Amortization of computer hardware and other property		150	—	150
		<u>9,636</u>	<u>768</u>	<u>10,404</u>
<b>Income before under noted item</b>		<u>6,990</u>	<u>(315)</u>	<u>6,675</u>
Unrealized losses on derivative instruments		7,159	—	7,159
<b>Income (loss) before income taxes</b>		<u>(169)</u>	<u>(315)</u>	<u>(484)</u>
Current income tax expense		2,771	—	2,771
Deferred income tax recovery	24.6	(2,866)	282	(2,584)
<b>Provision for (recovery of) income taxes</b>		<u>(95)</u>	<u>282</u>	<u>187</u>
<b>Net income (loss) and total comprehensive income (loss)</b>		<u>(74)</u>	<u>(597)</u>	<u>(671)</u>
<b>Average number of common shares outstanding</b>		<u>14,306</u>		<u>14,306</u>
<b>Basic and diluted earnings (loss) per share</b>		<u>\$(0.01)</u>		<u>\$(0.05)</u>

## Reconciliation of Consolidated Statement of Operations for the year ended December 31, 2010

(in thousands of Canadian dollars except per share amounts)

	December 31 2010 (Canadian GAAP) \$	Adjustments \$	December 31 2010 (IFRS) \$
<b>Interest income</b>			
Mortgage interest	47,516	616	48,132
Securities	80	—	80
Deposits with banks	347	—	347
	<u>47,943</u>	<u>616</u>	<u>48,559</u>
<b>Interest expense</b>			
Deposits	4,946	—	4,946
Medium-term debt	17,059	—	17,059
Subordinated debt	2,006	—	2,006
Unsecured subordinated debt	1,273	—	1,273
Bank term loan	221	—	221
	<u>25,505</u>	<u>—</u>	<u>25,505</u>
<b>Net interest income</b>	<u>22,438</u>	<u>616</u>	<u>23,054</u>
Provision for credit losses	773	—	773
<b>Net interest income after provision for credit losses</b>	<u>21,665</u>	<u>616</u>	<u>22,281</u>
<b>Non-interest income</b>			
Mortgage administration fees	117	—	117
	<u>117</u>	<u>—</u>	<u>117</u>
<b>Net interest income and non-interest income</b>	<u>21,782</u>	<u>616</u>	<u>22,398</u>
<b>Non-interest expenses</b>			
Salaries and benefits	5,800	1,024	6,824
Selling, general and administration	6,969	—	6,969
Amortization of intangible assets	164	—	164
Amortization of computer hardware and other property	201	—	201
	<u>13,134</u>	<u>1,024</u>	<u>14,158</u>
<b>Income before under noted item</b>	<u>8,648</u>	<u>(408)</u>	<u>8,240</u>
Unrealized losses on derivative instruments	9,434	—	9,434
<b>Income (loss) before income taxes</b>	<u>(786)</u>	<u>(408)</u>	<u>(1,194)</u>
Current income tax expense	1,306	—	1,306
Deferred income tax recovery	(2,215)	377	(1,838)
<b>Provision for income taxes (recovery)</b>	<u>(909)</u>	<u>377</u>	<u>(532)</u>
<b>Net income (loss) and total comprehensive income (loss)</b>	<u>123</u>	<u>(785)</u>	<u>(662)</u>
<b>Average number of common shares outstanding</b>	<u>14,327</u>		<u>14,327</u>
<b>Basic and diluted earnings (loss) per share</b>	<u>\$0.01</u>		<u>(\$0.05)</u>

## **CORPORATE INFORMATION**

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### **STOCK LISTING**

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

For further information, please contact:

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Senior Vice President and Chief Financial Officer

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#### **Scott G. Cameron, CA**

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