



**INTERIM MANAGEMENT
DISCUSSION & ANALYSIS
For the quarter ended
September 30, 2011**

FINANCIAL HIGHLIGHTS

(\$ thousands except per share and percentage amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OPERATING RESULTS				
Net income (loss)	1,719	589	2,245	(671)
Per share	0.12	0.04	0.15	(0.05)
Adjusted net income (1)	2,153	1,608	5,117	4,611
Per share	0.15	0.11	0.36	0.32
Return on equity (annualized)	7.1%	2.4%	3.1%	(0.9)%
Adjusted return on equity (annualized) (2)	9.4%	7.3%	7.7%	7.0%
Mortgage spread income (3)	7,867	6,920	21,114	20,323
Mortgage spread percentage	2.79%	3.01%	2.69%	3.04%
Dividends per share	0.07	0.07	0.21	0.21
Mortgage originations	54,538	52,038	171,835	158,298
Trailing four quarter origination cost %	5.5%	6.1%	5.7%	6.1%
Trailing four quarter administration expense %	0.67%	0.76%	0.59%	0.77%
Efficiency ratio	51.6%	60.1%	59.9%	58.7%
BALANCE SHEET HIGHLIGHTS				
Total assets			1,277,250	1,225,286
Mortgage principal plus accrued interest			1,139,223	985,029
Deposits			557,226	258,329
Medium-term debt			527,994	780,321
Subordinated debt			40,298	40,181
Unsecured subordinated debt			20,903	20,477
Bank term loan			10,605	10,109
Book value per share			6.74	6.80
PORTFOLIO QUALITY				
Appraised value of underlying properties			3,128,882	2,743,940
Average loan to value			36.4%	35.9%
Non-accrual mortgage value			2,244	2,996
Allowance for credit losses			3,318	2,898

- (1) Adjusted net income (loss) is explained in the Financial Results section on page 8 of the MD&A
(2) Adjusted return on equity is explained in the Financial Results section on page 8 of the MD&A
(3) Mortgage spread income, a non-GAAP measure, as discussed on pages 13 and 14 of the MD&A

Management Discussion and Analysis

TO OUR SHAREHOLDERS:

We are pleased to present the quarterly financial results for HOMEQ Corporation (HOMEQ) for the quarter ended September 30, 2011.

During the quarter, HOMEQ's business continued to favourably evolve and is proving its future potential. Adjusted net income per share increased by 36% over the same period in 2010, the portfolio grew by 16%, spreads remained firm, origination and administrative expenditure remained well controlled and the volume of inquiries and applications continued at a heightened pace.

HOMEQ is meeting growing demand for its reverse mortgages from across the country driven by several factors including the increasing number of seniors, Canada's fastest growing demographic. In addition, competitive pricing, effective publicity and engaging marketing campaigns are making the CHIP Home Income Plan more accessible and attractive to seniors. During the quarter, originations grew by 5% over 2010 and HOMEQ expects that demand for reverse mortgages will remain firm.

HOMEQ strives to achieve a high level of quality, consistency and predictability in its mortgage portfolio by adhering strictly to its underwriting philosophy and methodology. As a result, the average loan-to-value of its portfolio has remained consistently at 36% over the years while the compound annual growth rate of the portfolio has been 14% over the past five years. We constantly monitor real estate trends throughout the country to determine whether adjustments to our underwriting policies and methodologies are required.

During the quarter HOMEQ restated its first and second quarter results due to a correction to unrealized gains or losses on derivative instruments. The restatement had no impact on adjusted net income or adjusted return on equity during these periods and is explained in greater detail in the management discussion and analysis.

HOMEQ continues to operate at improving levels of sales, marketing and administrative efficiency, and both origination and administrative expenditure continue to fall on a relative basis. This reflects an improving selling capacity and indicates that additional expenditures incurred as a result of being a bank are substantially fixed in nature and have now been fully integrated into our cost structure.

Subsequent to the end of the quarter, HOMEQ concluded the sale of \$11.0 million unsecured subordinated debt (the "Notes") due October 31, 2021 with a coupon of 8.55%. The Notes constitute subordinated indebtedness within the meaning of the *Bank Act* (Canada) and qualify as Tier 2 B Capital of HomeEquity Bank. This new issue adds to the already strong capital base of HomeEquity Bank and will enable it to continue its strong growth.

In the near term, shareholders should be rewarded with steady increases in net income performance as a result of a combination of portfolio growth, efficient originations, managed spread and controlled overhead expenses. Central to our success is the burgeoning demographic of seniors, seeking to enjoy their retirement years. HOMEQ is uniquely positioned to satisfy seniors' financial needs and enable them to stay in their home.

Sincerely,



Steven K. Ranson
President & Chief Executive Officer

November 4, 2011

Management Discussion and Analysis

MANAGEMENT DISCUSSION AND ANALYSIS

The following management discussion and analysis (MD&A) of HOMEQ Corporation (HOMEQ) should be read in conjunction with the condensed interim consolidated financial statements for the three and nine month periods ended September 30, 2011, the MD&A and interim consolidated financial statements for the three months ended March 31, 2011 and the MD&A and audited annual consolidated financial statements and notes for the year ended December 31, 2010. These are available on the Canadian Securities Administrators' website at www.sedar.com. Unless otherwise indicated, all amounts are stated in Canadian dollars and have been primarily derived from the Company's annual or interim consolidated financial statements prepared in accordance with International Financial Reporting Standards. This MD&A has been prepared based on information available as at November 2, 2011. HOMEQ'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.

The management discussion and analysis is dated November 4, 2011.

HOMEQ adopted International Financial Reporting Standards (IFRS) as its financial reporting framework on January 1, 2011, with a transition date of January 1, 2010. IFRS are the generally accepted accounting principles (GAAP) for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. Transition as at January 1, 2010 required restatement of HOMEQ's 2010 financial information from its original Canadian GAAP (CGAAP) basis to the IFRS basis such that the comparatives presented in the financial statements and the MD&A of the first quarter of 2010 and future periods are on an IFRS basis. Information presented in the MD&A prior to 2010 has not been restated for IFRS. The impact of the adoption of IFRS is described in the Accounting Policies and Estimates section in the MD&A as well as in notes 24 and 27 of the September 30, 2011 interim consolidated financial statements.

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.

Any 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.

Management Discussion and Analysis

NON-GAAP MEASURES

HOMEQ uses a number of financial measures to assess its performance. Some measures are calculated in accordance with 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 incurred on the debt used to fund the mortgage portfolio as a percentage of the aggregate value of debt.

Mortgage Spread Income

Mortgage 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.

Mortgage Spread Percentage

Mortgage spread percentage is a measure that presents mortgage 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, as described in the MD&A, 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 during the quarter. Adjusted return on equity is calculated as adjusted net income multiplied by a factor of four divided by the average adjusted shareholders' equity during the quarter.

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 (LTV) measures the outstanding mortgage balance as a percentage of the appraised value of the property.

Management Discussion and Analysis

CORPORATE OVERVIEW AND STRATEGY

HOMEQ Corporation is the continuing company of Home Equity Income Trust (the Trust) subsequent to a court approved plan of arrangement where the Trust converted to a corporation on June 30, 2009 (the Conversion). HOMEQ Corporation and the Trust are together referred to as “HOMEQ” or the “Company”. Under the Conversion all outstanding trust units of the Trust were exchanged for common shares of HOMEQ on a one-for-one basis.

HOMEQ through its subsidiary HomEquity Bank provides reverse mortgages, under the CHIP Home Income Plan brand, to homeowners aged 55 and over, Canada's fastest growing demographic segment. The objective of HOMEQ is to increase net income and return on equity through the profitable growth of the mortgage portfolio.

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

- HomEquity Bank originates and finances reverse mortgages and provides mortgage administration services on the reverse mortgage portfolio. HomEquity Bank has been the main underwriter of reverse mortgages in Canada since its predecessor, Canadian Home Income Plan Corporation (CHIP), pioneered the concept in Canada in 1986. CHIP received its Letters Patent and Order to Commence as a federally regulated Schedule I bank, HomEquity Bank, from the Minister of Finance on October 13, 2009. HomEquity Bank issues Guaranteed Investment Certificate (GIC) deposits to fund its mortgage portfolio. Unless indicated otherwise, CHIP and HomEquity Bank are collectively referred to as HomEquity Bank.
- CHIP Mortgage Trust (CMT), a wholly owned subsidiary of HomEquity Bank, finances a segment of the reverse mortgages originated by HomEquity Bank by issuing medium-term debt. Senior debt is rated ‘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.

HOMEQ’s strategy is to continue to capitalize on the strong growth potential of reverse mortgages, adding new mortgages to a growing and increasingly profitable portfolio.

HOMEQ is benefiting from increased acceptance of reverse mortgages in the marketplace, driven by growing awareness of the solution and its benefits. Focused public relations and marketing efforts combined with unique solution features and competitive pricing are contributing to a successful positioning of reverse mortgages as a mainstream retirement financing solution for Canada’s senior homeowners. As well, an expansive distribution network that includes all major national Schedule I Canadian chartered banks, numerous credit unions, mortgage brokers, wealth management and financial planning organizations further broadens the awareness and availability of reverse mortgages.

The significant sustained benefits to HOMEQ’s net income are becoming evident as a result of a larger asset base on which spread is generated, significant efficiencies in generating originations, and from economies of scale in administration infrastructure.

Management Discussion and Analysis

FINANCIAL HIGHLIGHTS

Financial Overview

Reverse mortgages are long-term assets that earn interest over a multi-year period. Under GAAP, interest income is recognized in the period it is earned 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 and the share of overhead expenses applicable to new mortgage originations are expensed under GAAP in the period incurred. This can have the effect of reducing net income during periods of rapid growth, but benefiting HOMEQ in the longer term.

HOMEQ has restated its first and second quarter results due to a correction to unrealized gains or losses on derivative instruments. Details of the adjustment and the impact on net income are provided in the derivatives section of the MD&A on page 10.

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

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1 Restated	Q2 Restated	Q3
<i>(\$ thousands, except per share amounts)</i>									
Interest income	11,961	11,273	11,006	11,688	12,642	13,223	13,639	14,160	14,519
Interest expense	6,268	5,694	5,555	5,728	6,573	7,649	9,215	7,007	7,785
Net interest income	5,693	5,579	5,451	5,960	6,069	5,574	4,424	7,153	6,734
Provision for credit losses	(1,784)	(39)	(201)	(150)	(135)	(287)	(33)	(98)	(254)
Non-interest income	66	40	19	37	29	32	27	39	37
Net interest income and other income	3,975	5,580	5,269	5,847	5,963	5,319	4,418	7,094	6,517
Non-interest expenses	2,904	3,300	3,303	3,436	3,665	3,755	3,574	3,718	3,490
Income before undernoted items	1,071	2,280	1,966	2,411	2,298	1,564	844	3,376	3,027
Less:									
Unrealized (gain) loss on derivative instruments	1,595	3,819	1,971	3,816	1,372	2,275	1,894	1,393	584
Current income tax expense (recovery)	973	900	869	1,038	864	(1,465)	134	831	728
Future income tax expense (recovery)	(1,300)	(2,784)	(756)	(1,301)	(527)	745	(339)	(219)	(4)
Net income (loss)	(197)	345	(118)	(1,142)	589	9	(845)	1,371	1,719
Per share	(0.01)	0.02	(0.01)	(0.08)	0.04	0.00	(0.06)	0.09	0.12
Average number of shares outstanding	14,229	14,239	14,260	14,308	14,348	14,385	14,438	14,500	14,535

Management Discussion and Analysis

Adjusted Net Income and Adjusted 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, the adjustment to the provision for credit losses in Q3 2009 and changes in future income tax rates are not considered recurring items.

The restatement of Q1 and Q2 results has no impact on adjusted net income or adjusted return on equity in those quarters.

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1 Restated	Q2 Restated	Q3
(\$ thousands, except per share amounts)									
Net Income (loss) before tax	(524)	(1,539)	(5)	(1,405)	926	(711)	(1,050)	1,983	2,442
Add (deduct)									
Unrealized (gain) loss on derivatives	1,595	3,819	1,971	3,815	1,372	2,275	1,894	1,393	584
Conversion costs	65	—	—	—	—	—	—	—	—
Adjustment to provision for credit losses	1,741	—	—	—	—	—	—	—	—
Adjusted net income before tax	2,877	2,280	1,966	2,410	2,298	1,564	844	3,376	3,026
Tax provision as reported less tax effect of above items and changes in future income tax rates	(791)	(466)	(631)	(742)	(690)	59	(264)	(964)	(873)
Adjusted net income	2,086	1,814	1,335	1,668	1,608	1,623	580	2,412	2,153
Per share	0.15	0.13	0.09	0.12	0.11	0.11	0.04	0.17	0.15
Average number of shares outstanding	14,229	14,239	14,260	14,308	14,348	14,385	14,438	14,500	14,535

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 during the quarter. The table below details the adjustments between shareholders' equity and adjusted shareholders' equity for the past nine quarters.

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1 Restated	Q2 Restated	Q3
(\$ thousands)									
Shareholders' equity	102,486	100,982	99,621	97,712	97,592	96,913	95,334	95,991	97,003
Add (deduct)									
Derivative instruments, net	(16,271)	(14,101)	(12,818)	(10,001)	(9,135)	(6184)	(5,945)	(4,930)	(4,491)
Adjusted shareholders' equity	86,215	86,881	86,803	87,711	88,457	90,729	89,389	91,061	92,512
Adjusted return on equity (annualized)	9.7%	8.4%	6.0%	7.6%	7.3%	7.2%	2.6%	10.7%	9.4%

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

Management Discussion and Analysis

Net Interest Income

Net interest income is derived from the interest earned on the mortgage portfolio and cash resources less the interest costs on the GICs and debt used to fund the mortgage portfolio.

Interest income in Q3 2011 was \$14.5 million, an increase of \$1.9 million or 14.8% over Q3 2010. The increase is mainly due to the 15.9% larger average mortgage portfolio as compared to Q3 2010. Interest expense on the GICs and debt in Q3 2011 was \$7.8 million, an increase of \$1.2 million or 18.4% over Q3 2010. This increase is due to the increase in the average balance of GICs and debt of 8.9% and the higher cost of funds on the GICs and debt compared to Q3 2010. The resulting net interest income of \$6.7 million was \$0.7 million or 10.9% higher than Q3 2010. Net interest margin was 2.41% in Q3 2011, 12 bpts higher than 2010 mainly due to the negative impact of carrying excess cash in 2010 in advance of the MTN maturities in Q4 of 2010.

During the nine months ended September 30, 2011, interest income was \$42.3 million, an increase of \$7.0 million or 19.8% over 2010. The average yield earned on the mortgage portfolio was nine basis points higher than 2010 and the average mortgage portfolio increased by 16.3%. Interest expense on the GICs and debt during the nine months ended September 30, 2011 was \$24.0 million, an increase of \$6.2 million or 34.4% over 2010. The nine month average cost of funds was 44 basis points higher than 2010 and the average balance of GICs and debt increased 14.3%. The resulting net interest income of \$18.3 million was \$0.8 million or 4.8% higher than 2010.

Provision for Credit Losses

The provision for credit losses includes specific and general allowances determined in accordance with HOMEQ's internal policies.

The specific allowance increased \$0.1 million during Q3 2011 to \$0.4 million equal to 0.04% of the value of the mortgage portfolio. The general allowance for credit losses increased \$0.1 million to \$2.9 million, equivalent to 0.25% of the value of the mortgage portfolio.

Non-Interest Expenses

Non-interest expenses in Q3 2011 of \$3.5 million were \$0.2 million or 4.8% lower than Q3 2010 and similar to the \$3.6 million average quarterly expenditure experienced over the last four quarters indicating that a stable cost base has been established. HOMEQ's efficiency ratio for Q3 2011 was 51.6% compared to 60.1% in Q3 2010. In general, a lower efficiency ratio is associated with a more efficient cost structure, a primary objective of HOMEQ.

For the nine months ended September 30, 2010, non-interest expenses were \$10.8 million, \$0.4 million or 3.6% higher than 2010. The efficiency ratio was 59.9% compared to 58.7% in 2010 and is expected to improve throughout the remainder of the year.

Derivatives

Under GAAP, derivatives not designated for hedge accounting are valued at fair market value with changes in fair value recognized in the current period's statement of income (mark-to-market). 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 yield curve used to value the derivatives. As rates decrease or the yield curve flattens the fair value of the derivative portfolio increases. As the rates increase or the yield curve steepens, the fair value will decrease.

As the derivative portfolio matures, the derivative asset or liability will reduce in value resulting in unrealized gains or losses on derivative instruments being recorded in the statement of income. Since late 2009, HOMEQ has been designating most of its derivatives as hedges and applying the hedge accounting rules which have reduced the fluctuations to net income. Hedge accounting requires HOMEQ to recognize the ineffectiveness of the hedge as unrealized gains or losses (the ineffectiveness) in the statement of income.

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

Management Discussion and Analysis

unrealized gains or losses are timing differences and will be zero at maturity. Unrealized gains or losses on derivative instruments are removed from reported net income to arrive at adjusted net income.

Restatement of Prior Quarters

HOMEQ continuously evaluates and monitors the performance of hedged derivative instruments and the underlying calculations of hedge ineffectiveness. Following the review performed in the third quarter, 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 \$3.1 million and \$1.1 million, 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 of 2011 than previously presented.

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

	Three-months Ended March 31 2011	Three-months Ended June 30 2011
<i>(\$ thousands)</i>		
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

The adjustments to unrealized (gains) losses on derivative instruments and the related tax impact resulted in net income or loss for the periods ended March 31, 2011 and June 30, 2011 as follows:

	Three-months Ended March 31 2011	Three-months Ended June 30 2011
<i>(\$ thousands, except per share amounts)</i>		
Net income previously presented	1,502	2,184
Less:		
Adjustments to the carrying value of the hedged items	3,134	1,086
Adjustment to deferred income taxes	(787)	(273)
Net income (loss) restated	(845)	1,371
Net income per share previously presented	0.04	0.17
Net income (loss) per share restated	(0.06)	0.09

The adjustment also impacts the corresponding line items on the interim consolidated balance sheets; adjustment in carrying value of hedged items and deferred income tax liabilities and the interim consolidated statements of cash flows; net income or loss, deferred income tax recovery and unrealized gains or losses on derivatives.

In the nine months ended September 30, 2011, HOMEQ recorded an unrealized loss of \$3.9 million compared to \$7.2 million in 2010. This unrealized loss in 2011 is mainly due to the reversal of prior years' unrealized gains as the non designated derivatives near maturity. The unrealized loss in 2010 was a result of an increase in interest rates, elapsed remaining duration and the unwinding of certain derivatives in accordance with HOMEQ's asset and liability matching policy.

Income Taxes

HOMEQ recorded an income tax expense in Q3 2011 of \$0.7 million. For the nine month period ending September 30, 2011 HOMEQ recorded an income tax expense of \$1.1 million consisting of current taxes of \$1.7 million and a deferred tax recovery of \$0.6 million.

Management Discussion and Analysis

Deferred income taxes are accounted for under the liability method. Under this method of tax allocation, deferred 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. Deferred income tax assets are recorded in the consolidated financial statements to the extent that realization of such benefits is considered probable.

Net Income (loss) and Adjusted Net Income

In Q3 2011, HOMEQ reported a net income of \$1.7 million, \$0.12 per share compared to a net income of \$0.6 million or \$0.04 per share in Q3 2010. Adjusted net income in Q3 2011 was \$2.2 million or \$0.15 per share, 33.9% and 36.4% higher than Q3 2010 respectively.

For the nine months ended September 30, 2011, net income was \$2.2 million, \$0.15 per share compared to a net loss of \$0.7 million, \$0.5 per share in 2010. Adjusted net income for the nine months ended September 30, 2011 was \$5.1 million, \$0.35 per share, 11.0% and 9.4% higher than 2010 respectively..

Return on Equity and Adjusted Return on Equity

HOMEQ reported a return on equity (annualized) of 7.1% for Q3 2011 (2010 – 2.4%) and adjusted return on equity (annualized) of 9.4% (2010 – 7.3%).

Management Discussion and Analysis

Portfolio Growth

HOMEQ's objective is to grow the size of its mortgage portfolio between 15% - 20% per annum resulting in increased profits and cash flow. The mortgage portfolio was approximately \$1.1 billion dollars at September 30, 2011, increasing \$154.2 million or 15.7% over September 30, 2010. The following table shows the growth in the mortgage portfolio on a quarterly basis for the past nine quarters.

(\$ millions)	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Opening mortgage balance (1)	832.9	837.0	865.7	905.0	946.0	985.0	1,016.4	1,051.4	1,100.0
Originations (2)	29.5	43.4	47.3	59.0	52.0	47.5	47.6	69.7	54.5
Accrued mortgage interest	12.9	12.4	12.0	12.6	13.5	14.2	14.4	15.1	15.6
Repayments of principal	(26.1)	(17.7)	(13.8)	(21.1)	(18.3)	(20.8)	(19.3)	(25.3)	(21.6)
Repayments of accrued interest	(12.2)	(9.7)	(6.2)	(9.5)	(8.2)	(9.5)	(7.7)	(10.9)	(9.3)
Reclassification of specific allowance (3)	—	0.3	—	—	—	—	—	—	—
Ending mortgage balance (1)	837.0	865.7	905.0	946.0	985.0	1,016.4	1,051.4	1,100.0	1,139.2
Loan to value of new originations	29%	33%	34%	32%	31%	30%	32%	33%	31%
Total repayments as % of opening balance	4.6%	3.3%	2.3%	3.4%	2.8%	3.1%	2.6%	3.4%	2.8%
Trailing 4 quarters									
Originations	91.5	110.2	142.9	179.2	201.7	205.8	206.1	216.8	219.3
Total repayments	(108.5)	(112.1)	(114.8)	(116.3)	(104.6)	(107.4)	(114.4)	(120.0)	(124.4)

(1) Principal plus accrued interest

(2) Originations in Q2 2011 include the acquisition of \$3.7 million reverse mortgage portfolio.

(3) Starting in 2010, specific allowances are reported separately from the mortgage balance. An adjustment has been made in Q4 2009 in the above table.

New mortgage originations of \$54.5 million in Q3 2011 were \$2.5 million or 4.8% higher than Q3 2010. For the nine months ended September 30, 2011 originations of \$171.8 million, included the purchase of the remaining portfolio of reverse mortgages funded by the Canadian operations of a prior competitor, Seniors Money International (SMI). The principal and accrued interest of the SMI portfolio purchased in June 2011 was \$3.7 million with an average LTV of 24% which is well within HOMEQ's lending practices. Mortgage originations net of the portfolio acquisition were \$168.1 million, \$9.8 million or 6.2% higher than 2010.

Accrued mortgage interest in Q3 2011 of \$15.6 million increased \$2.1 million or 15.6% over Q3 2010 due to the 15.9% increase in the average balance of the mortgage portfolio earning a seven basis point higher yield.

Accrued mortgage interest for the nine months ended September 30, 2011 of \$45.1 million was \$7.0 million, 18.4% higher than 2010 due to the average mortgage portfolio being 16.3% larger and earning a nine basis point higher yield. The higher yield is due to the higher interest rate environment in 2011 partially offset by the increasing proportion of the mortgage portfolio being at posted rates as discussed further in the Mortgage Spread Income section.

Total repayments of principal and interest of \$30.9 million in Q3 2011 were \$4.4 million or 16.6% higher than Q3 2010. As a percentage of the opening mortgage balance, total repayments of 2.8% were within the historical range of 2.5% to 3.5% in a quarter. Short-term fluctuations in the level of originations and repayments will have an impact on the total portfolio balance in the future.

Total repayments of principal and interest of \$94.1 million for the nine months ended September 30, 2011 were \$17.0 million higher than 2010. As a percentage of the opening mortgage balance, total repayments of 8.6% were within the historical range.

Portfolio Quality

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 a 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.

Management Discussion and Analysis

The average LTV ratio of the \$54.5 million of new mortgages originated in Q3 2011, net of the acquired portfolio, was 31%, consistent with historical experience. For the entire mortgage portfolio, the most recently appraised value of the underlying properties was \$3.1 billion, for a LTV ratio of 36% at September 30, 2011, unchanged from that of September 30, 2010.

HOMEQ's policy is to cease accruing interest income from any mortgage where the loan to value (LTV) exceeds 83% by creating a specific allowance for the amount by which the LTV is higher than 83%. To ensure that these loans are reported as accurately as possible, each mortgage with a LTV in excess of 80% is reappraised at least once per year. At September 30, 2011, there were 18 loans with a specific allowance, an increase from 15 loans at June 30, 2011 and a decrease from 22 loans at December 31, 2010. These properties were disbursed across the country with some concentration in southern Ontario. The total principal and accrued interest of these files net of a \$0.4 million specific allowance was \$2.2 million, equating to 0.3% of the total portfolio. The appraised value of the properties securing the mortgages was \$2.7 million before disposition costs.

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 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 in the portfolio is approximately 1.1%; and
- Each mortgage originated is limited in maximum dollar amount and LTV.

The general allowance for credit losses increased \$0.1 million to \$2.9 million in Q3 2011, equivalent to 0.25% of the total value of the mortgage portfolio. As the mortgage portfolio grows the general allowance is expected to also increase. In Q3 2009, the general allowance increased by \$1.7 million in accordance with the amended provisioning methodology and is not expected to recur to that extent again in the future. The one time adjustment to the provision recorded in 2009 has therefore been excluded in the calculation of adjusted net income.

Management Discussion and Analysis

Mortgage Spread Income

HOMEQ's mortgage spread income is derived from the difference between the interest earned on the mortgage portfolio and the interest paid on the GICs and debt used to fund the portfolio. Within the mortgage portfolio, the interest rate on 52% of the mortgages is based on Prime or Government of Canada Treasury Bill (T-Bill) rates plus a fixed spread while the interest on 48% of the mortgages is based on HOMEQ's posted rates for new mortgages. Posted rates are determined based on, amongst other factors, HOMEQ's average cost of borrowing and the rates of comparative products.

HOMEQ's posted rates are lower than the historic rates earned on the mortgages priced at a fixed spread above Prime and T-Bill rates. Over a period of time the lower interest rates earned on posted rate mortgages will have a downward effect on mortgage spread percentage and net interest margin. However, the lower mortgage rates should result in an increase in mortgage origination volume with a corresponding improvement in efficiencies which are expected to more than offset the impact on net interest margin.

Mortgage interest income earned on the mortgage portfolio in Q3 2011 was \$15.7 million, an increase of \$2.2 million or 16.0% over Q3 2010. The higher earnings are mainly a result of the larger average mortgage portfolio which increased 15.9% from September 30, 2010. The yield earned on the mortgage portfolio was 5.56% similar to Q3 2010.

HOMEQ's mortgage portfolio is funded with a combination of GICs (49%) and debt (51%) (the Funding Portfolio). Debt consists of senior and subordinated medium-term debt, unsecured subordinated debt and a bank term loan. The cost of funds of the senior medium-term debt portfolio, on a swapped basis, at September 30, 2011 had an average credit spread of 91 basis points in comparison to 111 basis points at September 30, 2010. The all in cost of GICs is approximately 30 - 35 basis points lower than medium-term notes ("MTNs").

Interest expense on the Funding Portfolio in Q3 2011 was \$7.8 million, an increase of \$1.2 million or 18.4% over Q3 2010. The average cost of funds on the Funding Portfolio of 2.77%, was 23 basis points higher than Q3 2010. The average size of the Funding Portfolio increased 8.9%. The increase in cost of funds is a result of the higher interest rate environment and the full quarter effect of the higher interest on the unsecured subordinated debt and bank loan issued during Q3 2010. Also, HOMEQ in accordance with its asset and liability matching policy, unwound certain derivatives reducing the interest expense by \$0.1 million in 2011 and \$0.4 million in 2010.

The difference between mortgage interest income and interest expense resulted in a mortgage spread income of \$7.9 million in Q3 2011, \$0.9 million or 13.7% higher than Q3 2010. Mortgage spread income is expected to increase as the mortgage portfolio increases. Mortgage spread percentage earned in Q3 2011 of 2.79% was 22 basis points lower than Q3 2010 due mainly to the impact of the higher cost of funds.

During the nine months ended September 30, 2011, mortgage interest income earned on the mortgage portfolio was \$45.1 million, an increase of \$6.9 million or 18.2% over 2010. The average yield earned on the mortgage portfolio of 5.62% was nine basis points higher than 2010 and the average mortgage portfolio increased by 16.3%. The higher yield is due to the higher interest rate environment in 2011 partially offset by the increasing proportion of the mortgage portfolio priced at posted rates. Interest expense on the Funding Portfolio during the nine months ended September 30, 2011 was \$24.0 million, an increase of \$6.2 million or 34.4% over 2010. The average cost of funds on the Funding Portfolio of 2.93% was 44 basis points higher than 2010, due to the higher interest rate environment and the full period effect of the higher interest on the unsecured subordinated debt and bank loan issued during Q3 2010. Also, HOMEQ in accordance with its asset and liability matching policy, unwound certain derivatives reducing the interest expense by \$0.4 million in 2011 and \$1.9 million in 2010. The average size of the Funding Portfolio for the nine month period increased 14.3%. The resulting mortgage spread income of \$21.1 million was \$0.8 million or 3.9% higher than 2010. Mortgage spread percentage was 2.69% for the nine month period ended September 30, 2011.

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 I 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.

Management Discussion and Analysis

HOMEQ has elected under International Accounting Standards 39 *Financial Instruments: Recognition and Measurement* to apply hedge accounting for certain interest rate swaps in its derivative portfolio. The designated hedges remain effective at September 30, 2011. The objective of these hedges is to protect against changes in the fair value of the deposits and debt due to changes in the underlying benchmark interest rate. Unrealized gains or losses required to be recorded under GAAP on changes in fair market value on derivatives and any ineffectiveness of designated hedge relationships are recorded to unrealized gains or losses on derivative instruments in the statement of income which does not impact mortgage spread income.

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

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1	Q2	Q3
(\$ thousands)									
Mortgage interest income (1)	12,877	12,321	12,037	12,649	13,493	14,183	14,393	15,076	15,652
Average mortgage balance (2) (3)	832,866	848,452	883,077	924,459	964,032	999,592	1,032,586	1,073,695	1,117,048
Average mortgage yield – annualized (%)	6.13%	5.76%	5.53%	5.49%	5.55%	5.63%	5.65%	5.63%	5.56%
Interest expense	6,268	5,694	5,555	5,728	6,573	7,649	9,215	7,007	7,785
Average funding portfolio balance (3) (4)	846,418	864,221	900,225	944,874	1,025,044	1,064,201	1,088,344	1,100,456	1,116,388
Cost of funds – annualized (%)	2.94%	2.61%	2.50%	2.43%	2.54%	2.85%	3.43%	2.55%	2.77%
Mortgage spread income (\$)	6,609	6,627	6,482	6,921	6,920	6,533	5,178	8,069	7,867
Mortgage spread (%)	3.20%	3.15%	3.03%	3.06%	3.01%	2.78%	2.22%	3.08%	2.79%

- (1) Net of specific allowances for 2009, also excludes early repayment fees and amortization of purchase price premiums, deferred commissions and deferred mortgage fees and costs.
- (2) Excluding unamortized purchase price premiums, origination fees and commissions and deferred mortgage fees and costs.
- (3) Calculated on the average of the month end balances during the period.
- (4) Reflects the principal portion of GIC deposits and debt.

Management Discussion and Analysis

Net Interest Margin

HOMEQ has included a net interest margin calculation as it moves to a revised methodology of reviewing its spread calculation. Since becoming a bank, HOMEQ has carried substantially more liquid assets which have the impact of increasing its carrying costs. The net interest margin calculation includes the impact of liquid assets and is consistent with HOMEQ's peers.

The table below shows the calculation of net interest margin for Q3 2011 and 2010. In Q3 2011, net interest margin is higher than 2010 mainly due to the negative impact of carrying excess cash in 2010 in advance of the MTN maturities in Q4 of 2010.

	2011			2010		
	Q3			Q3		
(\$ thousands)	Average Balance (1)	Income/Expense	Average Rate	Average Balance (1)	Income/Expense	Average Rate
Assets						
Cash Resources and Securities	41,303	110	1.06%	104,537	147	0.56%
Residential reverse mortgages (2)	1,116,987	15,867	5.64%	965,506	13,791	5.60%
Total interest earning assets	1,158,290	15,977	5.47%	1,070,043	13,938	5.11%
Other assets (3)	94,505	(569)	(2.39)%	97,136	(470)	(1.92)%
Total assets	1,252,795	15,408	4.88%	1,167,179	13,468	4.52%
Liabilities and Shareholders' Equity						
Deposits (4)	536,548	3,195	2.36%	210,427	1,368	2.58%
Medium-term debt (4)	509,840	3,354	2.61%	768,507	4,217	2.18%
Subordinated debt (4)	40,000	613	6.08%	40,000	611	6.06%
Unsecured subordinated debt (4)	20,000	427	8.47%	20,000	363	7.20%
Bank term loan (4)	10,000	196	7.78%	—	14	—
Total interest-bearing liabilities	1,116,388	7,785	2.77%	1,038,394	6,573	2.51%
Other liabilities	37,104			29,544		
Shareholders' equity	99,303			98,702		
Total liabilities and shareholders' equity	1,252,795	7,785	2.47%	1,167,179	6,573	2.23%
Net interest margin		7,623			6,895	
Amortization of purchase price premiums and origination costs		(889)			(826)	
Net interest income		6,734			6,069	
Net interest margin % (net interest margin divided by average total assets)			2.41%			2.34%

- (1) Average balances are determined using month end balances in the period.
- (2) The average of the residential reverse mortgages is principal plus accrued interest.
- (3) The income/expense is the amortization of the deferred commissions and mortgage fees and costs, net.
- (4) The average of the deposits and debt is the principal.

Management Discussion and Analysis

Net interest margin for the prior nine quarters is shown below.

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1	Q2	Q3
(\$ thousands)									
Average cash resources and securities	44,404	43,810	40,043	48,062	104,537	111,198	87,962	62,367	41,303
Average mortgage principal plus accrued interest	832,866	848,452	885,314	925,475	965,506	1,000,706	1,032,586	1,073,738	1,116,987
Average total interest earning assets	877,472	892,510	925,356	973,452	1,070,043	1,111,905	1,120,577	1,136,104	1,158,290
Average other assets	108,852	105,627	101,407	97,901	97,136	93,546	86,824	86,395	94,505
Average total assets	986,324	998,137	1,026,763	1,071,438	1,167,179	1,205,451	1,207,401	1,222,499	1,252,795
Net interest margin (1)	5,693	5,579	6,300	6,809	6,895	6,456	5,252	7,980	7,623
Net interest margin % – annualized (%) (2)	2.34%	2.27%	2.49%	2.55%	2.34%	2.12%	1.76%	2.62%	2.41%

(1) Net interest income excluding amortization of purchase price premiums and origination fees.

(2) Net interest margin, annualized divided by average total assets

Mortgage Origination Cost

HOMEQ's objective is to limit mortgage origination costs to no more than 6% of the value of mortgages originated, and to focus on improving sales and marketing efficiencies in order to reduce this percentage over time.

Total origination costs of \$3.0 million in Q3 2011 were \$0.1 million lower than Q3 2010 and the origination cost percentage of 5.5% was 6.8% lower while mortgage originations of \$54.5 were 4.8% higher than Q3 2010. Marginal origination costs showed a slight improvement over the prior year at 4.0%.

On a trailing four-quarter basis both the marginal and the total origination cost percentage have improved over the same period in 2010.

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

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1	Q2	Q3
(\$ thousands)									
Mortgage originations (1)	29,460	43,365	47,260	59,000	52,038	47,461	47,624	69,673	54,538
Origination expenses									
Commissions	1,166	1,681	1,214	1,329	1,319	1,475	1,076	1,311	1,217
Direct origination expenses									
Origination salaries and benefits	191	197	250	250	267	252	311	345	322
Marketing	581	663	588	614	610	626	708	697	647
Marginal origination costs	1,938	2,541	2,052	2,193	2,196	2,353	2,095	2,353	2,186
Origination overhead expenses									
Salaries and benefits	1,106	1,502	1,231	1,321	1,428	1,608	1,225	1,253	1,336
Office	283	353	326	331	359	332	351	374	328
Subtotal	1,389	1,855	1,557	1,652	1,787	1,940	1,576	1,627	1,664
50% inclusion	695	927	778	826	893	970	788	814	832
Total origination cost	2,633	3,468	2,830	3,019	3,089	3,323	2,883	3,167	3,018
Origination cost (%)									
Marginal origination cost									
Current quarter	6.6%	5.9%	4.3%	3.7%	4.2%	5.0%	4.4%	3.4%	4.0%
Trailing four quarter	7.8%	6.8%	5.6%	4.8%	4.4%	4.3%	4.3%	4.1%	4.1%
Total origination cost									
Current quarter	8.9%	8.0%	6.0%	5.1%	5.9%	7.0%	6.1%	4.5%	5.5%
Trailing four quarter	10.8%	9.5%	—	—	—	6.0%	6.0%	5.7%	5.7%

(1) Originations in Q2 2011 include the \$3.7 million reverse mortgage portfolio purchase.

Management Discussion and Analysis

Mortgage Administration Expense

Cost effective administration of its mortgages is an important objective of HOMEQ. In Q3 2011, mortgage administration expenses were \$1.7 million, \$0.2 million, or 10.8% lower than Q3 2010 and within the average run rate of the last four quarters, reflecting that the cost base is now stable. In comparison, during this period the average mortgage portfolio grew by 15.9%. As a percentage of the average mortgage portfolio, mortgage administration expenses decreased to 0.59% in the quarter and decreased to 0.67% on a trailing four-quarter basis.

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.

	2009		2010				2011		
	Q3 (CGAAP)	Q4 (CGAAP)	Q1	Q2	Q3	Q4	Q1	Q2	Q3
(\$ thousands)									
Average mortgage balance	832,866	848,452	883,077	924,459	964,032	999,592	1,032,586	1,073,695	1,117,048
Administration expenses									
Mortgage administration	88	77	75	118	100	127	101	150	142
Origination overhead expenses	695	927	778	826	893	970	788	814	832
Professional services	502	478	508	549	640	424	567	642	485
Amortization of capital assets	66	91	102	88	86	89	105	112	114
Business and capital taxes	215	45	72	63	56	160	13	19	8
Other	63	91	151	95	107	130	193	126	108
Less:									
Conversion costs	(65)	—	—	—	—	—	—	—	—
Mortgage administration fees	(66)	(39)	(20)	(37)	(30)	(30)	(27)	(39)	(37)
Total administration expenses	1,498	1,670	1,663	1,702	1,852	1,870	1,740	1,824	1,653
Administration expense (%)									
Annualized	0.72%	0.79%	0.75%	0.74%	0.77%	0.75%	0.67%	0.68%	0.59%
Trailing four quarters	0.66%	0.69%	0.72%	0.75%	0.76%	0.75%	0.73%	0.72%	0.67%

Management Discussion and Analysis

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. HOMEQ manages the various funding sources 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 into account operating liquidity, uncertainties surrounding cash flows, the quality of liquid assets and the availability of 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 capital treatment of HomeEquity Bank's assets and the covenants in CMT's trust indenture, 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 HomeEquity Bank GICs and CMT debt.

HOMEQ finances its portfolio of mortgages with GICs, MTNs, subordinated debt, and to the extent necessary to maintain its regulatory capital and debt rating, unsecured subordinated debt and 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:

- GIC Deposits – HomeEquity Bank accepts deposits from the public by issuing 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 HomeEquity Bank'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 or the Investment Industry Regulatory Organization of Canada. HomeEquity Bank has longstanding relationships with the largest Schedule I banks through the mortgage origination partnership agreements which have been in place for many years. The majority of its deposits come from affiliated deposit agents of some of these banks.

- Medium-Term Notes – CMT has the option of raising funds through the issuance of medium-term debt.

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 MTNs. 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 period, CMT operated within these covenants. At September 30, 2011, the senior debt-to-mortgage ratio was 69.1% and the total debt-to-mortgage ratio was 76.0%. Subsequent to September 30, 2011, CMT issued \$122 million Class E Senior Short Term Notes. The Senior Short Term Notes rank pari-passu with all Senior Notes. The Notes were issued to CMT's parent HomeEquity Bank. After consideration for the Class E Notes, the senior debt-to-mortgage ratio was 83.6% and the total debt-to-mortgage ratio was 90.5%.

In order to mitigate the refinancing risk of existing MTNs, approximately 79% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2031 to 2036. We expect that any MTNs issued in the future will also have extended legal maturities.

As discussed earlier in the MD&A, the portfolio of reverse mortgages has a LTV 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 8,700 reverse mortgages is diversified by location, property

Management Discussion and Analysis

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 determined and invested in accordance with its liquidity management policy. The credit quality of these assets is such that they are easily marketable and can be readily sold to fulfill cash requirements, should the need arise.

HOMEQ held substantially more liquid assets at December 31, 2010 as it was raising funds well in advance of debt maturities in 2011. The table below summarizes the liquid assets held at September 30, 2011.

<i>(\$ thousands)</i>	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	0	15,993
Corporate notes	2,998	1,200
Cash and cash equivalents	32,014	66,074
Interest bearing deposits with banks	—	11,994
Total liquid assets	32,014	78,068

Deposits

HOMEQ commenced issuing GICs when HomeEquity Bank received its letters patent from the Minister of Finance on October 13, 2009. During the third quarter of 2011 HomeEquity Bank issued \$55.4 million of GICs in terms ranging from one to five years and had \$551.5 million of GICs outstanding at September 30, 2011. GICs have been used to fund new mortgages and to repay maturing MTNs.

The table below summarizes the timing of maturities of principal amount of deposits issued as of September 30, 2011.

<i>(\$ thousands)</i>	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	September 30, 2011	December 31, 2010
Issued to individuals	186,371	239,895	125,278	—	551,544	369,971

Debt

HOMEQ actively manages both its liquidity requirements and Assets-to-Capital multiple by, amongst other actions, raising funds well in advance of the expected final repayment dates of MTNs, repurchasing MTNs when available on the open market and exercising call features on MTNs prior to their maturity. Two series of MTNs aggregating \$280.0 million had May 2011 maturity dates. Both of these series were issued during the credit crisis of 2007/2008 at interest rates higher than had previously been experienced and in terms that were not consistent with HOMEQ's asset/liability matching. As a result, the concentration of MTN maturities in May 2011 was significantly larger than would normally have been the case. During Q1 2011, several pre-emptive actions were taken to manage the forthcoming maturities, ensuring sufficient funds were raised while also taking into consideration the impact of carrying large volumes of cash on HOMEQ's profitability and Asset-to-Capital Multiple.

On February 1, 2011, HOMEQ issued \$175.0 million of five-year MTNs having a coupon of 3.97% and an expected final payment date of February 1, 2016. The MTNs were swapped in accordance with HOMEQ's interest rate matching policy, resulting in a cost of funds of 138 basis points above the corresponding BA rate. Proceeds from this issue were used for the repayment made in the quarter and to partially repay the second tranche of MTNs maturing in May 2011. The weighted average spread to BAs of the May 2011 MTN was 187 basis points.

Management Discussion and Analysis

The total principal amount of debt outstanding at September 30, 2011 of \$579.4 million was \$258.6 million lower than at September 30, 2010. The decrease in the debt balance is the result of the repayment of MTNs with the proceeds of GICs.

HOMEQ continues to be satisfied with its ability to access the wholesale debt market.

The table below summarizes the timing of the expected final payments of the debt at September 30, 2011. Approximately 79% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2031 to 2036. The remaining debt has a bullet payment requirement at its respective expected final payment date.

<i>(\$ thousands)</i>	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	September 30, 2011	December 31, 2010
Medium-term debt	104,383	105,000	300,000	—	509,383	619,080
Subordinated debt	20,000	20,000	—	—	40,000	40,000
Unsecured subordinated debt	—	—	20,000	—	20,000	20,000
Bank term loan	—	—	10,000	—	10,000	10,000
Total	124,383	125,000	330,000	—	579,383	689,080

The \$124.4 million of notes due within one year of September 30, 2011 is made up of three series of notes; \$100.2 million has an expected final payment date of August 1, 2012 and a legal maturity date of August 1, 2031. The remaining \$4.2 million of medium term debt and the \$20.0 million subordinated debt are dependant on the mortgage repayments of a subset of mortgages within the portfolio.

CAPITAL

Equity

Periodically, as required, HOMEQ may issue additional shares to maintain its regulatory capital and debt rating as the mortgage portfolio grows. Total number of shares outstanding at September 30, 2011 was 14.5 million.

HOMEQ 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.

Under the RSP, the participant is entitled to receive one share for each Restricted Share Unit (RSU) on the vesting date. 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. During the nine months ended September 30, 2011, the Board of Directors granted 35,400 RSUs under the RSP. Prior to 2011, dividends declared by HOMEQ during the vesting period were paid in cash at the vesting date. The RSP now reinvests dividends declared during the vesting period in additional RSUs which will be paid at the vesting date. There were 5,185 shares credited on the RSUs vesting in March 2011 and 3,016 additional RSUs credited on unvested RSUs. Also during the nine months to September 30, 2011, 5,333 RSUs were cancelled.

The DSP allows the Directors to defer a portion of their cash compensation and receive the equivalent amount in Deferred Share Units (DSU) of the Company. On retiring from the Board, a Director will receive one share for each DSU accumulated in the plan. Dividends declared are reinvested in additional DSU and paid upon retirement.

HOMEQ intends to settle the DSUs and RSUs 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.

Options granted under the Option and Share Appreciation Rights Plan have a term of seven years and vest equally over three years. At September 30, 2011, 27,333 options were exercisable (2010 – nil). During the nine months ended September 30, 2011, the Board of Directors granted 88,100 stock options under the Option and Share Appreciation Rights Plan.

The table below summarizes HOMEQ's share activity for the period ended September 30, 2011.

Management Discussion and Analysis

	Voting	Management Restricted Share Plan	Directors' Deferred Share Plan	Total number of shares
Balance, December 31, 2010	14,117,792	75,399	197,199	14,390,390
Restricted shares redeemed (1)	39,853	(34,668)	—	5,185
Restricted share grants, net (2)	—	33,083	—	33,083
Deferred shares earned	—	—	39,707	39,707
Shares issued under DRIP	67,040	—	—	67,040
Balance, September 30, 2011	14,224,685	73,814	236,906	14,535,405

(1) includes reinvested dividends on vested RSUs

(2) includes RSUs granted, cancelled and reinvested dividends

HOMEQ has an optional Dividend Reinvestment Plan (DRIP) for shareholders. There were 22,513 shares issued under the DRIP in Q3 2011.

Shareholders participating in the DRIP are able to use the cash dividends paid on their existing HOMEQ shares to purchase additional shares. Under the DRIP, HOMEQ determines whether the additional shares are purchased on the secondary market or are newly issued by HOMEQ. Newly issued shares will be priced at the volume-weighted average trading price of the HOMEQ shares on the Toronto Stock Exchange on the five trading days preceding the dividend payment date, subject to a possible discount of up to 5%.

HOMEQ's Board of Directors has determined that until otherwise decided and announced, shares purchased under the DRIP will be newly issued and at a discount of 4%. Therefore, participating shareholders will receive shares valued at 104 percent of the cash dividend being reinvested. Further details of the DRIP can be found on the Company's website at www.homeq.ca.

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 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 Bank are determined in accordance with OSFI *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 HomeEquity Bank'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 Bank has implemented an Internal Capital Adequacy Assessment Process (ICAAP) based on HOMEQ's assessment of the business risks of HomeEquity Bank. As a result of this process, HOMEQ has established the capital ratios of HomeEquity Bank and has developed controls, mitigating actions and contingency plans 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.

As a result of changes to the qualifying criteria for capital under the guidelines published by the Basel Committee on Banking Supervision (BCBS) on December 16, 2010 and January 13, 2011 and subsequent OSFI guidance regarding the treatment of non-qualifying capital instruments published on February 4, 2011, certain capital instruments may no longer qualify as capital beginning January 1, 2013. HOMEQ's non-common equity capital instruments will be considered non-qualifying capital instruments under Basel III and will therefore be subject to a 10 per cent phase-out per year beginning in 2013. These non-common equity capital instruments include subordinated debentures.

Subsequent to the end of the quarter, HomeEquity Bank issued \$11.0 million unsecured subordinated debt, \$10.0 million to an independent investor and \$1,000,000 to directors and officers of HOMEQ, due October 31,

Management Discussion and Analysis

2021 with a coupon of 8.55% for the first five years following which they will bear interest at a rate equal to 3-month CDOR plus 7.30%. The debt constitutes subordinated indebtedness within the meaning of the *Bank Act* (Canada). The notes are unrated and qualify as Tier 2 B Capital of HomEquity Bank. On a pro-forma basis as at September 30, 2011, the total capital ratio inclusive of this debt would be in excess of 17.8% and the Assets-to-Capital multiple would be 11.7x. With the prior approval of the Superintendent of Financial Institutions, HomEquity Bank may redeem the Notes at par after 5 years.

HOMEQ pays quarterly dividends to shareholders. The amount of dividends paid is at the discretion of the Board of Directors, is evaluated annually and may be revised subject to business circumstance and expected capital requirements depending on, among other things, HOMEQ's earnings, financial requirements for future operations, the satisfaction of solvency tests imposed by the *Ontario Business Corporation Act* for the declaration and payment of dividends and other conditions existing from time to time.

Subsequent to the end of the quarter, the Board of Directors declared 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 on January 13, 2012 to shareholders of record at the close of business on December 29, 2011.

The table below summarizes HOMEQ's capital measures (relating solely to HomEquity Bank) as at September 30, 2011.

(\$ thousands)	September 30, 2011	December 31, 2010 (CGAAP)
Shareholders' equity per HomEquity Bank Consolidated Balance Sheet	76,089	75,494
Deductions	414	341
Tier 1 capital	75,675	75,153
Unsecured subordinated debt	30,000	30,000
Less: accumulated amortization for capital adequacy purposes	8,000	4,000
Tier 2 capital	22,000	26,000
Total regulatory capital	97,675	101,153
Credit risk	560,962	518,689
Off balance sheet exposure	7,304	3,463
Operational risk	42,712	41,001
Total risk-weighted assets	610,978	563,153
Capital ratios		
Tier 1 capital ratio	12.4%	13.3%
Total capital ratio	16.0%	18.0%
Assets-to-Capital multiple	12.9x	11.5x

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 at a level consistent with prior years.

Management Discussion and Analysis

FINANCIAL INSTRUMENTS

As reflected in Note 2 to the interim consolidated financial statements commencing on page 8 of the March 31, 2011 Interim Consolidated Financial Statements, 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 I Canadian chartered banks to reduce any counterparty risk associated with derivatives.

HOMEQ has elected under International Accounting Standards 39 *Financial Instruments: Recognition and Measurement* to apply hedge accounting for certain interest rate swaps in its derivative portfolio.

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. HomeEquity Bank 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, HomeEquity Bank 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 processes and activities. HomeEquity Bank has created a Conduct Review and Risk Management Committee in order to satisfy the above and assist the Board of Directors in fulfilling its responsibilities.

In addition to ongoing risk management processes, management regularly evaluates a range of extreme but plausible scenarios and stress tests to evaluate the potential impact that these events could have on its business. HOMEQ's stress testing program is in accordance with OSFI Guideline E-18, Stress Testing.

The stress testing program is an important part of the HOMEQ's enterprise risk management framework. Results from the stress testing program are used in part:

- To assess whether current portfolio exposures and policy limits remain consistent with the institution's risk appetite under stressed scenarios;
- To quantify the amount of additional capital required in stressed scenarios. Stress testing is an integral component of capital management; and
- To discover potential early warnings that would otherwise be overlooked allowing management to be more proactive in its decision making process.

Detailed below are the areas of risk that HOMEQ has identified and deemed to be its primary areas of exposure. A more complete analysis of HOMEQ's risk universe is included in the risk section of HOMEQ's Annual Information Form, which is available on www.sedar.com.

Credit Risk

Credit risk is the potential for financial loss if the assets as currently reflected on the balance sheet become impaired and not fully recoverable as a result of the occurrence of a specific event. In particular, this can result from a significant drop in real estate values persisting for an extended period of time.

Risks included in this category include underwriting risk, derivative related risk, and financial instrument risk.

Management Discussion and Analysis

This risk is managed and mitigated in the underwriting and administrative processes. In addition, each mortgage originated is limited in maximum dollar amount and LTV ratio in accordance with internal guidelines. Credit risk is mitigated further by the geographic diversity and the collateralization of the portfolio by mortgages with a current appraised value at September 30, 2011 of \$3.1 billion.

Mortgage Spread Income Risk

HOMEQ's operating margin is primarily derived from the spread between interest earned on the mortgage portfolio, and the interest paid on the deposits and debt used to fund the portfolio. Mortgage spread income risk is the exposure or potential impact to HOMEQ's earnings and financial condition to 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, are referenced to different underlying instruments or the long-term expectation of the quality of assets diminishes. Risks included in this category include basis risk, refinancing/cost of debt risk, underwriting risk and derivative related risk.

HOMEQ's objective is to maintain a relatively stable mortgage spread percentage 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.

Operational Risk

Operational risk involves breakdowns in internal controls and corporate governance which can lead to financial loss through a variety of means. Risks included in this category include but are not limited to fraud, security risk, process risk, business disruption and system failures and loss of key personnel. HOMEQ has implemented policies and procedures to manage and control business activity and specified risks.

Liquidity Risk

Liquidity risk is the potential that HOMEQ may not be capable of meeting its financial obligations when they are due to support the orderly continuation of operations. This can occur as a result of not being able to liquidate assets, payments not being received as expected, or obtain funding within the period of time required.

HOMEQ has a diversified range and proven sources of funding alternatives and has created policies and procedures to ensure that cash flows are accurately predicted and monitored. Access to sufficient funding at the precise moment it is required cannot, however, be guaranteed. HOMEQ must therefore maintain a sufficient amount of liquid assets to fund its anticipated loan commitments, operations, deposit maturities and interest payments should a shortfall arise.

Legal and Regulatory Risk

Legal and regulatory risk is the risk of non-compliance with applicable legal and regulatory requirements. This can be difficult to manage since there are multiple regulators to comply with. Risks considered within the broader category of legal and regulatory risk include capital risk and money laundering and terrorist financing risk. HOMEQ has developed and implemented a Legislative Compliance Management Framework in order to manage these risks.

Management Discussion and Analysis

CONTROLS AND PROCEDURES

Changes in Internal Controls over Financial Reporting

There have been no significant changes in HOMEQ's internal controls over financial reporting during the quarter ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, HOMEQ's internal control over financial reporting.

ACCOUNTING POLICIES AND ESTIMATES

HOMEQ's significant accounting policies are outlined in Note 2 of the interim consolidated financial statements commencing on page 8 of the March 31, 2011 interim consolidated financial statements.

Changes in Significant Accounting Policies

International Financial Reporting Standards replaced the existing Canadian GAAP for HOMEQ, effective for its 2011 interim and annual financial statements. Accordingly, HOMEQ's first interim consolidated financial statements using accounting policies consistent with IFRS were for the three month period ended March 31, 2011.

The adoption of IFRS generally requires retrospective application of the resulting changes in accounting policies. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

The adoption of IFRS resulted in changes to HOMEQ's accounting policies, and the changes have been applied in the preparation of an opening IFRS statement of financial position as at January 1, 2010 and to all subsequent periods presented.

The impact of the transition from Canadian GAAP to IFRS, including other changes to significant accounting policies is explained in detail in note 24 to the accompanying interim consolidated financial statements. The changes in accounting policy have not been applied to any information for periods prior to January 1, 2010.

Management Discussion and Analysis

One of the changes in significant accounting policies related to the treatment of costs associated with the origination of mortgages. HOMEQ determined that certain compensation costs related to the origination of mortgages do not qualify as transaction costs under IFRS and should not be included in the carrying value of the mortgages. Accordingly, the Company's accounting policy for these costs has been changed so that these costs are expensed as incurred. Under Canadian GAAP, the costs were included in the carrying value of the mortgages. The application of this new accounting policy increases expenses recognized in the statement of operations in the year mortgages are originated and lowers amortization of deferred costs over the expected term of the mortgages, which in turn results in a higher net interest income over the life of the mortgage.

Based on an assessment of the changes in accounting policies and business processes, HOMEQ has determined the adoption of IFRS did not have a material affect on internal control over financial reporting. HOMEQ had augmented certain existing controls and procedures to include the activities of the transition to IFRS.

Reconciliation of CGAAP to IFRS

The retrospective application of changes in accounting policies resulting from the adoption of IFRS reduced Shareholders' Equity by \$0.4 million as at January 1, 2010, \$0.9 million at September 30, 2010 and \$1.2 million at December 31, 2010. In addition, the IFRS transition reduces the 2010 reported Net Income by \$0.2 million, \$0.01 per share, for Q3 2010 and \$0.8 million, \$0.05 per share, for the full year of 2010.

The following tables provide reconciliations of shareholders' equity and net income from CGAAP to IFRS for the respective periods:

Reconciliation of equity

As at (\$ thousands)	December 31, 2010	September 30, 2010	January 1, 2010
	\$	\$	\$
Shareholders' equity under Canadian GAAP	98,068	98,564	100,982
Differences increasing (decreasing) reported shareholders' equity			
Change in transaction costs (1)	(4,958)	(4,869)	(4,556)
Tax effect of change in transaction costs (2)	1,271	1,253	1,198
Deferred income tax asset on inter-group transfers (2)	2,532	2,644	2,982
Change in recognition of share-based compensation (3)	—	—	—
Shareholders' equity under IFRS	96,913	97,592	100,606

Reconciliation of net income

(\$ thousands)	Year to date ended December 31, 2010	Three months ended September 30, 2010	Nine months ended September 30, 2010
	\$	\$	\$
Net income (loss) under Canadian GAAP	123	796	(74)
Impact of changes in accounting policies			
Change in transaction costs (4)	616	157	453
Salaries and benefits (5)	(1,024)	(270)	(768)
Deferred income tax expense (6)	(377)	(94)	(282)
Net loss under IFRS	(662)	589	(671)

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 (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.

Management Discussion and Analysis

4. The change in accounting policy so that certain compensation costs are no longer included in the carrying value of the mortgages results 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.

Critical Accounting Estimates

HOMEQ's critical accounting estimates are outlined in Note 3 of the interim consolidated financial statements commencing on page 7 of the September 30, 2011 interim consolidated financial statements.

Certain of the estimates are listed below as they are considered critical because they refer to material amounts and require management to make estimates that involve uncertainty.

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

HOMEQ's specific allowance policy is to cease accruing interest income on a mortgage having a LTV greater than 83%. Any increase or decrease in specific allowances is included with provision for credit losses on the consolidated statements of income.

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

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

All accounting standards effective for the periods beginning on or after January 1, 2011 have been adopted as part of the transition to IFRS. The following new IFRS pronouncements have been issued but are not effective and may have a future impact on HOMEQ.

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 HOMEQ as they are only disclosure requirements.

Management Discussion and Analysis

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 HOMEQ'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 HOMEQ's consolidated financial statements.

IFRS 11 Joint Arrangements

In May 2011, the IASB issued IFRS 11 Joint Arrangements. Management does not believe that these standards are applicable to HOMEQ'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 HOMEQ'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 HOMEQ's consolidated financial statements.

Management Discussion and Analysis

OUTLOOK

HOMEQ's goal is to continue to be Canada's leading provider of reverse mortgages. Market awareness of both HOMEQ and its products 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 an increasing seniors population.

Having established a solid base for portfolio growth and operational efficiency, management has set an objective to increase ROE to 15% in 2013. To achieve this goal, HOMEQ will focus on portfolio and origination growth as well as careful management and control of mortgage spread percentage, origination costs and overhead expenditure. Resulting primarily from the rate of growth in adjusted net income, adjusted return on equity has increased each quarter this year, growing to 9.4% in Q3.

HOMEQ expects that demand for reverse mortgages will remain firm. With a continued positive impact coming from the increasing number of Canadians over 55 years of age, an increase in the size of the sales force and additional experience in the sales and marketing functions, HOMEQ's objective is to increase the mortgage portfolio by between 15% and 20% per annum. Given the very rapid growth in originations in 2010, however, growth in 2011 might be expected to be somewhat lower than HOMEQ's annual objectives.

Credit markets have improved in 2011, as evidenced by MTN credit spreads falling relative to the prior three years, and GIC's are proving to be a highly efficient and cost effective method of financing the company's lending operations. HOMEQ expects that net interest income will increase in concert with HOMEQ's portfolio during the remainder of the year.

HOMEQ is achieving a significant improvement in sales and marketing efficiency and, as a result, marketing costs and commissions as a percentage of new mortgages originated have dropped to below historic rates. Mortgage origination costs as a percentage of originations were 6.0% in 2010 and have further dropped to 5.7% for the rolling four quarters ended September 30, 2011. HOMEQ's goal is to hold them to this level or less for the next three years.

Since absorbing the full overhead expenses associated with operating a bank in Q3 2010, the trailing four quarter administrative expense percentage has decreased each quarter indicating that these expenses are primarily of a fixed nature. While costs will increase as the scope of operations increases, HOMEQ's objective is to hold overhead growth to 5% or less per annum.

The combination of portfolio growth, efficient originations, management of net interest margin and overhead expense control should provide increases in adjusted net income per share on an IFRS basis of a minimum of 20% per annum commencing in 2011 so that HOMEQ achieves its objective of a minimum 15% ROE in 2013.

Summary of Objectives			
Measure	Target	Actual Results for period ending September 30, 2011	
		Three months	Nine months
Adjusted return on equity in 2013	Minimum 15%	9.4% in Q3 2011	7.7% year to date
Growth in adjusted net income per share	Minimum 20% per annum	36% over Q3 2010	13% growth year over year
Growth in portfolio value	15% to 20% per annum		16% from September 30, 2010
Growth in mortgage originations	Average of 25% per annum	5% over Q3 2010	9% growth year to date
Origination cost %	Maximum 6%	5.5% in Q3 2011	5.7% year to date
Non-interest expense growth	Maximum 5% per annum	decreased 5% over Q3 2010	4% year over year

In 2011, management expects to maintain quarterly dividends at \$0.07 per share.

November 4, 2011

NOTES



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