INTERIM MANAGEMENT DISCUSSION & ANALYSIS
For the quarter ended September 30, 2012

FINANCIAL HIGHLIGHTS

($ thousands except per share and percentage amounts)

	Three months ended September 30		Nine months ended September 30	
	2012	2011	**2012**	2011
OPERATING RESULTS				
Net income (loss)	**1,340**	1,719	**2,284**	2,245
Per share	**0.09**	0.12	**0.16**	0.15
Adjusted net income (1)	**1,956**	2,154	**5,841**	5,146
Per share	**0.13**	0.15	**0.40**	0.36
Return on equity (annualized)	**5.5%**	7.1%	**3.1%**	3.1%
Adjusted return on equity (annualized) (2)	**8.1%**	9.4%	**8.1%**	7.7%
Dividends per share	—	0.07	**0.07**	0.21
Mortgage originations	**64,564**	54,538	**166,238**	171,835
Origination cost %, for the trailing four quarters	**5.1%**	5.5%	**5.7%**	5.7%
Administration expense %, for the trailing four quarters	**0.59%**	0.59%	**0.65%**	0.67%
Efficiency ratio (3)	**55.9%**	51.6%	**57.3%**	58.6%
BALANCE SHEET HIGHLIGHTS				
Total assets			**1,433,537**	1,277,250
Mortgage principal plus accrued interest			**1,292,149**	1,139,223
Deposits			**849,923**	557,226
Medium-term debt			**398,628**	527,994
Subordinated debt			**20,373**	40,298
Unsecured subordinated debt			**31,917**	20,903
Bank term loan			**10,243**	10,605
Book value per share			**6.76**	6.74
PORTFOLIO QUALITY				
Appraised value of underlying properties			**3,517,663**	3,128,882
Average loan to value			**36.7%**	36.4%
Non-accrual mortgage value			**6,438**	2,244
Allowance for credit losses			**4,003**	3,318

(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) Administration expense % and efficiency ratio for 2012 is net of Transaction costs.

TO OUR SHAREHOLDERS:

Birch Hill Equity Partners Management Inc. ("Birch Hill") has received approval from the Minister of Finance that will enable the completion of the shareholder-approved Arrangement (the "Arrangement") under the *Business Corporations Act* (Ontario) by which Monaco Acquisition Inc., an entity controlled by Birch Hill, will acquire all of the outstanding common shares of HOMEQ Corporation.

In accordance with the terms of the Arrangement, HOMEQ shareholders will receive $9.50 in cash per common share. It is anticipated that the acquisition will close on or before November 30, 2012.

We are grateful to our shareholders for their commitment to HOMEQ since our IPO in 2002. During this period HOMEQ has become recognized as Canada's leading provider of reverse mortgage solutions and our portfolio of mortgages has grown from less than $400 million to over $1.3 billion. We thank our shareholders for their part in helping HOMEQ achieve its objective to help Canadian senior homeowners enjoy retirement on their own terms.

Sincerely,

Steven K. Ranson
President & Chief Executive Officer

MANAGEMENT DISCUSSION AND ANALYSIS

The following management discussion and analysis (MD&A) is provided in order to enable readers to assess the financial position and results of operations of HOMEQ Corporation (HOMEQ) for the three and nine month periods ended September 30, 2012. This MD&A should be read in conjunction with the interim consolidated financial statements for the three months ended September 30, 2012 and the MD&A and audited annual consolidated financial statements and accompanying notes for the year ended December 31, 2011. 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 (GAAP). This MD&A has been prepared based on information available as at November 12, 2012. 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 12, 2012.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included herein constitute "forward-looking statements". All statements, other than statements of historical fact, included in this release that address future activities, events, developments or financial performance are forward-looking statements. These forward-looking statements can be identified by the use of forward-looking words such as "may", "should", "will", "could", "expect", "intend", "plan", "estimate", "anticipate", "believe", "future" or "continue" or the negative thereof or similar variations. In particular, statements about the proposed Arrangement between Birch Hill and HOMEQ, including the expected timetable for completing the Transaction and any other statements regarding HOMEQ's future expectations, beliefs, goals or prospects are or involve forward-looking information. These forward-looking statements are based on certain assumptions and analyses made by HOMEQ and its management, in light of their experiences and their perception of historical trends, current conditions and expected future developments, as well as other factors they believe are appropriate in the circumstances. Shareholders are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of performance and are subject to a number of uncertainties, assumptions and other factors, many of which are outside the control of Birch Hill and HOMEQ, that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include, among other things, the parties' ability to consummate the Arrangement; the parties' ability to satisfy the conditions to the completion of the Arrangement; general economic and market factors (including changes in global, national or regional financial, credit, currency or securities markets), changes or developments in global, national or regional political conditions (including any act of terrorism or war), changes in government laws or regulations (including tax laws) and changes in GAAP or regulatory accounting requirements. Readers are cautioned that the foregoing lists are not exhaustive.

Such forward-looking statements should, therefore, be construed in light of such factors. If any of these risks or uncertainties were to materialize or if the factors and assumptions underlying the forward-looking information were to prove incorrect, actual results could vary materially from those that are expressed or implied by the forward-looking information contained herein. All forward-looking statements attributable to HOMEQ, or persons acting on its behalf, are expressly qualified in their entirety by the cautionary statements set forth above. Readers are cautioned not to place undue reliance on forward-looking statements contained herein, which reflect the analysis of the management of Birch Hill or HOMEQ, as appropriate, only as of the date of this MD&A.

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.

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 (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 meet the needs of its customer base and in so doing increase net income and return on equity through the profitable growth of its portfolio of reverse mortgages.

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. 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 growth potential of reverse mortgages as a viable source of cash flow for Canadian senior homeowners. At the same time, and despite steady financial results in the quarter ended September 30, 2012, the business is experiencing competition from alternate products including low priced conventional mortgages and secured lines of credit offered by other banks and financial institutions.

Arrangement Agreement

On November 8, 2012, Birch Hill Equity Partners Management Inc. ("Birch Hill") received approval from the Minister of Finance that will enable the completion of the shareholder-approved Arrangement (the Arrangement) under the *Business Corporations Act* (Ontario) by which Monaco Acquisition Inc., an entity controlled by Birch Hill, will acquire all of the outstanding common shares of HOMEQ Corporation.

In accordance with the terms of the Arrangement, HOMEQ shareholders will receive $9.50 in cash per common share (the Transaction). It is anticipated that the acquisition will close on or before November 30, 2012. Following completion of the Arrangement, it is expected that the HOMEQ shares will be delisted from the Toronto Stock Exchange and HOMEQ will apply to cease to be a reporting issuer.

HOMEQ has incurred $0.1 million of costs related to the Transaction in Q3 2012 and $1.6 million in the nine months to September 30, 2012. HOMEQ estimates that the total costs to finalize the Transaction including fees contingent on the Transaction closing, will be $3.8 million.

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.

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

	2010		2011				2012		
($ thousands, except per share amounts)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Interest income	12,642	13,223	13,639	14,160	14,519	15,024	15,197	15,727	16,024
Interest expense	6,573	7,649	9,215	7,007	7,785	7,645	8,668	8,773	9,165
Net interest income	6,069	5,574	4,424	7,153	6,734	7,379	6,529	6,954	6,859
Provision for credit losses	(135)	(287)	(33)	(98)	(254)	(135)	(132)	(502)	(137)
Non-interest income	29	32	27	39	37	39	32	45	43
Net interest income and other income	5,963	5,319	4,418	7,094	6,517	7,283	6,429	6,497	6,765
Non-interest expenses	3,665	3,754	3,574	3,718	3,490	4,001	4,540	4,855	3,944
Income before undernoted items	2,298	1,565	844	3,376	3,027	3,282	1,889	1,642	2,821
Less:									
Unrealized loss on derivative instruments	1,372	2,275	1,894	1,393	584	1,673	976	937	987
Current income tax expense (recovery)	864	(1,466)	134	831	728	445	415	497	348
Future income tax expense (recovery)	(527)	746	(339)	(219)	(4)	(28)	(131)	(107)	146
Net income (loss)	589	10	(845)	1,371	1,719	1,192	629	315	1,340
Per share	0.04	0.00	(0.06)	0.09	0.12	0.08	0.04	0.02	0.09
Average number of shares outstanding	14,348	14,385	14,438	14,500	14,535	14,559	14,547	14,569	14,569

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 Transaction are not considered recurring items.

	2010		2011				2012		
($ thousands, except per share amounts)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Net Income (loss) before tax	926	(710)	(1,050)	1,983	2,443	1,609	913	705	1,834
Add (deduct)									
Unrealized (gain) loss on derivatives	1,372	2,276	1,894	1,393	584	1,673	976	937	987
Transaction costs	—	—	—	—	—	—	560	962	87
Adjusted net income before tax	2,298	1,566	844	3,376	3,027	3,282	2,449	2,604	2,908
Tax provision as reported less tax effect of above items and changes in future income tax rates	(690)	59	(264)	(964)	(873)	(846)	(533)	(635)	(952)
Adjusted net income	1,608	1,625	580	2,412	2,154	2,436	1,916	1,969	1,956
Per share	0.11	0.11	0.04	0.17	0.15	0.17	0.13	0.14	0.13
Average number of shares outstanding	14,348	14,385	14,438	14,500	14,535	14,559	14,547	14,569	14,569

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.

	2010		2011				2012		
($ thousands)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Shareholders' equity	97,592	96,913	95,334	95,991	97,003	97,135	96,977	96,989	98,450
Add (deduct)									
Derivative instruments, net	(9,135)	(6,184)	(5,945)	(4,930)	(4,491)	(3,257)	(2,534)	(1,821)	(1,093)
Adjusted shareholders' equity	88,457	90,729	89,389	91,061	92,512	93,878	94,444	95,168	97,357
Adjusted return on equity (annualized)	7.3%	7.2%	2.6%	10.7%	9.4%	10.4%	8.3%	8.3%	8.1%

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

Net Interest Income

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

Interest income in Q3 2012 was $16.0 million, an increase of $1.5 million or 10.4% over Q3 2011. The increase is due to the 13.7% higher average mortgage portfolio offset by a 22 basis point lower average rate earned on the portfolio. Interest expense on the GICs and debt was $9.2 million during Q3 2012, $1.4 million or 17.7% higher than Q3 2011. The increase in interest expense is due to a 16.5% increase in the average debt portfolio, the cost of buying back debt in advance of its maturity ($0.3 million) and having a full quarter of expense on the unsecured debt issued in Q4 2011 ($0.2 million). The resulting net interest income of $6.9 million was $0.1 million or 1.9% higher than Q3 2011.

During the nine months ended September 30, 2012, interest income was $46.9 million, an increase of $4.6 million or 10.9% over 2011. The increase is mainly a result of the 15.0% higher average mortgage portfolio partially offset by a reduction in the average yield earned on the mortgage portfolio by 21 basis points from the same period in 2011. Interest expense on the GICs and debt during the nine months ended September 30, 2012 was $26.6 million, an increase of $2.6 million or 10.8% over 2011. The increase in interest expense is due to the average balance of GICs and debt being 14.3% higher, partially offset by the cost of funds being 10 basis points lower in the period. The resulting net interest income of $20.3 million was $2.0 million or 11.1% higher than 2011.

Provision for Credit Losses

The provision for credit losses includes the effect of changes in specific and general allowances on the mortgage portfolio determined in accordance with HOMEQ's internal policies.

The specific allowance at September 30, 2012 was $0.7 million, equal to 0.05% of the value of the mortgage portfolio. The specific allowance increased $0.1 million in Q3 2012 as the number of mortgages requiring a reserve increased to 36. The general allowance for credit losses was $3.3 million, a decrease of $0.1 million in Q3 2012, equivalent to 0.26% of the value of the mortgage portfolio.

Non-Interest Expenses

Non-interest expenses in Q3 2012 of $3.9 million were $0.5 million or 13.0% higher than Q3 2011. The increase includes $0.1 million of costs incurred in the quarter relating to the Transaction. Without the costs incurred for the Transaction, total non-interest expenses were the 10.5% higher than 2011. HOMEQ's efficiency ratio for Q3 2012 was 57.2% and 55.9% net of the one time costs relating to the Transaction compared to 51.6% for Q3 2011. In general, a lower efficiency ratio is associated with a more efficient cost structure, a primary objective of HOMEQ.

For the nine months to September 30, 2012, non-interest expenses of $13.3 million were $2.6 million or 23.7% higher than the same period in 2011. Without the $1.6 million of Transaction costs incurred, non-interest expenses were $0.9 million or 8.3% higher than 2011. The year-to-date efficiency ratio without Transaction costs was 57.3% (2011 – 58.6%).

Derivatives

Under GAAP, derivatives not designated for hedge accounting (Non-Designated) are valued at fair market value with changes in fair value recognized in the current period's statement of income (mark-to-market). On the other hand, derivatives designated for hedge accounting (Designated) are also valued at fair market value, however only the ineffectiveness of the hedge is recognized in the current period's statement of income.

As the derivative portfolio matures, the derivative asset or liability will reduce in value resulting in unrealized gains or losses on the remaining Non-Designated hedges being recorded in the statement of income. HOMEQ's derivatives are generally neither held for resale nor traded. For derivatives that are Non-Designated, HOMEQ believes that there is an asymmetry in the recognition methods which has resulted in net income volatility not indicative of the business. Unrealized gains or losses on derivative instruments are thus removed from reported net income to arrive at adjusted net income.

Since late 2009, substantially all of HOMEQ's derivatives have been Designated which has significantly reduced the extent of fluctuations to net income previously experienced.

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.

In Q3 2012, HOMEQ recorded unrealized losses of $1.0 million (Q3 2011 $0.6 million) primarily due to the amortization of prior period unrealized gains as Non-Designated derivatives near maturity.

Interest rates were relatively stable during the nine months ended September 30 in 2011 and 2012. The majority of unrealized losses are due to the amortization of prior period gains from the Non-Designated derivative portfolio. The Non-Designated portfolio was significantly smaller in 2012 compared to 2011 as existing derivatives matured and new derivatives are designated for hedge accounting. As a result, in the nine months ended September 30, 2012, HOMEQ recorded unrealized losses of $2.9 million compared to $3.9 million unrealized loss in 2011.

Income Taxes

During Q3 2012 HOMEQ recorded income tax expense of $0.5 million (2011 $0.7 million).

Net Income (loss) and Adjusted Net Income

HOMEQ reported $1.3 million of net income or $0.09 per share in Q3 2012 compared to $1.7 million $0.12 per share in Q3 2011. Adjusted net income in Q3 2012 was $1.9 million or $0.13 per share, $0.2 million or $0.02 per share lower than Q3 2011 which was $2.2 million or $0.15 per share.

For the nine months ended September 30, 2012, net income was $2.3 million, $0.16 per share comparable to 2011. Adjusted net income for the nine months ended September 30, 2012 was $5.8 million, $0.40 per share, compared to adjusted net income of $5.1 million or $0.35 per share in 2011.

Return on Equity and Adjusted Return on Equity

HOMEQ's return on equity (annualized) was 5.5% for Q3 2012 (2011 – 7.1%) and adjusted return on equity (annualized) was 8.1% (2011 – 9.4%).

Management Discussion and Analysis

Portfolio Growth

The mortgage portfolio was approximately $1.3 billion dollars at September 30, 2012, increasing $152.9 million or 13.4% over September 30, 2011. The following table shows the growth in the mortgage portfolio on a quarterly basis for the past nine quarters.

	2010		2011				2012		
($ millions)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Opening mortgage balance (1)	946.0	985.0	1,016.4	1,051.4	1,100.0	1,139.2	1,185.0	1,219.6	1,250.3
Originations (2)	52.0	47.5	47.6	69.7	54.5	67.1	44.6	57.1	64.6
Accrued interest	13.5	14.2	14.4	15.1	15.6	16.1	16.3	16.7	17.1
Repayments of principal	(18.3)	(20.8)	(19.3)	(25.3)	(21.6)	(25.1)	(17.9)	(30.4)	(28.2)
Repayments of accrued interest	(8.2)	(9.5)	(7.7)	(10.9)	(9.3)	(12.3)	(8.4)	(12.7)	(11.7)
Ending mortgage balance (1)	985.0	1,016.4	1,051.4	1,100.0	1,139.2	1,185.0	1,219.6	1,250.3	1,292.1
Loan-to-value of new originations	31%	30%	32%	33%	31%	31%	30%	29%	32%
Total repayments as % of opening balance	2.8%	3.1%	2.6%	3.4%	2.8%	3.3%	2.2%	3.5%	3.2%
Trailing 4 quarters:									
Originations	201.7	205.8	206.1	216.8	219.3	239.0	235.9	223.3	233.4
Total repayments	(104.6)	(107.4)	(114.4)	(120.0)	(124.4)	(131.5)	(130.8)	(137.7)	(146.7)

(1) Principal plus accrued interest
(2) Originations in Q2 2011 include the acquisition of $3.7 million reverse mortgage portfolio.

New mortgage originations of $64.6 million in Q3 2012 were $10.1 million or 18.5% higher than Q3 2011. The higher originations were due in part to a reduction in the rate on new mortgages in response to competition from substitute products, in particular, low rate conventional mortgages and secured lines of credit. At the same time, demand for reverse mortgages continued to grow, fuelled by long term demographic trends, as well as increasing solution awareness. HOMEQ's marketing programs continued to be effective in driving increased market awareness and acceptance while the expertise of the sales-force contributed positively. For the nine months ended September 30, 2012, originations were $166.3 million, $5.5 million or 3.2% lower than 2011 or $1.8 million lower net of the portfolio acquisition in Q2 2011.

Accrued mortgage interest in Q3 2012 of $17.1 million increased $1.5 million or 9.6% over Q3 2011 due to the 13.7% increase in the average balance of the mortgage portfolio offset by a 22 basis point lower yield earned on the portfolio.

Total repayments of principal and interest of $39.9 million in Q3 2012 were $9.0 million or 29.1% higher than Q3 2011. As a percentage of the opening mortgage balance, total repayments of 3.2% were within the historical range of 2.0% to 5.0% 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.

Accrued mortgage interest for the nine months ended September 30, 2012 of $50.1 million was $5.0 million or 11.1% higher than 2011 due to the average mortgage portfolio being 15.0% larger and earning a 22 basis point lower yield. The lower yield is due to the lower T-Bill rate on the portion of the mortgage portfolio resetting in the year and also due to the increasing proportion of the mortgage portfolio being at posted rates as discussed further in the Net Interest Margin section.

Total repayments of principal and interest of $109.3 million for the nine months ended September 30, 2012 were $15.2 million higher than 2011. As a percentage of the opening mortgage balance, total repayments of 9.2% were within the historical range. The trailing four-quarter repayments of $146.7 million increased 17.9% in line with the increase with increase in the average mortgage portfolio.

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.

At September 30, 2012, the most recently appraised value of the underlying properties within the entire mortgage portfolio was $3.5 billion, which results in an average LTV ratio of approximately 37%, similar to September 30, 2011. The average LTV ratio of the $64.6 million of new mortgages originated in Q3 2012 was 32%, consistent with historical quarterly experience

HOMEQ's internal policy is to cease accruing interest income on any mortgage where the LTV exceeds 83% by creating a specific allowance for the mortgage 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, 2012, there were 36 mortgages with a specific allowance, 14 more than at December 31, 2011 and 18 more than at September 30, 2011. These properties were located across the country with some concentration in southern Ontario. The specific allowance on these files totalled $0.7 million an increase of $0.3 million from September 30, 2011. The total principal and accrued interest of these mortgages net of the $0.7 million specific allowance was $6.4 million, equating to 0.5% of the total portfolio. The appraised value of the properties securing the mortgages was $7.8 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 over 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 0.9%; and
- Each mortgage originated is limited in maximum dollar amount and LTV.

There is an inherent risk that the expected occupancy term, interest rate and property appreciation experienced over the life of a mortgage might vary from the assumed factors used in underwriting the mortgage. In addition, the value of a mortgage may increase unexpectedly as a result of charges being applied to the mortgage during the course of its life. Charges applied to the mortgage can include fire insurance, property taxes, property maintenance and legal fees which the client has not paid. HOMEQ covers these charges in order to retain its registered mortgage in first position.

HOMEQ has a loan provisioning methodology that:

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

HOMEQ, in following its loan provisioning policy, decreased its general allowance for credit losses by $0.1 million to $3.3 million in Q3 2012 compared to $2.9 million at September 30, 2011. The general allowance of $3.3 million is 0.26% of the total value of the mortgage portfolio. As the mortgage portfolio grows the general allowance is expected to also increase.

Net Interest Margin

HOMEQ's net interest margin is derived from the difference between the interest earned on the interest earning assets and the interest paid on the interest bearing liabilities used to fund the assets.

The interest earning assets include the mortgage portfolio and the cash resources. Within the mortgage portfolio, the interest rate on 59% of the mortgages is based on HOMEQ's posted rates for new mortgages while the interest on 41% of the mortgages is based on Prime or Government of Canada Treasury Bill (T-Bill) rates plus a fixed spread. The T-Bill rate on the mortgages that re-priced in the quarter decreased 27 basis points from Q3 2011. 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 net interest margin. However, the lower mortgage rates are contributing to higher mortgage origination volumes with a corresponding improvement in efficiencies which are expected to more than offset the impact on net interest margin.

Interest income earned on the mortgage portfolio before amortization of deferred origination commissions and mortgage fees and costs and purchase price premiums and origination costs in Q3 2012 was $17.3 million, an increase of $1.5 million or 9.4% over Q3 2011. The higher earnings are mainly a result of the 15.0% larger average mortgage portfolio partially offset by the 22 basis points lower average yield earned on the mortgage portfolio of 5.42%. The variance in yield was due to T-Bill based mortgages resetting against lower benchmark rates and the portfolio's continued shift towards lower yielding posted rate mortgages.

HOMEQ's mortgage portfolio is funded with a combination of GICs (66%) and debt (34%) (the interest bearing liabilities). Debt consists of senior and subordinated medium-term debt (MTNs), unsecured subordinated debt and a bank term loan. The cost of GICs and MTNs remained relatively stable in Q3 2012 compared to 2011.

Interest expense on the interest bearing liabilities in Q3 2012 was $9.2 million, an increase of $1.4 million or 17.7% over Q3 2011. The increase is due in part to the 16.5% increase in the average interest bearing liabilities portfolio, the cost of buying back debt in advance of its maturity ($0.3 million) and having a full quarter of expense on the unsecured debt issued in Q4 2011 ($0.2 million).

The difference between interest income and interest expense resulted in a net interest margin of $7.7 million in Q3 2012 which was compressed in the quarter due to lower yields earned on the mortgage portfolio and higher interest costs on the interest bearing liabilities. Net interest margin is expected to increase as the mortgage portfolio increases subject to market conditions on the underlying interest rates. Net interest margin for Q3 2012 was $7.7 million, 1.2% higher than Q3 2011 and net interest margin percentage earned in Q3 2012 was 2.12% compared to 2.41% in Q3 2011. The difference is mainly due to lower mortgage yields and the impact of the transactions referred to above.

During the nine months ended September 30, 2012, net interest margin percentage was 2.68%, 10 basis points lower than 2011. Mortgage income increased by $5.0 million, 11.0% higher than 2011 due to the 15.0% increase in the average mortgage portfolio partially offset by a 21 basis point decrease in the yield earned on the portfolio due to declines in the benchmark Government of Canada yields and the continued shift in the portfolio to posted rate mortgages. Interest expense on the interest bearing liabilities increased $2.6 million or 10.8% during the nine months to September 30, 2012. The increase in interest expense is due to the average balance of GICs and debt being 14.3% higher, partially offset by the cost of funds being 10 basis points lower in the period. Cost of funds have decreased year over year as a result of the benefits from expensive senior and subordinated notes maturities. However, the reduction in interest expense has been offset by a year over year increase in term deposit costs on a swapped basis. The resulting net interest margin of $22.8 million was $2.0 million or 9.5% higher than 2011.

The table below shows the calculation of net interest margin for Q3 2012 and Q3 2011.

	2012			2011		
	Q3			Q3		
($ thousands)	Average Balance (1)	Income/ Expense	Average Rate	Average Balance (1)	Income/ Expense	Average Rate
Assets						
Cash Resources and Securities	82,746	218	1.05%	41,303	110	1.06%
Residential reverse mortgages (2)	1,269,699	17,356	5.42%	1,116,987	15,867	5.64%
Total interest earning assets	1,352,446	17,574	5.16%	1,158,290	15,977	5.47%
Other assets (3)	90,465	(692)	-3.03%	94,505	(569)	-2.39%
Total assets	1,442,911	16,882	4.64%	1,252,795	15,408	4.88%
Liabilities and Shareholders' Equity						
Deposits (4)	827,472	5,184	2.49%	536,548	3,195	2.36%
Medium-term debt (4)	412,188	2,790	2.69%	509,840	3,354	2.61%
Subordinated debt (4)	20,000	316	6.27%	40,000	613	6.08%
Unsecured subordinated debt (4)	30,975	678	8.68%	20,000	427	8.47%
Bank term loan (4)	10,000	197	7.82%	10,000	196	7.78%
Total interest-bearing liabilities	1,300,635	9,165	2.80%	1,116,388	7,785	2.77%
Other liabilities	44,668			37,104		
Shareholders' equity	97,608			99,303		
Total liabilities and shareholders' equity	1,442,911	9,165	2.52%	1,252,795	7,785	2.47%
Net interest margin		7,717			7,623	
Amortization of purchase price premiums and origination costs		(858)			(889)	
Net interest income		6,859			6,734	
Net interest margin % (net interest margin divided by average total assets)			2.12%			2.41%

(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 balance of deposits and debt is based on the principal amounts.

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

	2010		2011				2012		
($ thousands)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Average cash resources and securities	104,537	111,198	87,962	62,367	41,303	36,324	54,956	67,958	**82,746**
Average mortgage principal plus accrued interest	965,506	1,000,706	1,032,586	1,073,738	1,116,987	1,160,691	1,200,916	1,234,641	**1,269,699**
Average total interest earning assets	1,070,043	1,111,905	1,120,577	1,136,104	1,158,290	1,197,015	1,255,872	1,302,600	**1,352,446**
Average other assets	97,136	93,546	86,824	86,395	94,505	101,123	96,703	91,880	**90,465**
Average total assets	1,167,179	1,205,451	1,207,401	1,222,499	1,252,795	1,298,137	1,352,575	1,394,480	**1,442,911**
Net interest margin (1)	6,895	6,456	5,252	7,980	7,623	8,232	7,343	7,780	**7,717**
Net interest margin % – annualized (%) (2)	2.34%	2.12%	1.76%	2.62%	2.41%	2.52%	2.18%	2.24%	**2.12%**

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

Total origination costs of $3.3 million in Q3 2012 were $0.3 million or 9.0% higher than Q3 2011. The increase is due in part to higher compensation costs in the quarter. Mortgage originations of $64.6 million were 18.5% higher than Q3 2011. The resultant origination cost percentage was 5.1% in comparison to 5.5% in Q3 2011. The trailing four-quarter origination cost was 5.7%. Marginal origination costs were 3.6% in Q3 2012 in comparison to 4.0% in Q3 2011.

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

	2010		2011				2012		
($ thousands)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Mortgage originations (1)	52,038	47,461	47,624	69,673	54,538	67,133	44,564	57,110	**64,564**
Origination expenses									
Commissions	1,319	1,475	1,076	1,311	1,217	1,702	1,197	1,285	**1,363**
Direct origination expenses									
Origination salaries and benefits	267	252	311	345	322	310	306	342	**349**
Marketing	610	626	708	697	647	564	821	753	**624**
Marginal origination costs	2,196	2,353	2,095	2,353	2,186	2,576	2,324	2,380	**2,336**
Origination overhead expenses									
Salaries and benefits	1,431	1,617	1,225	1,253	1,336	1,421	1,362	1,344	**1,552**
Office	365	314	351	374	328	395	357	381	**357**
Subtotal	1,796	1,931	1,576	1,627	1,664	1,816	1,719	1,725	**1,909**
50% inclusion	898	966	788	814	832	908	859	862	**955**
Total origination cost	3,094	3,319	2,883	3,167	3,018	3,484	3,183	3,242	**3,291**
Origination cost (%)									
Marginal Origination cost									
Current quarter	4.2%	5.0%	4.4%	3.4%	4.0%	3.8%	5.2%	4.2%	**3.6%**
Trailing four quarter	4.4%	4.3%	4.3%	4.1%	4.1%	3.9%	4.0%	4.2%	**4.1%**
Total Origination cost									
Current quarter	5.9%	7.0%	6.1%	4.5%	5.5%	5.2%	7.1%	5.7%	**5.1%**
Trailing four quarter	—	6.0%	6.0%	5.7%	5.7%	5.3%	5.4%	5.8%	**5.7%**

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

Mortgage Administration Expense

Cost effective administration of its mortgages is an important objective of HOMEQ. In Q3 2012, mortgage administration expenses were $1.9 million, $0.2 million, or 14.2% higher than Q3 2011. The increase relates to operating a larger entity and the timing of expenditures year over year. During this period the average mortgage portfolio grew by 15.0%. As a percentage of the average mortgage portfolio, mortgage administration expenses were 0.59% for the quarter and 0.65% 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.

	2010		2011				2012		
($ thousands)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Average mortgage balance	964,032	999,592	1,032,615	1,073,800	1,117,048	1,160,691	1,200,916	1,234,641	**1,269,699**
Administration expenses									
Mortgage administration	100	127	101	150	142	144	163	165	**137**
Origination overhead expenses	898	966	788	814	832	908	859	862	**955**
Professional services	640	424	567	642	485	900	1,204	1,600	**645**
Amortization of capital assets	86	89	105	112	114	115	111	137	**141**
Business and capital taxes	56	160	13	19	8	10	13	16	**23**
Other	107	148	193	126	108	142	203	117	**116**
Less:									
Transaction costs	—	—	—	—	—	—	(560)	(962)	**(87)**
Mortgage administration fees	(30)	(30)	(27)	(39)	(37)	(39)	(32)	(45)	**(43)**
Total administration expenses	1,857	1,884	1,740	1,824	1,652	2,180	1,961	1,890	**1,887**
Administration expense (%)									
Annualized	0.77%	0.75%	0.67%	0.68%	0.59%	0.75%	0.65%	0.61%	**0.59%**
Trailing four quarters	0.76%	0.75%	0.73%	0.72%	0.67%	0.67%	0.67%	0.65%	**0.65%**

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 its 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's business model 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 HomEquity 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 HomEquity 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 – HomEquity 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 HomEquity 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. HomEquity Bank has longstanding relationships with the largest Schedule I Canadian chartered 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%. 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, 2012, the senior debt-to-mortgage ratio was 90.3% and the total debt-to-mortgage ratio was 94.9%.

  In order to mitigate the refinancing risk of existing MTNs, approximately 78% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2035 to 2036. It is expected 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 37% 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 9,500 reverse mortgages is diversified by location, property type, date of origination and age of borrower. As supported by prior experience, between 2% and 5% of the mortgage portfolio is repaid each quarter, providing a predictable source of cash flow.

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

Liquid Assets

HOMEQ holds liquid assets determined and invested in accordance with its liquidity management policies. 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.

The table below summarizes the liquid assets held at September 30, 2012 and December 31, 2011. HOMEQ is holding higher liquid assets as a conservative measure at this time.

($ thousands)	**September 30 2012**	December 31 2011
Cash and non-interest bearing deposits with banks	**39,974**	19,662
Corporate notes	**5,000**	7,894
Cash and cash equivalents	**44,974**	27,556
Interest bearing deposits with banks	**9,995**	2,968
Total liquid assets	**54,969**	30,524

Securities

($ thousands)	September 30 2012	December 31 2011
Treasury bills issued or guaranteed by provinces	—	2,989
Corporate notes	**3,006**	3,000
Cash and cash equivalents	**3,006**	5,989

Deposits

HOMEQ issues fixed rate, non refundable GICs in terms ranging from one to five years to fund new mortgages and to repay maturing MTNs. In Q3 2012, HomEquity Bank issued $181.8 million GICs and $382.1 million year to date. HOMEQ had $845.4 million GICs outstanding at September 30, 2012.

The table below summarizes the timing of maturities of principal amount of deposits issued as of September 30, 2012.

($ thousands)	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	September 30 2012	December 31 2011
Issued to individuals	184,029	425,855	235,481	—	**845,365**	589,185

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. During Q3 2012, HOMEQ bought back $15.5 million of the MTNs having an expected final payment date in February 2013.

The principal amount of aggregate debt outstanding at September 30, 2012 of $446.2 million was $135.0 million lower than at December 31, 2011. 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 principal amounts of debt outstanding at September 30, 2012. Approximately 72% of these instruments can be extended from their expected final payment dates to their legal maturities which range from 2021 to 2036. The remaining debt have bullet payment requirements at the respective expected final payment date.

($ thousands)	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	September 30 2012	December 31 2011
Medium-term debt	85,217	125,000	175,000	—	**385,217**	500,246
Subordinated debt	20,000	—	—	—	**20,000**	40,000
Unsecured subordinated debt	—	10,000	10,000	10,975	**30,975**	30,975
Bank term loan	—	—	10,000	—	**10,000**	10,000
Total	105,217	135,000	195,000	10,975	**446,192**	581,221

The $85.2 million of medium-term debt due within one year of September, 2012 has an expected final payment date and a legal maturity date of February 1, 2013. The $20.0 million subordinated debt due within one year is made up of two series of notes; $10.0 million was repaid on October 9, 2012 and $10.0 million has an expected final payment date of August 1, 2013 and a legal maturity date of August 1, 2031.

CAPITAL

Equity

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 on a graded basis.

During 2011, an employee benefit trust (the EBT) was established. HOMEQ funds the EBT with cash, which is used by a trustee to purchase common shares of HOMEQ on the open market. These shares will be held in trust by the trustee until the RSUs vest. Participants in the RSP receive additional RSUs as dividend equivalents, or additional common shares in the EBT, on dividends declared during the vesting period which will be paid at the vesting date. At September 30, 2012 there were 78,336 shares held by the EBT.

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 DSUs and paid upon retirement.

Until they vest, non-funded RSUs and DSUs do not trade on the TSX, have no voting rights and cannot be sold or liquidated early. The RSUs held in the EBT are voted following instructions from HOMEQ. Pursuant to the terms of the Arrangement Agreement, RSUs, DSUs and options held under the respective plans will be distributed, disposed and cancelled in exchange for a cash payment of $9.50.

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, 2012, 84,031 options were exercisable (September 30, 2011 – 27,333), of which none have been exercised. The Board of Directors has not granted any additional stock options under the Option and Share Appreciation Rights Plan in 2012.

The table below summarizes HOMEQ's share activity for the period ended September 30, 2012.

	Common Shares	Management Restricted Share Plan	Directors' Deferred Share Plan	Total number of shares
Balance, December 31, 2011	14,271,923	38,414	211,548	14,521,885
Restricted shares redeemed	30,408	(30,408)	—	—
Restricted share grants, net (1)	—	2,189	—	2,189
Deferred shares earned	—	—	17,729	17,729
Shares issued under DRIP	27,264	—	—	27,264
	14,329,595	10,195	229,277	14,569,067
Common shares held by the EBT	(78,336)	78,336	—	—
Balance, September 30, 2012	**14,251,259**	**88,531**	**229,277**	**14,569,067**

(1) includes RSUs on reinvested dividends

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 HomEquity 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 HomEquity 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, HomEquity Bank has implemented an Internal Capital Adequacy Assessment Process (ICAAP) based on HOMEQ's assessment of the business risks of HomEquity Bank. As a result of this process, HOMEQ has established the capital ratios of HomEquity Bank and has developed controls, mitigating actions and contingency plans to be enacted on the occurrence of pre-determined events.

HOMEQ intends to maintain its 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 unsecured subordinated debentures.

The table below summarizes HOMEQ's capital measures (relating solely to HomEquity Bank) as at September 30, 2012.

($ thousands)	**September 30 2012**	December 31 2011
Shareholders' equity per HomEquity Bank Consolidated Balance Sheet	**81,296**	76,760
Deductions	**507**	422
Tier 1 capital	**80,789**	76,338
Unsecured subordinated debt	**40,975**	40,975
Less: accumulated amortization for capital adequacy purposes	**10,000**	8,000
	30,975	32,975
Eligible general allowance	**3,313**	—
Tier 2 capital	**34,288**	32,975
Total regulatory capital	**115,077**	109,313
Credit risk	**633,006**	583,106
Off balance sheet exposure	**4,400**	6,454
Operational risk	**46,263**	43,987
Total risk-weighted assets	**683,699**	633,547
Capital ratios		
Tier 1 capital ratio	**11.8%**	12.1%
Total capital ratio	**16.8%**	17.3%
Assets-to-Capital multiple	**12.4x**	11.9x

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.

FINANCIAL INSTRUMENTS

In the normal course of business, HOMEQ uses derivative financial 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. HomEquity 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, HomEquity 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. HomEquity 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 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.

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, 2012 of $3.5 billion.

Net Interest Margin Risk

HOMEQ's operating margin is derived from the spread between interest earned on the mortgage portfolio and other liquid assets, and the interest paid on the deposits and debt used to fund the portfolio. Net interest margin 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 net interest margin percentage. 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 not being able to 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.

Capital Risk

The amount of capital required in relation to the size of HOMEQ's operations is determined by regulation and by the judgment of the Board and senior management.

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.

A risk exists that, as a result of the outcome of various occurrences, HOMEQ may find itself in a situation in which it no longer meets its capital requirements as determined by regulation and by the judgment of the Board and senior management. HOMEQ is a "small-cap" entity and trading volumes for its common shares are low. HOMEQ believes that this often results in a share price that does not adequately reflect its core business and results of operations. Issuing additional capital in the form new common stock at non-economically attractive terms may be dilutive to the book value per common share.

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 is developing and implementing a Legislative Compliance Management Framework in order to manage these risks.

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 period ended September 30, 2012, that have materially affected, or are reasonably likely to materially affect, HOMEQ's internal control over financial reporting.

ACCOUNTING POLICIES AND ESTIMATES

The significant accounting policies are outlined in Note 2 of the September 30, 2012 Interim Consolidated Financial Statements.

Changes in Significant Accounting Policies

There have been no changes in significant accounting policies during year other than as described below

Critical Accounting Estimates

HOMEQ's critical accounting estimates are outlined in Note 3 of the September 30, 2012 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

The following IFRS pronouncements have been issued but are not effective and may have a future impact on HOMEQ.

IAS 1 Presentation of Financial Statements

In June 2011, the IASB issued the revised IAS 1. The amendments may result in changes in the way Other Comprehensive Income is presented in the consolidated statements of comprehensive income. Revisions to IAS 1 are applicable to annual periods beginning on or after July 1, 2012, with early adoption permitted. Management is currently evaluating the potential impact IAS 1 will have on the presentation of the Company's consolidated financial statements.

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. In December 2011, the IASB issued further amendments to IFRS 7 which contain new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position or subject to master netting arrangements or similar arrangements. These amendments will not have an impact on the results of operations or financial position of the Company as they are only disclosure requirements.

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, 2015, with earlier application permitted.

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 IASB continues to deliberate on amendments to impairment and hedge accounting requirements. 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 HOMEQ as this standard does not change the entities consolidated as part of 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.

IAS 32, Offsetting Financial Assets and Financial Liabilities

In December 2011, the IASB issued amendments to IAS 32. The amendments are effective for annual periods beginning on or after January 1, 2014. The amendments clarify that an entity currently has a legally enforceable right to set-off if that right is 1) not contingent on a future event, and 2) enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. Management is currently assessing the potential impact the amendments would have on HOMEQ's consolidated financial statements.

OUTLOOK

HOMEQ's objective is to balance new mortgage origination and portfolio growth with increased profitability and improved ROE. To achieve this goal, it will focus on prudent management and control of net interest margin percentage, origination costs and overhead expenditure. It will also focus on all available alternatives to raise suitable amounts of equity at appropriate pricing.

HOMEQ expects that demand for reverse mortgages will remain firm. At the same time, the business is experiencing competition from recently introduced low priced conventional mortgages and secured lines of credit offered by other banks and financial institutions. The reduced rate of originations experienced in 2012 have had the effect of reducing the rate of portfolio growth, which in turn has had a detrimental effect on efficiency improvements and return on equity. HOMEQ believes its unique product type and growing customer base will again result in its meeting its objectives in the near future.

Summary of 2012 Objectives		
Measure	**Target**	**Actual Results for the nine months ending September 30, 2012**
Adjusted return on equity	10%	8.1% year to date
Growth in adjusted net income per share	Minimum 20% per annum	14% growth year over year
Growth in portfolio value	15% to 20% per annum	13% from September 30, 2011
Growth in mortgage originations	Average of 15% - 20% per annum	3% decline year to date
Origination cost %	Maximum 6%	5.8% year to date
Non-interest expense growth	Maximum 5% per annum	8% growth year over year (net of Transaction costs)

November 12, 2012

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