



**THIRD QUARTER REPORT 2008
MCAN MORTGAGE CORPORATION**

MCAN MORTGAGE CORPORATION

REPORT FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

This Management's Discussion and Analysis of Operations ("MD&A") should be read in conjunction with the interim unaudited consolidated financial statements and accompanying notes for the quarter ended September 30, 2008 and the audited consolidated financial statements, accompanying notes and MD&A for the year ended December 31, 2007. These items and additional continuous disclosure materials such as the Annual Information Form are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com and our website at www.mcanmortgage.com. Except as indicated below, all other factors discussed and referred to in the MD&A for fiscal 2007 remain substantially unchanged. Information has been presented as of November 6, 2008.

RESULTS OF OPERATIONS

MCAN Mortgage Corporation ("MCAN", the "Company" or "we") reported net income of \$10.4 million for the third quarter of 2008, up from \$3.1 million a year earlier. Earnings per share for the quarter were \$0.73 compared to \$0.21 last year. Net income for the nine months ended September 30, 2008 was \$20.4 million, up from \$11.7 million a year earlier, while earnings per share in the same period were \$1.44 compared to \$0.89 in 2007.

(in thousands, except for per share amounts)

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|---|--|----------|---|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net investment income | \$ 12,485 | \$ 4,083 | \$ 24,611 | \$ 14,667 |
| Operating expenses | 2,088 | 1,000 | 4,183 | 3,030 |
| Income before income taxes | 10,397 | 3,083 | 20,428 | 11,637 |
| Provision for (recovery of) income taxes and large corporation taxes | - | - | - | (26) |
| Net income | \$ 10,397 | \$ 3,083 | \$ 20,428 | \$ 11,663 |
| Basic and diluted earnings per share | \$ 0.73 | \$ 0.21 | \$ 1.44 | \$ 0.89 |
| Dividends per share | \$ 0.25 | \$ 0.23 | \$ 0.71 | \$ 0.77 |

The current turmoil in the general economy, and specifically in the financial and real estate markets, has impacted MCAN both positively and negatively. In our core spread business, decreases in the prime rate that have not been matched by corresponding decreases in the cost of our term deposits have compressed the spread on our mortgage portfolio, of which over 50% is floating rate (prime-based). However, the changing interest rate environment has had a positive impact on our participation in the Canada Mortgage Bonds ("CMB") program. Also, the market turmoil has created opportunities for us, in conjunction with MCAP Commercial LP ("MCLP"), to acquire portfolios from other lenders at favourable pricing, and the aggressive management of these portfolios resulted in significant incremental income in the third quarter. While the net result was a record for quarterly income and earnings per share, it must be cautioned that the primary contributing activities are significantly more volatile than our core activities.

Net Investment Income

(in thousands)

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|---------------------------------------|--|-----------------|---|------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Investment Income | | | | |
| Mortgage interest | \$ 9,742 | \$ 7,238 | \$ 24,786 | \$ 20,685 |
| Interest on loans and investments | 1,339 | 1,447 | 4,484 | 4,356 |
| Interest on cash and cash equivalents | 255 | 458 | 926 | 757 |
| Fees | 1,598 | 858 | 3,268 | 2,389 |
| Equity income from MCAP Commercial LP | 1,229 | 946 | 2,237 | 1,707 |
| Securitization income | 1,688 | (141) | 4,996 | 679 |
| Marketable securities | (104) | 40 | (97) | 951 |
| Gain on sale of mortgages | 3,475 | 15 | 3,475 | 20 |
| | 19,222 | 10,861 | 44,075 | 31,544 |
| Financial Expenses | | | | |
| Term deposit interest and expenses | 5,196 | 4,856 | 15,783 | 13,453 |
| Mortgage expenses | 805 | 888 | 2,647 | 2,621 |
| Provision for losses | 736 | 1,034 | 1,034 | 803 |
| | 6,737 | 6,778 | 19,464 | 16,877 |
| Net Investment Income | \$ 12,485 | \$ 4,083 | \$ 24,611 | \$ 14,667 |

Net investment income for the third quarter increased by \$8.4 million over 2007 and increased by \$9.9 million for the nine months ended September 30, 2008.

During the quarter, we realized \$1.6 million relating to the partial recovery of purchase price discounts on mortgages that we acquired. A further \$875,000 was earned under a profit sharing arrangement with MCLP, also relating to the partial recovery of purchase price discounts on mortgages that MCLP acquired.

Mortgage interest income for the quarter increased by \$2.5 million from the prior year. The average portfolio size increased by \$56 million as our additional capacity resulting from the rights offering completed in July 2007 was deployed. In addition, the average mortgage yield increased from 7.36% in 2007 to 8.62% in 2008. The increase of \$4.1 million for the nine months ended September 30, 2008 was a combination of a \$56 million increase in the average portfolio and an increase in the average mortgage yield from 7.26% to 7.54%.

The significant increase in yield in the third quarter was a result of higher effective yields on the mortgages in the acquired portfolios. The portion of the discount that we expect to recover is amortized into income over the remaining term of the respective mortgages. Upon the payout of a mortgage, the remaining unamortized discount is recognized as income. In the third quarter, payout volumes were significantly higher than anticipated.

The prime rate decreased by 1.50% for the twelve months ended September 30, 2008. This decrease has negatively impacted mortgage interest income, as approximately 56% of our mortgages at quarter end were floating rate loans. However, this negative impact has been more than offset by the higher effective yields on the mortgages in the acquired portfolios. Although we have been attempting to reduce our floating rate mortgage portfolio in 2008, it increased significantly in the quarter from 45% at June 30, 2008. We sold a significant portfolio of fixed rate mortgages to create capacity to fund the portfolio acquisitions, of which \$34 million were floating rate at quarter end.

Interest on loans and investments for the quarter and nine months ended September 30, 2008 was comparable to the prior year. A higher average balance in the current year was offset by a significantly lower average prime rate.

Fees increased by \$740,000 over the prior year, primarily due to fees paid by MCLP related to the profit sharing noted above. Fees also include construction commitment fees, which are amortized into income over the term of the related loans. Construction commitment fees earned in the quarter and year to date decreased slightly over 2007 due to a lower payout volume, despite a higher average construction loan balance.

Equity income from our ownership interest in MCLP was \$1.2 million in the quarter compared to \$946,000 in 2007. For the nine months ended September 30, 2008, equity income was \$2.2 million, up from \$1.7 million in 2007. In the third quarter, MCLP recognized significant income from its sharing in the income from the mortgages in the acquired portfolios, both on its own account and from MCAN. For the year to date, MCLP has also earned origination fees from large construction projects and significant income from its single-family operations.

MCAN securitizes insured residential mortgages through the CMB program. We recorded securitization income of \$1.7 million during the quarter, a significant increase from a loss of \$141,000 in the prior year. For the nine months ended September 30, 2008, we recorded securitization income of \$5.0 million, up from \$679,000 in 2007. In the current year, up-front gains from securitization have been significant as a result of wide interest rate spreads between mortgages and government bonds. The loss in the third quarter of 2007 was primarily due to write-downs of interest-only strips as a result of a change in permitted investments for CMB principal collections. Residual securitization income was significantly higher in the current year due to more outstanding CMB issuances.

At quarter end, we recorded a write-down of \$260,000 on the interest-only strips related to the March 2007 and June 2007 CMB issuances. Both issuances have had higher than anticipated principal repayment levels, which has decreased expected future cash flows as the assets in which we reinvest principal collections generally yield less than the securitized mortgages.

We sold our remaining income trust portfolio in the third quarter, resulting in a loss of \$107,000 for the quarter and the year to date. In the prior year, there were gains on sales of \$12,000 in the third quarter and \$667,000 for the year to date.

During the quarter, we earned \$3.5 million from sales of mortgages. These sales related primarily to the acquired portfolios.

Term deposit interest and expenses increased by \$340,000 during the quarter. There was an increase of \$54 million in the average outstanding balance as a result of increased capacity from the rights offering, partly offset by a decrease in the average term deposit interest rate to 4.29% in 2008 from 4.46% in 2007. The increase of \$2.3 million for the nine months ended September 30, 2008 is due to a \$54 million increase in the average outstanding balance and an increase in the average interest rate from 4.33% to 4.51%. The interest rate on new term deposits is relatively high as deposit rate decreases have not kept pace with the declines in the prime rate.

Mortgage expenses for the quarter and year to date are comparable to the prior year. Although our average mortgage portfolio increased significantly over 2007, the decrease in mortgage expenses from our construction loans (which have a higher servicing rate) was approximately equal to the increase in mortgage expenses from our single-family mortgages, which have a lower servicing rate.

In the third quarter of 2007, we recorded a \$700,000 write-down on an unrated subordinated loan investment in a securitization program which is subject to the proposed restructuring of Third Party ABCP by the Pan-Canadian Investors Committee (the "Montreal Accord"). The write-down was increased to \$794,000 at December 31, 2007. To protect our investment, we acquired the assets of that securitization program in the first quarter of 2008, which included \$4.1 million of commercial paper of a securitization program previously R1 (high) rated which is also subject to the Montreal Accord. We reversed the \$794,000 write-down previously taken on the unrated subordinated loan upon its repayment and recorded a write-down of \$1.2 million on the new commercial paper. We recorded an additional write-down of \$800,000 on the commercial paper in the third quarter of 2008 based on our current estimate of net realizable value. The Montreal Accord restructuring is now scheduled to be finalized by November 30, 2008, although this date has been extended several times.

Allowances for loan losses were decreased by \$64,000 during the quarter, which consisted of a reversal of mortgage provisions of \$106,000, new specific mortgage provisions of \$25,000 and new provisions of \$17,000 related to loans receivable and other investments. There was an increase in allowances of \$334,000 for the same period of 2007, which consisted of mortgage provisions of \$315,000 and provisions on loans receivable and other investments of \$19,000. The \$22 million increase in outstanding mortgages during the quarter consisted of a \$33 million increase in insured mortgages (against which no provisions are required) and an \$11 million decrease in uninsured mortgages, leading to a decrease in allowances. For the nine months ended September 30, 2008, allowances for loan losses were decreased by \$172,000 compared to an increase of \$103,000 in the prior year. Mortgage balances have increased by \$48 million for the year to date compared to a \$19 million increase in 2007.

The allowance for credit losses reduces the carrying value of mortgage assets to provide for an estimate of the principal amounts that borrowers may not repay in the future. In assessing the estimated realizable value of assets, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. A number of factors can affect the amount that we ultimately collect, including the quality of our underwriting process and credit criteria, the diversification of the portfolio, the underlying security relating to the loans and the overall economic environment. Specific allowances include all of the accumulated provisions for losses on particular assets required to reduce the related assets to estimated realizable value. The general allowance represents losses that we believe have been incurred but not yet specifically identified. Reserving rates depend on asset class, as different classes have varying underlying risks. Based on our best judgment, we believe that the general allowance is indicative of probable losses within the next two years based on current economic conditions and risk profile. However, future changes in circumstances could materially affect our future provisions for credit losses from those provisions determined in the current period, and there could be a need to increase or decrease the allowance for credit losses.

Impaired loans net of specific allowances were 0.89% at September 30, 2008 (\$4.3 million), compared to 0.93% (\$4.2 million) at June 30, 2008 and 0.61% (\$2.4 million) at September 30, 2007. We continue to proactively monitor loan arrears and take prudent steps to collect overdue accounts. Total mortgages past due but not impaired increased from \$18 million at June 30,

2008 to \$25 million at September 30, 2008. The increase is consistent with the general deterioration in the Canadian economy. There were no other assets in arrears at quarter end.

Write-offs were \$1,000 for the quarter, unchanged from \$1,000 in the prior year.

Operating Expenses

(in thousands)

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|----------------------------|--|-----------------|---|-----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Salaries and benefits | \$ 657 | \$ 425 | \$ 1,544 | \$ 1,367 |
| General and administrative | 1,431 | 575 | 2,639 | 1,663 |
| | \$ 2,088 | \$ 1,000 | \$ 4,183 | \$ 3,030 |

Operating expenses have increased significantly over the prior year for the quarter and nine months ended September 30, 2008, primarily due to incentives payable with respect to the acquisition of mortgage portfolios.

Income Taxes

(in thousands)

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|-------------------------------------|--|---------------|---|-----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Provision (recovery) against income | \$ - | \$ - | \$ - | \$ (26) |
| Charge to retained earnings | 2,797 | 167 | 4,722 | 1,053 |
| | \$ 2,797 | \$ 167 | \$ 4,722 | \$ 1,027 |

We have had a significant increase in our future taxes payable during 2008, which are charged directly to retained earnings. This is largely because year to date taxable income has been higher than the dividends which relate to that income. We pay no income tax on taxable income if it is paid out as dividends to our shareholders within 90 days of year end, and we generally make such distributions. In addition, there was an increase in the future tax liability that arises from the fair valuation of CMB interest rate swaps (when they are in an asset position) and the upfront gains on securitization from the CMB program.

Cash Flows

Operating activities provided cash flows of \$3.3 million in the quarter and provided \$6.5 million in the prior year. For the nine months ended September 30, 2008, operating activities provided cash flows of \$9.1 million compared to \$11 million provided in 2007. The decreases are a result of lower receivables in 2007.

Investing activities used cash flows of \$23 million in the quarter and used \$45 million in 2007 as a result of higher net mortgage fundings in 2007. Investing activities used cash flows of \$51 million for the nine months ended September 30, 2008 and used \$16 million last year. Net mortgage advances were higher in the current year, and there were \$12 million of marketable securities sales in 2007.

Financing activities provided \$25 million of cash in the quarter and provided \$76 million in 2007. For the nine months ended September 30, 2008, financing activities provided cash flows of \$8 million and provided \$37 million last year. Both decreases are a result of higher net term deposit advances in the prior year plus the funds received from the rights offering.

Selected Quarterly Financial Data

(in thousands, except for per share amounts)

| | 2006 | | 2007 | | | 2008 | | |
|---|---------|---------|---------|---------|---------|---------|---------|----------|
| | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| Net investment income | \$6,232 | \$5,444 | \$5,140 | \$4,083 | \$4,259 | \$6,064 | \$6,062 | \$12,485 |
| Operating expenses | 1,080 | 1,075 | 955 | 1,000 | 1,079 | 922 | 1,173 | 2,088 |
| Income before income taxes | 5,152 | 4,369 | 4,185 | 3,083 | 3,180 | 5,142 | 4,889 | 10,397 |
| Provision for (recovery of) income taxes and large corporations taxes | (54) | (24) | (2) | - | - | - | - | - |
| Net income | \$5,206 | \$4,393 | \$4,187 | \$3,083 | \$3,180 | \$5,142 | \$4,889 | \$10,397 |
| Basic and diluted earnings per share | \$0.42 | \$0.35 | \$0.33 | \$0.21 | \$0.23 | \$0.36 | \$0.35 | \$0.73 |
| Dividends per share | | | | | | | | |
| Regular | \$0.21 | \$0.19 | \$0.23 | \$0.23 | \$0.23 | \$0.12 | \$0.23 | \$0.25 |
| Capital gains | - | 0.12 | - | - | - | 0.11 | - | - |
| Total | \$0.21 | \$0.31 | \$0.23 | \$0.23 | \$0.23 | \$0.23 | \$0.23 | \$0.25 |

The fourth quarter of 2006 had significant gains on sales of marketable securities and substantial equity income from MCLP, whose income can be volatile. Quarterly income in the first two quarters of 2007 was higher than previous quarters due to increased interest income from higher mortgage and loan portfolios and securitization income from the CMB program. The third quarter of 2007 was significantly lower due to the write-down of securitization investments and the loss from the CMB program, while the fourth quarter of 2007 had a significant equity loss from MCLP due to write-downs taken on its securitization programs. The first half of 2008 was comparable to the first two quarters of 2007, but with higher securitization income. The third quarter of 2008 had substantially higher net income than previous quarters due to significant income from the sale of mortgages and income earned as a result of the portfolio acquisitions noted above.

FINANCIAL POSITION

As of September 30, 2008, total consolidated assets were \$588 million, an increase of \$36 million from June 30, 2008.

Assets

| (in thousands) | September 30, 2008 | | June 30, 2008 | | December 31, 2007 | |
|---------------------------|--------------------|---------------|-------------------|---------------|-------------------|---------------|
| Cash and cash equivalents | \$ 20,764 | 3.5% | \$ 14,993 | 2.7% | \$ 53,804 | 9.7% |
| Mortgages | 460,428 | 78.3 | 438,656 | 79.5 | 412,685 | 74.0 |
| Loans and investments | 78,778 | 13.4 | 75,543 | 13.7 | 71,286 | 12.8 |
| Equity investment in MCLP | 19,331 | 3.3 | 18,103 | 3.3 | 17,095 | 3.1 |
| Marketable securities | - | - | 109 | - | 156 | - |
| Other assets | 8,491 | 1.5 | 4,608 | 0.8 | 2,399 | 0.4 |
| | \$ 587,792 | 100.0% | \$ 552,012 | 100.0% | \$ 557,425 | 100.0% |

Cash increased by \$6 million during the quarter. We manage our cash and cash equivalents in the \$20 to \$30 million range. Although the quarter-end balance was only \$21 million, we have recently been maintaining our cash balances at the higher end of this range to maintain high liquidity levels given current market conditions.

Mortgages increased by \$22 million in the quarter, primarily due to increases of \$22 million in insured single-family mortgages, \$16 million in residential construction loans and \$4 million in commercial mortgages, partially offset by a decrease of \$17 million in uninsured single-family mortgages.

As at September 30, 2008, the Company continues to hold discounted mortgages with an aggregate discount of \$36 million. We are entitled to 50% of any recoveries of that amount, and we pay the remaining 50% to MCLP. The amount of the discount ultimately recovered is dependent on the value of the real estate securing the mortgage, as well as the financial capacity of the borrower. Additionally, these mortgages have maturity dates ranging from two years for the fixed rate mortgages to 23 years for the floating rate mortgages. As such, it is difficult to accurately estimate the timing and quantum of the discount ultimately recovered. However, we do expect that material amounts will be realized over the next few years.

MCAN has no exposure to the United States mortgage market. We invest in insured and uninsured single-family mortgages in Canada, which are lower risk than United States sub-prime mortgages. The uninsured mortgages may not exceed 80% of the value of the real estate securing such loans ("LTV") at the time of funding.

Loans and investments increased by \$3 million, primarily due to a new investment with a private investor during the quarter. The CMB interest-only strips, which are retained interests in the securitized mortgages consisting of the discounted value of future mortgage interest and principal reinvestment interest receipts less coupon interest payments, decreased by \$1.9 million during the quarter. The interest-only strips increase (decrease) in value as cash is paid (received). During the quarter, we recognized a new interest-only strip of \$1.7 million upon the closing of this quarter's issuance, however this increase was more than offset by a \$3.1 million downward adjustment in the fair value and a \$260,000 write-down of the interest-only strips. The quarter end balance includes \$2.6 million of non bank-sponsored securitization investments that are subject to the Montreal Accord.

Our equity investment in MCLP increased by \$1.2 million, representing equity income for the quarter.

Liabilities and Shareholders' equity

(in thousands)

| | September 30 2008 | June 30 2008 | Increase (Decrease) | December 31 2007 |
|---|----------------------|-------------------|------------------------|---------------------|
| Liabilities | | | | |
| Term deposits | \$ 466,018 | \$ 437,255 | \$ 28,763 | \$ 445,368 |
| Accounts payable and accrued charges | 9,432 | 5,357 | 4,075 | 8,089 |
| Future taxes payable | 3,585 | 3,358 | 227 | 961 |
| | 479,035 | 445,970 | 33,065 | 454,418 |
| Shareholders' equity | | | | |
| Share capital | 97,493 | 97,337 | 156 | 96,370 |
| Contributed surplus | 510 | 510 | - | 510 |
| Retained earnings | 12,286 | 8,238 | 4,048 | 6,654 |
| Accumulated other comprehensive income (loss) | (1,532) | (43) | (1,489) | (527) |
| | 108,757 | 106,042 | 2,715 | 103,007 |
| | \$ 587,792 | \$ 552,012 | \$ 35,780 | \$ 557,425 |

Term deposits increased by \$29 million during the quarter. To fund our investment operations, we issue term deposits that are insured pursuant to the standard terms of coverage set out by the Canada Deposit Insurance Corporation. We do not use capital markets (including asset-backed commercial paper) for liquidity.

Share capital increased by \$156,000, which was raised through the dividend reinvestment plan for the September 30, 2008 dividend.

Retained earnings increased by \$4.0 million during the quarter. The increase was a result of quarterly income of \$10.4 million, partially offset by the third quarter dividend of \$3.6 million and a charge to retained earnings of \$2.8 million relating to current and future income taxes.

Accumulated other comprehensive income (loss) represents the changes in unrealized gains or losses (net of taxes) on available for sale financial assets and cash flow hedges. The change in the quarter is due to a significant decrease in the value of available for sale CMB interest-only strips as a result of a decrease in expected future interest rates. In addition, there was a decrease in the fair value adjustment of fixed-rate mortgages due to an increase in market rates during the quarter. The decrease in the fair value of the interest-only strips was offset by an increase in the fair value of the CMB interest rate swaps, which are used to hedge interest rate risk on the interest-only strips. The change in the fair value of the interest rate swaps is recognized through income.

CONTRACTUAL OBLIGATIONS

We have contractual obligations to make principal and interest payments on term deposits and an operating lease. In addition, we have outstanding commitments for future fundings of mortgages intended for our own portfolio, almost all of which relate to floating rate residential construction loans. Historically, our construction portfolio has an average ratio of total outstanding loan balances to total outstanding commitments of 50%.

As part of the CMB program, we are required to pay servicing expenses on the securitized mortgages and other ongoing costs.

| (in thousands) | Less than one year | One to five years | Over five years | Total |
|-------------------|-----------------------|----------------------|--------------------|-------------------|
| Term deposits | \$ 438,366 | \$ 27,652 | \$ - | \$ 466,018 |
| Operating lease | 148 | 443 | - | 591 |
| Mortgage fundings | 81,038 | - | - | 81,038 |
| CMB obligations | 591 | 1,566 | - | 2,157 |
| | \$ 520,143 | \$ 29,661 | \$ - | \$ 549,804 |

CHANGES IN ACCOUNTING POLICY

On January 1, 2008, we adopted the new accounting standards of the Canadian Institute of Chartered Accountants ("CICA") as follows: *Capital Disclosures*, *Financial Instruments - Disclosures* and *Financial Instruments - Presentation*. For further details, refer to Note 2 to the consolidated financial statements.

FUTURE CHANGES IN ACCOUNTING POLICY

For the fiscal year commencing January 1, 2011, we will cease to use Canadian generally accepted accounting principles ("GAAP") and will adopt International Financial Reporting Standards ("IFRS"). The impact of the transition to IFRS on our consolidated financial statements is not yet determinable.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure Controls and Procedures

Company management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings) as of September 30, 2008 and has concluded that such disclosure controls and procedures are effective.

Internal Control over Financial Reporting

During the interim period ended September 30, 2008, the Company did not make any changes in its internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

OUTLOOK

The continuing disruption in debt markets has afforded us with opportunities to acquire mortgages on a profitable basis. While these transactions are opportunistic and cannot necessarily be planned, we expect that the disruption in debt markets will not materially improve for several months, and as such future opportunities may present themselves. We plan to retain investment capacity so that we can take advantage of these opportunities.

Decreases in the prime rate during 2008 are expected to have an adverse effect on net investment income over the next several quarters. Subsequent to quarter end, the prime rate decreased by 0.75%. New term deposit funding rates have not decreased to this extent, which will continue to compress spread income in the near term. With the exception of the floating rate mortgages purchased as part of the portfolio acquisitions, we have increased our fixed rate mortgage portfolio and decreased our floating rate mortgage portfolio in 2008 in order to minimize this compression. We are generally targeting fixed rate mortgages, rather than floating rate mortgages. Higher profitability from the CMB program and the acquired portfolios has more than offset the reduction in spread income. As a result, we remain optimistic about our income prospects for the remainder of the year. Subsequent to the end of the quarter, we earned approximately \$1.9 million from the sale of mortgages.

Slower economic activity has moderated housing market activity, compared to last year, and this is expected to continue for the balance of the year. While the credit environment is also less favourable than it was last year, the Canadian residential property market continues to exhibit stable fundamentals.

The disruption in debt markets has not yet resolved itself and this could be several months away. This disruption has not affected the capital or liquidity of the Company.

DIVIDENDS

The Board of Directors declared a fourth quarter dividend of \$0.25 per share to be paid January 2, 2009 to shareholders of record as of December 15, 2008.

We expect to pay a special dividend on March 31, 2009 in addition to the regular March 31, 2009 dividend that is sufficient to fully offset 2008 taxable income. Based on results to September 30, 2008, we expect to pay a special dividend of approximately \$0.20, but this special dividend will be revised subject to fourth quarter results.



Blaine Welch
President and Chief Executive Officer



Tammy Oldenburg
Vice President and Chief Financial Officer

This report may contain forward-looking statements, including statements regarding the business and anticipated financial performance of the Company. These forward looking statements can generally be identified as such because of the context of the statements and often include words such as the Company "believes", "anticipates", "expects", "plans", "estimates" or words of a similar nature. These statements are based on current expectations, and are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause such differences include legislative or regulatory developments, competition, technology change, global market activity, interest rates, changes in government and economic policy and general economic conditions in geographic areas where the Company operates. Reference is made to the risk factors disclosed in the Company's 2008 Annual Information Form, which are incorporated herein by reference. These and other factors should be considered carefully and undue reliance should not be placed on the Company's forward-looking statements. Subject to applicable securities law requirements, we do not undertake to update any forward-looking statements.

Notice required under National Instrument 51-102, "Continuous Disclosure Obligations," Part 4.3 (3)(a).

The accompanying consolidated interim financial statements of MCAN have not been reviewed by an auditor.

The Company is in compliance with the interim Management's Discussion and Analysis of Operations requirements set out by National Instrument 51-102.

CONSOLIDATED BALANCE SHEETS
(Unaudited) (dollars in thousands)

| As at | Note | September 30 2008 | December 31 2007 | September 30 2007 |
|---|------|----------------------|---------------------|----------------------|
| Assets | | | | |
| Investments | | | | |
| Cash and cash equivalents | | \$ 20,764 | \$ 53,804 | \$ 49,723 |
| Mortgages | 3 | 460,428 | 412,685 | 414,741 |
| Loans and investments | 5 | 78,778 | 71,286 | 63,359 |
| Equity investment in MCAP Commercial LP | | 19,331 | 17,095 | 17,911 |
| Marketable securities | | - | 156 | 175 |
| | | 579,301 | 555,026 | 545,909 |
| Other assets | | 8,491 | 2,399 | 2,191 |
| | | \$ 587,792 | \$ 557,425 | \$ 548,100 |
| Liabilities and Shareholders' Equity | | | | |
| Liabilities | | | | |
| Term deposits | | \$ 466,018 | \$ 445,368 | \$ 437,427 |
| Accounts payable and accrued charges | | 9,432 | 8,089 | 5,589 |
| Future taxes payable | | 3,585 | 961 | 1,595 |
| | | 479,035 | 454,418 | 444,611 |
| Shareholders' Equity | | | | |
| Share capital | 6 | 97,493 | 96,370 | 96,059 |
| Contributed surplus | | 510 | 510 | 510 |
| Retained earnings | | 12,286 | 6,654 | 6,536 |
| Accumulated other comprehensive income (loss) | | (1,532) | (527) | 384 |
| | | 108,757 | 103,007 | 103,489 |
| | | \$ 587,792 | \$ 557,425 | \$ 548,100 |

See accompanying notes

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited) (dollars in thousands except for per share amounts)

| For the Quarters Ended September 30 | Note | 2008 | 2007 |
|---|------|------------------|-----------------|
| Investment Income | | | |
| Mortgage interest | | \$ 9,742 | \$ 7,238 |
| Interest on loans and investments | | 1,339 | 1,447 |
| Interest on cash and cash equivalents | | 255 | 458 |
| Fees | | 1,598 | 858 |
| Equity income from MCAP Commercial LP | | 1,229 | 946 |
| Securitization income | 4 | 1,688 | (141) |
| Marketable securities | | (104) | 40 |
| Gain on sale of mortgages | | 3,475 | 15 |
| | | 19,222 | 10,861 |
| Financial Expenses | | | |
| Term deposit interest and expenses | | 5,196 | 4,856 |
| Mortgage expenses | | 805 | 888 |
| Provision for losses | | 736 | 1,034 |
| | | 6,737 | 6,778 |
| Net Investment Income | | 12,485 | 4,083 |
| Operating Expenses | | | |
| Salaries and benefits | | 657 | 425 |
| General and administrative | | 1,431 | 575 |
| | | 2,088 | 1,000 |
| Income Before Income Taxes | | 10,397 | 3,083 |
| Provision for (recovery of) income taxes and large corporations taxes | | - | - |
| Net Income | | \$ 10,397 | \$ 3,083 |
| Basic and diluted earnings per share | | \$ 0.73 | \$ 0.21 |
| Dividends per share | | \$ 0.25 | \$ 0.23 |
| Weighted average number of basic and diluted shares (000's) | | 14,207 | 14,004 |

See accompanying notes

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited) (dollars in thousands except for per share amounts)

| For the Nine Months Ended September 30 | Note | 2008 | 2007 |
|---|-------------|------------------|------------------|
| Investment Income | | | |
| Mortgage interest | | \$ 24,786 | \$ 20,685 |
| Interest on loans and investments | | 4,484 | 4,356 |
| Interest on cash and cash equivalents | | 926 | 757 |
| Fees | | 3,268 | 2,389 |
| Equity income from MCAP Commercial LP | | 2,237 | 1,707 |
| Securitization income | 4 | 4,996 | 679 |
| Marketable securities | | (97) | 951 |
| Gain on sale of mortgages | | 3,475 | 20 |
| | | 44,075 | 31,544 |
| Financial Expenses | | | |
| Term deposit interest and expenses | | 15,783 | 13,453 |
| Mortgage expenses | | 2,647 | 2,621 |
| Provision for losses | | 1,034 | 803 |
| | | 19,464 | 16,877 |
| Net Investment Income | | 24,611 | 14,667 |
| Operating Expenses | | | |
| Salaries and benefits | | 1,544 | 1,367 |
| General and administrative | | 2,639 | 1,663 |
| | | 4,183 | 3,030 |
| Income Before Income Taxes | | 20,428 | 11,637 |
| Provision for (recovery of) income taxes and large corporations taxes | | - | (26) |
| Net Income | | \$ 20,428 | \$ 11,663 |
| Basic and diluted earnings per share | | \$ 1.44 | \$ 0.89 |
| Dividends per share | | \$ 0.71 | \$ 0.77 |
| Weighted average number of basic and diluted shares (000's) | | 14,181 | 13,039 |

See accompanying notes

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited) (dollars in thousands)

| For the Quarters Ended September 30 | 2008 | 2007 |
|---|-------------------|-------------------|
| Share capital | | |
| Balance, beginning of period | \$ 97,337 | \$ 79,724 |
| Common shares issued | 156 | 16,335 |
| Balance, end of period | 97,493 | 96,059 |
| Contributed surplus | | |
| Balance, beginning of period | 510 | 510 |
| Changes to contributed surplus | - | - |
| Balance, end of period | 510 | 510 |
| Retained earnings | | |
| Balance, beginning of period | 8,238 | 6,856 |
| Net income | 10,397 | 3,083 |
| Income taxes charged to retained earnings | (2,797) | (167) |
| Dividends declared | (3,552) | (3,236) |
| Balance, end of period | 12,286 | 6,536 |
| Accumulated other comprehensive income | | |
| Balance, beginning of period | (43) | (401) |
| Other comprehensive income (loss) | (1,489) | 785 |
| Balance, end of period | (1,532) | 384 |
| Total shareholders' equity | \$ 108,757 | \$ 103,489 |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited) (dollars in thousands)

| For the Quarters Ended September 30 | 2008 | 2007 |
|---|-----------------|-----------------|
| Net income | \$ 10,397 | \$ 3,083 |
| Other comprehensive income (loss), net of income taxes | | |
| Change in unrealized gain on available for sale marketable securities | (36) | (39) |
| Transfer of losses on sale of marketable securities to net income | 108 | 6 |
| Change in unrealized gain on available for sale mortgages | (716) | 633 |
| Change in unrealized gain on available for sale loans and investments | (847) | (27) |
| Change in cash flow hedges | 2 | 212 |
| Other comprehensive income (loss) | (1,489) | 785 |
| Comprehensive income | \$ 8,908 | \$ 3,868 |

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited) (dollars in thousands)

| For the Nine Months Ended September 30 | 2008 | 2007 |
|---|-------------------|-------------------|
| Share capital | | |
| Balance, beginning of period | \$ 96,370 | \$ 78,211 |
| Common shares issued | 1,123 | 17,848 |
| Balance, end of period | 97,493 | 96,059 |
| Contributed surplus | | |
| Balance, beginning of period | 510 | 510 |
| Changes to contributed surplus | - | - |
| Balance, end of period | 510 | 510 |
| Retained earnings | | |
| Balance, beginning of period | 6,654 | 5,890 |
| Net income | 20,428 | 11,663 |
| Income taxes charged to retained earnings | (4,722) | (1,053) |
| Dividends declared | (10,074) | (9,964) |
| Balance, end of period | 12,286 | 6,536 |
| Accumulated other comprehensive income | | |
| Balance, beginning of period | (527) | 1,261 |
| Other comprehensive income (loss) | (1,005) | (877) |
| Balance, end of period | (1,532) | 384 |
| Total shareholders' equity | \$ 108,757 | \$ 103,489 |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited) (dollars in thousands)

| For the Nine Months Ended September 30 | 2008 | 2007 |
|---|------------------|------------------|
| Net income | \$ 20,428 | \$ 11,663 |
| Other comprehensive income (loss), net of income taxes | | |
| Change in unrealized gain on available for sale marketable securities | (74) | (77) |
| Transfer of losses (gains) on sale of marketable securities to net income | 108 | (549) |
| Change in unrealized gain on available for sale mortgages | 782 | (382) |
| Change in unrealized gain on available for sale loans and investments | (1,827) | 171 |
| Change in cash flow hedges | 6 | (40) |
| Other comprehensive income (loss) | (1,005) | (877) |
| Comprehensive income | \$ 19,423 | \$ 10,786 |

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (dollars in thousands)

| For the Quarters Ended September 30 | 2008 | 2007 |
|--|------------------|------------------|
| Cash Provided by (used for): | | |
| Operating Activities | | |
| Net income | \$ 10,397 | \$ 3,083 |
| Adjusted for non-cash items: | | |
| Equity income | (1,232) | (931) |
| Provision for losses | 706 | 1,014 |
| Securitization income | (970) | 163 |
| Amortization of other assets | 287 | 144 |
| Amortization of mortgage discounts | (1,622) | - |
| Gain on sale of mortgages | (3,475) | (15) |
| Distributions from MCAP Commercial LP | - | 250 |
| Decrease (increase) in accounts receivable | (788) | 2,824 |
| Decrease in accounts payable and accrued charges | (45) | (77) |
| Cash flows from operating activities | 3,258 | 6,455 |
| Investing Activities | | |
| Mortgage advances | (652,796) | (805,206) |
| Mortgage reductions | 86,316 | 120,038 |
| Proceeds on sale of mortgages | 549,878 | 649,637 |
| Increase in loans and investments | (5,438) | (10,336) |
| Additions to other assets | (1,043) | (102) |
| Marketable securities | 229 | 539 |
| Cash flows for investing activities | (22,854) | (45,430) |
| Financing Activities | | |
| Issue of term deposits | 205,874 | 275,183 |
| Repayment of term deposits | (177,111) | (215,531) |
| Issue of common shares | 156 | 16,335 |
| Dividends paid | (3,552) | - |
| Cash flows from financing activities | 25,367 | 75,987 |
| Increase in cash and cash equivalents | 5,771 | 37,012 |
| Cash and cash equivalents, beginning of period | 14,993 | 12,711 |
| Cash and cash equivalents, end of period | \$ 20,764 | \$ 49,723 |

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (dollars in thousands)

| For the Nine Months Ended September 30 | 2008 | 2007 |
|--|------------------|------------------|
| Cash Provided by (used for): | | |
| Operating Activities | | |
| Net income | \$ 20,428 | \$ 11,663 |
| Adjusted for non-cash items: | | |
| Equity income | (2,228) | (1,692) |
| Provision for losses | 1,004 | 833 |
| Securitization income | (3,945) | (649) |
| Amortization of other assets | 740 | 507 |
| Amortization of mortgage discounts | (1,644) | - |
| Gain on sale of mortgages | (3,475) | (20) |
| Distributions from MCAP Commercial LP | - | 1,135 |
| Increase in accounts receivable | (369) | (256) |
| Decrease in accounts payable and accrued charges | (1,378) | (360) |
| Cash flows from operating activities | 9,133 | 11,161 |
| Investing Activities | | |
| Mortgage advances | (2,037,086) | (1,904,298) |
| Mortgage reductions | 270,321 | 313,430 |
| Proceeds on sale of mortgages | 1,722,762 | 1,569,456 |
| Increase in loans and investments | (5,408) | (6,160) |
| Additions to other assets | (1,448) | (1,009) |
| Marketable securities | 229 | 12,244 |
| Cash flows for investing activities | (50,630) | (16,337) |
| Financing Activities | | |
| Issue of term deposits | 485,557 | 504,973 |
| Repayment of term deposits | (464,907) | (476,280) |
| Issue of common shares | 1,123 | 17,848 |
| Dividends paid | (13,316) | (9,327) |
| Cash flows from financing activities | 8,457 | 37,214 |
| Increase (decrease) in cash and cash equivalents | (33,040) | 32,038 |
| Cash and cash equivalents, beginning of period | 53,804 | 17,685 |
| Cash and cash equivalents, end of period | \$ 20,764 | \$ 49,723 |

1. Basis of Presentation

MCAN Mortgage Corporation (the “Company” or “MCAN”) is a Loan Company under the Trust and Loan Companies Act (the “Trust Act”) and a Mortgage Investment Corporation (“MIC”) under the Income Tax Act (Canada) (the “Tax Act”).

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The Company’s 22.0% partnership interest in MCAP Commercial LP (“MCLP”) is accounted for using the equity method. MCAN holds a 25% voting interest in MCLP.

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and follow the same accounting policies and methods of application as the Company’s consolidated financial statements for the year ended December 31, 2007. Under GAAP, additional disclosures are required in the annual financial statements and accordingly, these interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2007 and the accompanying notes included on pages 18 to 36 of the Company’s 2007 Annual Report. The interim consolidated financial statements include all adjustments, which are, in the opinion of management, necessary for a fair presentation of the results for the periods presented.

2. Changes in Accounting Policy

On January 1, 2008, the Company adopted the new accounting standard of the Canadian Institute of Chartered Accountants (“CICA”), *Capital Disclosures*, which requires the disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the entity’s objectives, policies and processes for managing capital.

On January 1, 2008, the Company adopted the new standards of the CICA, *Financial Instruments - Disclosures* and *Financial Instruments - Presentation*, which enhance the abilities of users of financial statements to evaluate the significance of financial instruments to an entity, related exposures and the management of these risks.

3. Mortgages

| As at September 30 | Principal | Allowance | 2008 Net | 2007 Net |
|---|-------------------|------------------|---------------------|---------------------|
| Single-family mortgages | | | | |
| - Uninsured | \$ 171,210 | \$ 980 | \$ 170,230 | \$ 123,146 |
| - Uninsured (completed inventory loans) | 25,884 | 247 | 25,637 | 32,369 |
| - Insured | 49,812 | - | 49,812 | 32,533 |
| Construction loans | | | | |
| - Residential | 177,622 | 1,596 | 176,026 | 190,999 |
| - Non-residential | 7,644 | 69 | 7,575 | 99 |
| Commercial | 28,615 | 134 | 28,481 | 32,998 |
| | 460,787 | 3,026 | 457,761 | 412,144 |
| Fair value adjustment | 415 | - | 415 | 344 |
| | 461,202 | 3,026 | 458,176 | 412,488 |
| Accrued interest | 2,252 | - | 2,252 | 2,253 |
| | \$ 463,454 | \$ 3,026 | \$ 460,428 | \$ 414,741 |

MCAN has no exposure to the United States mortgage market. The Company invests in insured and uninsured single-family mortgages in Canada, which are lower risk than United States sub-prime mortgages. The uninsured mortgages may not exceed 80% of the value of the real estate securing such loans at the time of funding. Residential mortgages insured by Canada Mortgage and Housing Corporation or Genworth Financial Mortgage Insurance Company Canada may exceed this ratio.

Uninsured completed inventory loans are credit facilities extended to provide interim mortgage financing on fully completed residential units (condominium or freehold).

Residential construction loans are made to homebuilders to finance residential construction projects.

Commercial loans include commercial term mortgages and high ratio mortgage loans.

Principal balances presented above are net of the unamortized discount on the Company’s portfolio of single-family mortgages purchased at a discount. As at September 30, 2008, the Company continues to hold discounted mortgages with

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an aggregate discount of \$35,770 and is entitled to 50% of any recoveries of that amount. The amount of the discount ultimately recovered is dependent on the value of the real estate securing the mortgage, as well as the financial capacity of the borrower. Additionally, these mortgages have maturity dates ranging from two years for the fixed rate mortgages to 23 years for the floating rate mortgages. As such, it is difficult to accurately estimate the timing and quantum of the discount ultimately recovered. However, the Company expects that material amounts will be realized over the next few years.

An allowance for mortgage loan losses, consisting of specific and general provisions, is maintained at a level that, in management's judgment, is adequate to absorb all credit related losses in the Company's portfolio. Specific provisions include all of the accumulated provisions for losses on particular assets required to reduce the related assets to estimated realizable value. The general provision includes provisions for losses which are considered to have occurred but cannot be determined on an item-by-item basis.

The allowance is increased by provisions for losses, which are charged against income, and reduced by write-offs, net of recoveries. Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further collection is considered to be remote.

In management's judgment, no abnormal credit risk exists and the levels of loan loss provisions are adequate to absorb all expected credit related losses in the Company's portfolio, given existing conditions.

The geographical breakdown of mortgages by province is as follows:

| As at September 30 | 2008 | | 2007 | |
|---------------------------|-------------------|---------------|-------------------|---------------|
| Ontario | \$ 179,055 | 38.9% | \$ 196,944 | 47.5% |
| Alberta | 158,097 | 34.3 | 116,446 | 28.1 |
| British Columbia | 93,345 | 20.3 | 65,301 | 15.7 |
| Other | 29,931 | 6.5 | 36,050 | 8.7 |
| | \$ 460,428 | 100.0% | \$ 414,741 | 100.0% |

Outstanding commitments for future fundings of mortgages intended for the Company's portfolio are \$81,038 at September 30, 2008 (2007 - \$117,796). Substantially all of these commitments relate to floating rate residential construction loans. Historically, the Company's construction portfolio has an average ratio of total outstanding loan balances to total outstanding commitments of 50%.

The details of the mortgage allowances are as follows:

| | General | Specific | 2008 Total | General | Specific | 2007 Total |
|--------------------------------|-----------------|-----------------|-----------------------|-----------------|-----------------|-----------------------|
| Balance, beginning of quarter | \$ 3,061 | \$ 47 | \$ 3,108 | \$ 3,391 | \$ - | \$ 3,391 |
| Provisions (recoveries) | (106) | 25 | (81) | 315 | - | 315 |
| Write-offs | (1) | - | (1) | (1) | - | (1) |
| Balance, end of quarter | \$ 2,954 | \$ 72 | \$ 3,026 | \$ 3,705 | \$ - | \$ 3,705 |

Mortgages past due but not impaired at September 30, 2008 are as follows:

| | 1 to 30 days | 31 to 60 days | 61 to 90 days | Over 90 days | Total |
|---------------------------|-------------------------|--------------------------|--------------------------|-------------------------|------------------|
| Single-family - uninsured | \$ 10,111 | \$ 7,803 | \$ 6,047 | \$ - | \$ 23,961 |
| Single-family - insured | 842 | 109 | - | - | 951 |
| | \$ 10,953 | \$ 7,912 | \$ 6,047 | \$ - | \$ 24,912 |

At September 30, 2008, the Company had \$4,344 of impaired loans (2007 - \$2,382), as follows: uninsured single-family (\$4,344, 2007 - \$1,352) and residential construction (\$nil, 2007 - \$1,030).

4. Securitization Income

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|--------------------------------|--|-----------------|---|---------------|
| | 2008 | 2007 | 2008 | 2007 |
| Gain on securitization | \$ 553 | \$ (249) | \$ 2,898 | \$ 528 |
| Residual securitization income | 1,135 | 108 | 2,098 | 151 |
| | \$ 1,688 | \$ (141) | \$ 4,996 | \$ 679 |

During the quarter, the Company securitized \$178,662 (2007 - \$305,511) of insured residential mortgages through the Canada Mortgage Bonds ("CMB") program. The Company participated in the securitization with MCAP Service Corporation ("MSC"). For the nine months ended September 30, 2008, the Company has securitized \$737,869 (2007 - \$727,946) of mortgages.

Upon sale, the Company recognized an interest-only strip of \$1,663 (2007 - \$1,847), which is a retained interest in the securitized mortgages, included in securitization investments (note 5). The Company's interest-only strips consist of the discounted value of future mortgage interest and principal reinvestment interest receipts less coupon interest payments. In addition, the Company established a liability for future mortgage servicing and other costs totalling \$227 (2007 - \$384) that is included in accounts payable and accrued charges. The Company subcontracts CMB servicing obligations to MSC. The total outstanding interest-only strips at September 30, 2008 were \$9,732 (2007 - \$3,501), while total outstanding CMB liabilities were \$1,949 (2007 - \$912).

At quarter-end, the Company recorded a write-down of \$260 on the interest-only strips related to the March 2007 and June 2007 CMB issuances. Both issuances have had higher than anticipated principal repayment levels, which has decreased expected future cash flows as the assets in which principal collections are reinvested generally yield less than the securitized mortgages.

Residual securitization income includes the yield earned on interest-only strips and the CMB liabilities, penalty income, refinancing and renewal gains, interest rate swap receipts (payments) and fair value changes in the interest rate swaps and interest-only strips classified as held for trading. Fair value changes had positive impacts of \$524 to income for the quarter and \$873 for the year to date.

The following table summarizes certain cash flows received from the CMB program.

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|---|--|------------|---|------------|
| | 2008 | 2007 | 2008 | 2007 |
| Proceeds from new securitizations | \$ 180,018 | \$ 306,252 | \$ 744,069 | \$ 728,447 |
| Net cash flows received on interest-only strips | \$ 503 | \$ 1,052 | \$ 1,459 | \$ 1,053 |

5. Loans and Investments

| | | 2008 | 2007 |
|--|-----|------------------|------------------|
| Securitization investments | (a) | \$ 37,207 | \$ 32,214 |
| Loans receivable and other investments | (b) | 41,571 | 31,145 |
| | | \$ 78,778 | \$ 63,359 |

(a) Securitization Investments

Investments in Securitization Programs

| As at September 30 | Principal | Allowance | 2008 Net | 2007 Net |
|--|------------------|------------------|---------------------|---------------------|
| Subordinated loans - residential mortgage securitization programs | \$ 7,881 | \$ - | \$ 7,881 | \$ 14,589 |
| Asset-backed commercial paper | 4,122 | 2,000 | 2,122 | - |
| Deferred purchase price receivable - residential construction mortgage loan securitization program | | | | |
| - senior position | 6,820 | - | 6,820 | 6,320 |
| - first loss position | 3,020 | - | 3,020 | 2,798 |
| Bonds - commercial securitization program | 458 | - | 458 | 458 |
| Bonds - residential mortgage securitization program | - | - | - | 343 |
| | \$ 22,301 | \$ 2,000 | \$ 20,301 | \$ 24,508 |

Of the investments in securitization programs, \$17,721 are invested in bank-sponsored securitization programs, while the remaining \$2,580 of these investments are non bank-sponsored, consisting of asset-backed commercial paper of \$2,122 and bonds of \$458.

At December 31, 2007, the Company had investments in a residential mortgage non bank-sponsored securitization program subject to the proposed restructuring of Third Party Structured Asset-Backed Commercial Paper (“ABCP”) by the Pan-Canadian Investors Committee (the “Montreal Accord”). The investments consisted of a \$2,010 subordinated loan (net of a \$794 allowance) and a \$342 investment in a bond rated A by Dominion Bond Rating Service (“DBRS”). To protect its investment, the Company purchased the assets of that securitization program, including \$4,122 of ABCP previously rated R1 (high) by DBRS from another securitization program subject to the Montreal Accord, which resulted in the repayment of the aforementioned securitization investments in full.

A write-down of \$1,200 was taken on the commercial paper in the first quarter. The Company recorded an additional write-down of \$800 the third quarter upon a decline in the Company’s current estimate of net realizable value. The Montreal Accord restructuring is now scheduled to be finalized by November 30, 2008, although this date has been extended several times.

Other Securitization Investments

| As at September 30 | 2008 | 2007 |
|---|------------------|------------------|
| CMB - interest-only strips | \$ 9,732 | \$ 3,501 |
| Insured mortgage-backed securities | 6,219 | 2,680 |
| Other securitization assets | 955 | 1,525 |
| | \$ 16,906 | \$ 7,706 |
| Total securitization investments | \$ 37,207 | \$ 32,214 |

(b) Loans Receivable and Other Investments

Loans receivable and other investments consist of loans to private entities and employees. At September 30, 2008, loans receivable and other investments was net of an allowance of \$296 (2007 - \$223).

6. Share Capital

The authorized share capital of the Company is unlimited common shares with no par value.

| Issued | Number of Shares | 2008 | Number of Shares | 2007 |
|-------------------------------|---------------------|------------------|---------------------|------------------|
| Balance, January 1 | 14,097,994 | \$ 96,370 | 12,372,939 | \$ 78,211 |
| Issued | | | | |
| Dividend reinvestment plan | 86,571 | 787 | 88,728 | 1,038 |
| Executive Share Purchase Plan | 38,941 | 336 | 45,791 | 526 |
| Rights offering | - | - | 1,559,981 | 16,380 |
| Share issue costs | - | - | - | (96) |
| Balance, September 30 | 14,223,506 | \$ 97,493 | 14,067,439 | \$ 96,059 |

As at November 6, 2008, the Company had 14,223,506 common shares outstanding. Shares are issued out of treasury for the dividend reinvestment plan and the Executive Share Purchase Plan at the average closing price for the 20 days preceding such issues.

7. Derivative Financial Instruments

As part of the CMB program, the Company enters into “pay-floating, receive-fixed” interest rate swaps. The purpose of these swaps is to hedge interest rate risk on the interest-only strips. The Company receives interest on reinvested CMB principal collections, the discounted future value of which is included in the interest-only strips. To September 30, 2007, the majority of the swaps were designated as cash flow hedges, wherein changes in fair value were recognized in accumulated other comprehensive income. However, the swaps qualifying as cash flow hedges were de-designated as of October 1, 2007, and now all changes in the fair value of the swaps are recognized to income.

The following chart outlines the Company’s derivative financial instruments by term to maturity:

| | Less than one year | One to five years | Over five years | 2008 Total | 2007 Total |
|--|-----------------------|----------------------|--------------------|---------------|---------------|
| CMB interest rate swaps - fair value | \$ - | \$ 5,422 | \$ - | \$ 5,422 | \$ 30 |
| CMB interest rate swaps - outstanding notional | \$ - | \$ 81,632 | \$ - | \$ 81,632 | \$ 770 |

The interest rate swaps are included in other assets if positive, and accounts payable and accrued liabilities if negative. Changes in the fair value of the swaps are included in residual securitization income.

8. Capital Management

The Company's primary capital management objectives are to maintain sufficient capital for regulatory purposes and to earn acceptable and sustainable risk weighted returns for shareholders. The Company typically pays out all of its taxable income by way of dividends, so capital growth is achieved through rights offerings and the dividend reinvestment plan.

The Company's capital management is driven by the guidelines set out by the Tax Act and the Superintendent of Financial Institutions Canada (“OSFI”). As a MIC under the Tax Act, the Company is limited to a liabilities to capital ratio of 5:1 (or an assets to capital ratio of 6:1), based on the non-consolidated balance sheet measured at its tax value. As a loan company under the Trust Act, the Company has been granted a maximum consolidated regulatory assets to capital ratio by OSFI. The Company manages its assets to a level of 5.75 times capital on a tax basis to provide a prudent cushion between its limit and total actual assets. The Company manages its capital to comply with the requirements of the MIC test and OSFI regulations at all times.

OSFI has issued a new regulatory capital management framework, Basel II, which was adopted by the Company effective January 1, 2008. The primary changes for the Company are revisions to the risk-weighting of certain assets and the calculation of regulatory capital. The Company has implemented the standardized approach to calculating risk-weighted assets for credit risk and the basic indicator approach for the calculation of operational risk. Basel II has not had a significant impact on the Company’s regulatory capital and risk-weighted assets.

Tier 1 capital includes common shares, contributed surplus, retained earnings and certain components of accumulated other comprehensive income. Tier 1 and Tier 2 capital are both reduced by 50% of unrated securitization exposures and Tier 1

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capital is reduced by a portion of gains on securitization. OSFI's target minimum Tier 1 and Total capital ratios for the Company are 7% and 10% respectively. The Company's target minimum Tier 1 and Total capital ratios are both 15%.

| As at September 30 | 2008 | 2007 |
|---|-------------|-------------|
| Tax Act Test | | |
| Income tax assets | \$ 579,406 | \$ 545,674 |
| Income tax capital | \$ 105,465 | \$ 103,046 |
| Income tax assets to capital ratio | 5.49 | 5.30 |
| Regulatory Tests (OSFI) | | |
| Tier 1 capital | | |
| Share capital | \$ 97,493 | \$ 96,059 |
| Contributed surplus | 510 | 510 |
| Retained earnings | 12,286 | 6,536 |
| Unrealized loss on available for sale marketable securities | - | (20) |
| Tier 1 capital deductions | (5,592) | - |
| | 104,697 | 103,085 |
| Tier 2 capital | | |
| Tier 2 capital deductions | (1,814) | - |
| | (1,814) | - |
| Deductions from total capital | - | (2,798) |
| Total capital | \$ 102,883 | \$ 100,287 |
| Total regulatory assets | \$ 595,681 | \$ 557,696 |
| Capital ratios | | |
| Tier 1 capital to risk-weighted assets ratio | 20.68% | 22.10% |
| Total capital to risk-weighted assets ratio | 20.32% | 21.50% |
| Assets to capital multiple | 5.79 | 5.56 |

The Company's capital positions were calculated based on Basel II as at September 30, 2008 and Basel I as at September 30, 2007. As of September 30, 2008, the Company was in compliance with the capital guidelines issued by OSFI under Basel II.

The Company's assets, analyzed on a risk-weighted basis, are as follows:

| As at September 30 | 2008 | | 2007 | |
|---|-------------------|-------------------|-------------------|-------------------|
| | Balance | Risk-Weighted | Balance | Risk-Weighted |
| On-Balance Sheet Assets | | | | |
| Cash and cash equivalents | \$ 20,764 | \$ 4,705 | \$ 49,723 | \$ 10,476 |
| Mortgages | 460,428 | 301,894 | 414,741 | 320,805 |
| Loans and investments | 78,778 | 83,869 | 61,834 | 56,386 |
| Equity investment in MCLP | 19,331 | 19,331 | 17,911 | 17,911 |
| Marketable securities | - | - | 175 | 175 |
| Other assets | 8,491 | 3,069 | 3,716 | 3,716 |
| | <u>\$ 587,792</u> | <u>\$ 412,868</u> | <u>\$ 548,100</u> | <u>\$ 409,469</u> |
| Off-Balance Sheet Assets | | | | |
| Letters of credit | | 6,267 | | 4,856 |
| Mortgage funding commitments | | 40,519 | | 52,102 |
| | | <u>46,786</u> | | <u>56,958</u> |
| Derivative Financial Instruments | | | | |
| Interest rate swaps | | 1,166 | | 7 |
| | | <u>45,438</u> | | <u>-</u> |
| Charge for operational risk | | | | |
| Total Risk-Weighted Assets | | \$ 506,258 | | \$ 466,434 |

9. Financial Instruments

The majority of the Company's consolidated balance sheet consists of financial instruments, and the majority of net income is derived from the related income, expenses, gains and losses. Financial instruments include cash and cash equivalents, marketable securities, mortgages, loans and investments, term deposits and derivative financial instruments.

Of the financial instruments carried on the consolidated balance sheet at fair value, only marketable securities are valued using published market prices quoted in active markets. All other financial instruments carried at fair value (mortgages, certain loans and investments and derivative financial instruments) are estimated using valuation techniques based on observable market data such as market interest rates currently charged for similar financial investments to expected maturity dates.

The various risks to which the Company is exposed as a result of the use of financial instruments are as follows:

Interest Rate Risk

Interest rate risk arises when principal and interest cash flows, both on and off balance sheet, have mismatched repricing and maturity dates. Interest rate risk, or sensitivity, is the potential impact of changes in interest rates on financial assets and liabilities.

The Company's interest rate risk management practices are included in note 16 to the 2007 consolidated financial statements.

An immediate and sustained 1% increase (decrease) to market interest rates at September 30, 2008 would have a positive (adverse) effect of \$1,261 (\$1,591 in 2007) to net investment income over the following twelve month period.

Credit Risk

Credit risk is the risk of financial loss resulting from the failure of a counterparty, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from the Company's mortgage and lending activities. Fluctuations in real estate values may increase the risk of default and may also reduce the net realizable value of the collateral property to the Company. Credit losses occur when a counterparty fails to meet its obligations to the Company and the value realized on sale of the underlying security deteriorates below the carrying amount of the exposure. All members of management are subject to limits on their ability to commit the Company to credit risk. Credit and commitment exposure is closely monitored through a reporting process that includes a formal quarterly review involving senior management and the Investment Committee ("ICB"). Furthermore, the Company's exposure to credit risk is

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managed through risk management policies and procedures that emphasize the quality and diversification of its investments. The Company's policies establish limits on concentration by asset class, geographic region, dollar amount and borrower.

Liquidity Risk

Liquidity risk is the risk that cash inflows, supplemented by assets readily convertible to cash, will be insufficient to honour all cash outflow commitments (both on and off-balance sheet) as they come due. The failure of borrowers to make regular mortgage payments increases the uncertainties associated with liquidity management, notwithstanding that the Company may eventually collect the amounts outstanding. The Company closely monitors its liquidity position to ensure that it has sufficient cash to meet liability obligations as they become due. The ICB is responsible for the review and approval of liquidity policies. In general, the Company maintains liquid investments and credit facilities in excess of 20% of term deposits maturing within 100 days. In addition, all marketable securities and single-family mortgages are readily marketable within a time frame of one to three months, providing the Company with added flexibility to meet its liquidity needs. The Company has access to funding through its ability to issue term deposits insured pursuant to the standard terms of coverage set out by the Canada Deposit Insurance Corporation. These term deposits also provide the Company with the ability to fund asset growth as needed. There is also a \$30,000 banking facility in place to fund asset growth or meet short-term obligations as required. The Company's liquidity position and access to funding support its ability to meet current and future commitments. For further details on the Company's liquid assets and ability to meet liability obligations, refer to note 10.

Market Risk

Market risk is the exposure to adverse changes in the value of financial assets. For the Company, market risk factors include interest rates, real estate values and commodity prices, among others. Market risk on marketable securities is managed through prudent investment selection and diversification by security and industry.

10. Interest Rate Sensitivity

| | Floating Rate | Within 3 Months | 3 Months to 1 Year | 1 to 5 Years | Over 5 Years | Non- Interest Sensitive | 2008 Total | 2007 Total |
|---|-------------------|--------------------|-----------------------|------------------|------------------|-------------------------------|---------------|---------------|
| ASSETS | | | | | | | | |
| Investments | | | | | | | | |
| Cash and cash equivalents | \$ 5,785 | \$ 14,979 | \$ - | \$ - | \$ - | \$ - | \$ 20,764 | \$ 49,723 |
| Mortgages | 256,621 | 87,146 | 28,509 | 83,284 | 375 | 4,493 | 460,428 | 414,741 |
| Loans and investments | 42,739 | 350 | 87 | 10,540 | 12,003 | 13,059 | 78,778 | 61,834 |
| Equity investment in MCAP Commercial LP | - | - | - | - | - | 19,331 | 19,331 | 17,911 |
| Marketable securities | - | - | - | - | - | - | - | 175 |
| | 305,145 | 102,475 | 28,596 | 93,824 | 12,378 | 36,883 | 579,301 | 544,384 |
| Other assets | - | - | - | - | - | 8,491 | 8,491 | 3,716 |
| Total Assets | \$ 305,145 | \$ 102,475 | \$ 28,596 | \$ 93,824 | \$ 12,378 | \$ 45,374 | \$ 587,792 | \$ 548,100 |
| Yield | 7.53% | 6.09% | 7.25% | 7.49% | 8.09% | - | - | - |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | |
| Term deposits | \$ - | \$ 141,085 | \$ 297,281 | \$ 27,652 | \$ - | \$ - | \$ 466,018 | \$ 437,427 |
| Accounts payable and accrued charges | - | - | - | - | - | 9,432 | 9,432 | 5,589 |
| Future taxes payable | - | - | - | - | - | 3,585 | 3,585 | 1,595 |
| Shareholders' equity | - | - | - | - | - | 108,757 | 108,757 | 103,489 |
| Total Liabilities and Shareholders' Equity | \$ - | \$ 141,085 | \$ 297,281 | \$ 27,652 | \$ - | \$ 121,774 | \$ 587,792 | \$ 548,100 |
| Yield | - | 4.14% | 4.00% | 4.19% | - | - | - | - |
| GAP | \$ 305,145 | \$ (38,610) | \$ (268,685) | \$ 66,172 | \$ 12,378 | \$ (76,400) | \$ - | \$ - |
| YIELD SPREAD | 7.53% | 1.95% | 3.25% | 3.30% | 8.09% | - | - | - |

11. Guarantees

The Company guarantees certain of the credit and operating activities of MCAP Financial Corporation (“MFC”) and MCLP. CDP Capital – Real Estate Advisory Inc. (“CDP Capital – Real Estate Advisory”) indemnifies the Company to the extent of 75% of the costs resulting from any claims on the guarantees. The effect of this indemnity is that the cost of any claim will be borne by the Company and CDP Capital – Real Estate Advisory pro rata to their respective voting interests in MCLP.

The guarantees subject to the CDP Capital – Real Estate Advisory indemnity are as follows:

- (a) guarantee of the performance of MFC and MCLP pursuant to various agreements with respect to MCLP’s residential construction loan securitization program;
- (b) guarantee of the performance of MFC and MCLP pursuant to various agreements with respect to the warehousing of residential construction loans intended for MCLP’s residential construction loan securitization program; and
- (c) guarantee of the premises lease with respect to the premises occupied by MFC, MCLP and the Company at 200 King Street West, Toronto with a current monthly rent of \$108 increasing to \$116 in 2010 and expiring in September 2014.

MCLP has issued Class B units to management of MCLP, which were financed by bank loans to management. Under certain circumstances, the Company may be required to contribute up to 25% of the fair value of the Class B units to MCLP in order to repurchase the Class B units or to repay the bank financing and subrogate the bank’s position. At September 30, 2008, the outstanding bank loan balances were \$8,488.

12. Subsequent Event

Subsequent to the end of the quarter, the Company earned approximately \$1.9 million from the sale of mortgages.

13. Comparative Amounts

Certain comparative amounts have been reclassified to conform to the presentation adopted in the current year.

14. Future Changes in Accounting Policy

For the fiscal year commencing January 1, 2011, the Company will cease to use GAAP and will adopt International Financial Reporting Standards (“IFRS”). The impact of the transition to IFRS on the Company’s consolidated financial statements is not yet determinable.