



**THIRD QUARTER REPORT 2009
MCAN MORTGAGE CORPORATION**

MCAN MORTGAGE CORPORATION

REPORT FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009

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, 2009 and the audited consolidated financial statements, accompanying notes and MD&A for the year ended December 31, 2008. 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 2008 remain substantially unchanged. Information has been presented as of November 3, 2009.

RESULTS OF OPERATIONS

MCAN Mortgage Corporation ("MCAN", the "Company" or "we") reported net income of \$6.6 million for the third quarter of 2009, down from \$10.4 million a year earlier. Earnings per share for the quarter were \$0.46 compared to \$0.73 last year. Net income for the nine months ended September 30, 2009 was \$18.6 million, down from \$20.4 million a year earlier, while earnings per share in the same period were \$1.30 compared to \$1.44 in 2008.

(in thousands, except for per share amounts)

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|--------------------------------------|--|-----------|---|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| Net investment income | \$ 8,007 | \$ 12,485 | \$ 22,585 | \$ 24,611 |
| Operating expenses | 1,410 | 2,088 | 3,947 | 4,183 |
| Income before income taxes | 6,597 | 10,397 | 18,638 | 20,428 |
| Provision for income taxes | - | - | - | - |
| Net income | \$ 6,597 | \$ 10,397 | \$ 18,638 | \$ 20,428 |
| Basic and diluted earnings per share | \$ 0.46 | \$ 0.73 | \$ 1.30 | \$ 1.44 |
| Dividends per share | \$ 0.25 | \$ 0.25 | \$ 1.18 | \$ 0.71 |

Although general economic conditions remain weak, MCAN continued its strong 2009 performance in the third quarter. Despite historically low interest rates, the yield on our mortgage portfolio increased by 0.47% over the second quarter as a result of strong management of our asset mix and increased realization of discounts embedded in our mortgage portfolio. The decreases in the prime rate since 2008 also facilitated a 0.50% decrease in our average term deposit interest rate over the second quarter, which contributed to a significant increase in spreads over last quarter.

MCAN continued its participation in the Canada Mortgage Bonds ("CMB") program during the third quarter, which has led to significant incremental income in recent quarters.

The deterioration in the economy has also led to a significant increase in impaired mortgages and total mortgage arrears during 2009. Impaired mortgages increased from 3.47% at June 30th to 5.88% at September 30th, although total mortgage arrears decreased from \$43 million to \$35 million during the same period. While MCAN's arrears levels are much higher than last year, we have not experienced material losses for the year to date.

Although earnings per share have decreased from 2008, our results are strong by historical standards. However, 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 | |
|---------------------------------------|--|------------------|---|------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Investment Income | | | | |
| Mortgage interest | \$ 6,726 | \$ 9,742 | \$ 20,007 | \$ 24,786 |
| Interest on loans and investments | 736 | 1,339 | 2,968 | 4,484 |
| Fees | 1,219 | 1,598 | 6,131 | 3,268 |
| Equity income from MCAP Commercial LP | 707 | 1,229 | 933 | 2,237 |
| Securitization income | 2,272 | 1,688 | 5,757 | 4,996 |
| Interest on cash and cash equivalents | 33 | 255 | 200 | 926 |
| Gain on sale of mortgages | - | 3,475 | - | 3,475 |
| Marketable securities | - | (104) | - | (97) |
| | 11,693 | 19,222 | 35,996 | 44,075 |
| Financial Expenses | | | | |
| Term deposit interest and expenses | 2,912 | 5,196 | 10,608 | 15,783 |
| Mortgage expenses | 600 | 805 | 2,146 | 2,647 |
| Provision for losses | 174 | 736 | 657 | 1,034 |
| | 3,686 | 6,737 | 13,411 | 19,464 |
| Net Investment Income | \$ 8,007 | \$ 12,485 | \$ 22,585 | \$ 24,611 |

Net investment income for the third quarter decreased by \$4.5 million over the prior year, primarily due to a one-time gain on the sale of mortgages in 2008, in addition to lower spread income in the current year. The decrease for the nine months ended September 30, 2009 was \$2.0 million, as we received income from the acquired portfolios for a full nine months in the current year compared to only three months in 2008.

During the quarter, we realized \$1.2 million (2008 - \$1.6 million) relating to the partial recovery of purchase price discounts on several portfolios of discounted mortgages that we acquired in 2008. We also received \$476,000 (2008 - \$875,000) of fees from MCAP Commercial LP ("MCLP") from a profit sharing arrangement relating to discounted mortgages acquired by MCLP. For the year to date, we have realized \$2.5 million (2008 - \$1.6 million) of discount income on our portfolios and received \$3.7 million (2008 - \$875,000) of fees from MCLP relating to its portfolios.

Mortgage interest income for the quarter decreased by \$3.0 million from the prior year as a result of a decrease in the average portfolio size from \$443 million in 2008 to \$383 million in 2009 and a decrease in the average mortgage yield from 8.62% in 2008 to 7.41% in 2009. The decrease in the yield for the quarter is partly due to a lower yield on the acquired portfolios in the current year as a result of the aforementioned decrease in discount income from lower payout volumes. In addition, the prime rate has decreased from 4.75% at September 30, 2008 to 2.25% at September 30, 2009. This decrease has had a negative impact on mortgage interest income, as 49% of our mortgages at quarter end were floating rate mortgages.

The decrease of \$4.8 million for the nine months ended September 30, 2009 is a result of a \$47 million decrease in the average portfolio and a decrease of 0.42% in the average yield. The impact of the decrease in the prime rate in 2009 has been partly offset by a higher current year yield on the acquired portfolios for the year to date.

The mortgages in the acquired portfolios have higher effective yields than those in our regular portfolio, as they have been acquired at a discount to their par values. 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.

Although we do not accrue interest on impaired mortgages, we include interest owing but not accrued in the mortgage yield calculation to accurately represent the underlying portfolio. Actual interest losses are incorporated into the yield once realized. During the third quarter, interest owing but not accrued on impaired mortgages increased by \$423,000. The mortgage yield for the quarter would have decreased by 0.44% to 6.97% if interest owing but not accrued was not included in the yield calculation.

Interest on loans and investments decreased by \$603,000 for the quarter and \$1.5 million for the nine months ended September 30, 2009 as a result of the aforementioned decrease in the prime rate and a smaller average portfolio.

Fees decreased by \$379,000 for the quarter and increased by \$2.9 million for the nine months ended September 30, 2009. Fees received from MCLP related to the profit sharing noted above decreased in the third quarter, however they have increased significantly for the year to date as we did not begin to recover discounts until the third quarter of 2008. Fees also include construction commitment fees, which are amortized into income over the term of the related loans.

Equity income from our ownership interest in MCLP was \$707,000 during the quarter compared to \$1.2 million in the prior year. MCLP's gains from sales of single family mortgages and realization of discounts decreased in the current year.

MCAN securitizes insured mortgages through the CMB program. During the quarter, we recognized securitization income of \$2.3 million compared to \$1.7 million in the prior year. Current quarter income consists of an up-front gain from securitization of \$1.7 million (2008 - \$813,000) and residual securitization income of \$604,000 (2008 - \$1.1 million), while the third quarter of 2008 included a write-down on the interest-only strips of \$260,000. The increase in up-front gains from securitization is primarily due to an increase in our economic participation in the CMB program. Residual securitization income decreased as a result of negative fair value adjustments to CMB-related financial instruments of \$747,000 (2008 - positive impact of \$738,000). Forward interest rates have been volatile since early 2008, which can lead to unanticipated income variances in either direction. Other components of residual securitization income increased from \$397,000 to \$1.4 million due to an increase in refinancing and renewal gains and a larger CMB portfolio. Securitization income for the nine months ended September 30, 2009 increased over the prior year, as the impact of significantly higher up-front gains exceeded that of lower residual securitization income.

In the third quarter of 2008, we earned \$3.5 million from sales of mortgages.

Term deposit interest and expenses decreased by \$2.3 million during the quarter as a result of a decrease of \$93 million in the average outstanding balance and a decrease in the average term deposit interest rate from 4.29% in 2008 to 2.92% in 2009. The decrease of \$5.2 million for the nine months ended September 30, 2009 is due to a \$58 million decrease in the average outstanding balance and a decrease of 1.10% in the average term deposit rate. Although new term deposit funding rates are low by historical standards, the decrease in the term deposit yield has not decreased to the extent of the prime rate. However, the yield has continued to decrease over the last two quarters despite no changes in the prime rate, as the funding rate on new term deposits has been significantly lower than that of the majority of maturing term deposits.

Mortgage expenses decreased by \$205,000 for the quarter and \$501,000 for the nine months ended September 30, 2009, both consistent with the decrease in the average mortgage portfolio.

Provisions for losses for the third quarter of the current and prior year were as follows:

| | <u>2009</u> | <u>2008</u> |
|--|-------------------|-------------------|
| Mortgages - general provision (recovery) | \$ (375,000) | \$ (106,000) |
| Mortgages - specific provision | 573,000 | 25,000 |
| Loans and investments - general provision (recovery) | (24,000) | 17,000 |
| Loans and investments - specific provision | - | 800,000 |
| | <u>\$ 174,000</u> | <u>\$ 736,000</u> |

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 mortgages 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.

Specific provision activity consists of an increase of \$646,000 relating to residential construction loans and a decrease of \$73,000 relating to uninsured single family mortgages. Construction loan specific provisions increased from \$600,000 to \$1,246,000 as we increased an existing provision by \$60,000 and recorded two new provisions. The construction loans consist of MCAN's 20% participation in a multi-phased land development loan that has experienced slow sales and cost increases, a land loan that has been delayed by municipal negotiations and a small land development loan that has experienced slow sales and cost increases. Given the timeline for repayment and market price point fluctuations, specific reserves have been established for anticipated losses.

The reduction in specific provisions on uninsured single family mortgages was primarily due to write-offs of \$58,000 through the realization of losses on mortgages that had specific allowances at the end of the second quarter. There were no write-offs on other mortgage classes during the quarter. Write-offs were \$1,000 in the prior year.

In the third quarter of 2008, we recorded an additional write-down of \$800,000 on commercial paper that we held at that time.

Impaired mortgages net of specific allowances are as follows:

| (in thousands) | September 30 2009 | June 30 2009 | March 31 2009 | September 30 2008 |
|--------------------------|----------------------|------------------|------------------|----------------------|
| Residential construction | \$ 17,607 | \$ 8,604 | \$ 1,197 | \$ - |
| Uninsured single family | 3,537 | 5,584 | 4,984 | 4,344 |
| | \$ 21,144 | \$ 14,188 | \$ 6,181 | \$ 4,344 |
| | 5.88% | 3.47% | 1.42% | 0.89% |

The increase in impaired loans is mostly due to the impairment of the aforementioned residential construction loans on which we recorded new specific allowances during the quarter. We continue to proactively monitor loan arrears and take prudent steps to collect overdue accounts. Although impaired mortgages increased during the third quarter, total mortgage arrears decreased by \$8 million from \$43 million to \$35 million. The high arrears levels experienced in 2009 are primarily due to two significant residential construction loan arrears in Ontario and one in Alberta. Our current arrears levels are a reflection of the general deterioration in the Canadian economy over the past year. There were no other assets in arrears at quarter end.

Operating Expenses

| (in thousands) | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|----------------------------|--|-----------------|---|-----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Salaries and benefits | \$ 580 | \$ 657 | \$ 1,654 | \$ 1,544 |
| General and administrative | 830 | 1,431 | 2,293 | 2,639 |
| | \$ 1,410 | \$ 2,088 | \$ 3,947 | \$ 4,183 |

Operating expenses have decreased over the prior year for the quarter and nine months ended September 30, 2009. In the third quarter of 2008, we incurred significant 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 | |
|--|--|-----------------|---|-----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Provision against income | \$ - | \$ - | \$ - | \$ - |
| Charge (recovery) to retained earnings | 384 | 2,797 | (943) | 4,722 |
| | \$ 384 | \$ 2,797 | \$ (943) | \$ 4,722 |

We had an increase in current taxes payable (which are charged directly to retained earnings) during the third quarter of 2009 as a result of an excess of taxable income over dividends. The substantial charge to retained earnings for the quarter and nine months ended September 30, 2008 is a result of a much more significant excess.

The recovery of taxes for the nine months ended September 30, 2009 is primarily due to the payment of the March 31, 2009 dividend, which was significantly higher than usual. 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. As a result of this, we had a significant future tax liability at December 31, 2008 as the March 31, 2009 dividend, which related to the 2008 tax year, had not yet been paid. The reversal of this liability through the payment of the dividend led to a significant recovery of future taxes in the first quarter.

Cash Flows

Operating activities provided cash flows of \$5.6 million in the quarter compared to \$3.3 million provided in the prior year. Operating activities provided \$9.4 million for the nine months ended September 30, 2009 compared to \$9.1 million provided in the prior year.

Investing activities provided cash flows of \$32 million in the quarter and used \$23 million in the prior year. Net loan and investment advances increased over the prior year, while there were significant net mortgage repayments in the current year compared to net advances in the prior year. Investing activities provided \$56 million for the nine months ended September 30, 2009 compared to \$51 million used in the prior year. The current year cash flow consists almost entirely of net mortgage repayments, while the prior year consisted almost entirely of net mortgage advances.

Financing activities used \$11 million of cash in the quarter and provided \$25 million in the prior year. Net term deposit repayments increased significantly in the current year. Financing activities used \$85 million for the nine months ended September 30, 2009 compared to \$8 million provided in the prior year. Net term deposit redemptions and dividends paid increased significantly in the current year.

SELECTED QUARTERLY FINANCIAL DATA

(in thousands, except for per share amounts)

| | 2009 | | | 2008 | | | | 2007 |
|--------------------------------------|---------|---------|---------|---------|---------|----------|----------|---------|
| | Q1 | Q2 | Q3 | Q1 | Q2 | Q3 | Q4 | Q4 |
| Net investment income | \$7,703 | \$6,875 | \$8,007 | \$6,064 | \$6,062 | \$12,485 | \$11,471 | \$4,259 |
| Operating expenses | 1,269 | 1,268 | 1,410 | 922 | 1,173 | 2,088 | 1,551 | 1,079 |
| Income before income taxes | 6,434 | 5,607 | 6,597 | 5,142 | 4,889 | 10,397 | 9,920 | 3,180 |
| Provision for income taxes | - | - | - | - | - | - | - | - |
| Net income | \$6,434 | \$5,607 | \$6,597 | \$5,142 | \$4,889 | \$10,397 | \$9,920 | \$3,180 |
| Basic and diluted earnings per share | \$0.45 | \$0.39 | \$0.46 | \$0.36 | \$0.35 | \$0.73 | \$0.70 | \$0.23 |
| Dividends per share | | | | | | | | |
| Regular | \$0.68 | \$0.25 | \$0.25 | \$0.12 | \$0.23 | \$0.25 | \$0.25 | \$0.23 |
| Capital gains | - | - | - | 0.11 | - | - | - | - |
| Total | \$0.68 | \$0.25 | \$0.25 | \$0.23 | \$0.23 | \$0.25 | \$0.25 | \$0.23 |

Income in the fourth quarter of 2007 was lower than usual due to a significant equity loss from MCLP. The first half of 2008 saw an improvement in income as a result of higher securitization income. The second half of 2008 had a substantial increase in net income due to significant income from the sale of mortgages and income earned as a result of the portfolio acquisitions noted above. Securitization income and income from the acquired portfolios have remained strong for the 2009 year to date.

FINANCIAL POSITION

As of September 30, 2009, total consolidated assets were \$500 million, unchanged from June 30, 2009.

Assets

| (in thousands) | September 30, 2009 | | June 30, 2009 | | December 31, 2008 | |
|---------------------------|--------------------|---------------|-------------------|---------------|-------------------|---------------|
| Cash and cash equivalents | \$ 41,269 | 8.3% | \$ 15,158 | 3.0% | \$ 58,071 | 10.2% |
| Mortgages | 343,458 | 68.6 | 391,749 | 78.3 | 393,010 | 68.9 |
| Loans and investments | 83,727 | 16.7 | 60,957 | 12.2 | 75,367 | 13.2 |
| Equity investment in MCLP | 17,723 | 3.5 | 17,016 | 3.4 | 18,300 | 3.2 |
| Other assets | 14,068 | 2.9 | 15,565 | 3.1 | 25,406 | 4.5 |
| | \$ 500,245 | 100.0% | \$ 500,445 | 100.0% | \$ 570,154 | 100.0% |

Cash increased by \$26 million during the quarter as a result of significant mortgage sales near quarter end. In general, we maintain our cash balance in the \$20 to \$30 million range.

Mortgages decreased by \$48 million in the quarter, primarily due to decreases of \$21 million in commercial mortgages, \$20 million in uninsured single family mortgages and \$16 million in residential construction loans, partially offset by an increase of \$10 million in insured single family mortgages. As a result of reduced mortgage product availability due to adverse market

conditions, we have continued to be selective in our mortgage approvals. Consequently, we have observed significant repayments on our uninsured single family mortgage portfolio. In addition, we have been applying minimum rates on renewed and newly funded construction loans where possible and aggressively managing the repayment of these loans, as they are mostly prime-based and have less attractive yields in the current interest rate environment.

As at September 30, 2009, we held discounted mortgages with an aggregate discount of \$28 million. We retain 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 continue to be realized over the next few years.

We do not invest in the United States mortgage market. We invest in insured and uninsured single family mortgages in Canada, which we believe 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.

Arrears in our single family mortgage portfolio remain high due to job losses. Property values have stabilized in several markets on rising sales volume. We have not experienced material loan losses resulting from these arrears.

Loans and investments increased by \$23 million, primarily due to a \$22 million increase in insured mortgage backed securities. The CMB interest-only strips, which are retained interests in the securitized mortgages consisting of the discounted value of future mortgage interest income, principal reinvestment interest receipts and penalty income less coupon interest payments, increased by \$2.4 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 \$3.5 million upon the closing of this quarter's issuance. In addition, there was a \$1.2 million downward adjustment in the fair value of the interest-only strips.

Our equity investment in MCLP increased by \$707,000, consisting of net of equity income for the quarter.

Other assets at September 30, 2009 consist almost entirely of interest rate swaps relating to the CMB program. We have entered into "pay-floating, receive-fixed" swaps to hedge against interest rate risk on reinvested CMB principal collections. The fair market value of the swaps increased significantly during 2008 and early 2009 as a result of a substantial decrease in forward interest rates. Other assets also include capital assets, prepaid expenses, accounts receivable and deferred costs.

Liabilities and shareholders' equity

(in thousands)

| | September 30 2009 | June 30 2009 | Increase (Decrease) | December 31 2008 |
|--|----------------------|-------------------|------------------------|---------------------|
| Liabilities | | | | |
| Term deposits | \$ 361,156 | \$ 368,938 | \$ (7,782) | \$ 426,663 |
| Securitization liabilities | 5,005 | 4,504 | 501 | 7,095 |
| Accounts payable and accrued charges | 7,718 | 5,144 | 2,574 | 12,186 |
| Future taxes payable | 5,385 | 4,714 | 671 | 7,601 |
| | 379,264 | 383,300 | (4,036) | 453,545 |
| Shareholders' equity | | | | |
| Share capital | 98,490 | 98,333 | 157 | 97,493 |
| Contributed surplus | 510 | 510 | - | 510 |
| Retained earnings | 20,048 | 17,413 | 2,635 | 17,313 |
| Accumulated other comprehensive income | 1,933 | 889 | 1,044 | 1,293 |
| | 120,981 | 117,145 | 3,836 | 116,609 |
| | \$ 500,245 | \$ 500,445 | \$ (200) | \$ 570,154 |

Term deposits decreased by \$8 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.

Securitization liabilities relate to CMB interest-only strips in liability positions. The interest-only strips generally only go into liability positions after a significant decrease in forward rates after issuance, which was the case with certain interest-only strips in late 2008 and early 2009. Changes in the fair value of the interest-only strips are generally offset by changes in the fair value of CMB interest rate swaps (included in other assets).

Share capital increased by \$157,000, which was raised through the dividend reinvestment plan for the September 30, 2009 dividend.

Retained earnings increased by \$2.6 million during the quarter. The increase was a result of quarterly income of \$6.6 million, partly offset by the third quarter dividend of \$3.6 million and a charge to retained earnings of \$384,000 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 primarily due to an increase in the fair market value of available for sale fixed-rate mortgages as a result of a decrease in market mortgage rates and an increase in the fair market value of mortgage-backed securities.

CMB PROGRAM

We participate in the CMB program, which involves the securitization of insured single family and multi family mortgages. The current quarter securitization was the first in which we securitized insured multi family mortgages. We participate in the CMB program with MCAP Service Corporation ("MSC") and MCLP. For accounting purposes, we recognize an up-front gain on securitization, and at that time we recognize an interest-only strip, which is a retained interest in the securitized mortgages. The interest-only strips consist of the discounted value of future mortgage interest, principal reinvestment interest receipts and penalty income less coupon interest payments. The interest-only strips are generally in asset positions, however they can potentially go into liability positions upon a significant decrease in forward interest rates after issuance, which occurred with certain interest-only strips in 2008. In addition, we recognize liabilities for future mortgage servicing, which we subcontract to MSC and MCLP, and other costs. For tax purposes, we recognize CMB-related income on the cash basis, wherein the payment of upfront CMB expenses is a deduction from taxable income at the date of issuance, and the ongoing collection of net CMB cash flows, representing the interest-only strips, is recognized in taxable income as received over the duration of the issuance.

In addition, we earn residual securitization income, which includes the net yield earned on the interest-only strips and the CMB liabilities, refinancing and renewal gains, interest rate swap receipts (payments) and fair value changes in the interest-only strips and interest rate swaps.

During the quarter, we securitized \$191 million of mortgages through the CMB program, consisting of \$149 million of single family mortgages and \$42 million of multi family mortgages. We recorded \$3.5 million of interest-only strips and \$534,000 of liabilities on the respective closing dates.

As part of the CMB program, we enter into "pay-floating, receive-fixed" interest rate swaps. The purpose of these swaps is to hedge interest rate risk on the interest-only strips. We receive interest on reinvested CMB principal collections, the discounted future value of which is included in the interest-only strips. Changes in the fair market value of the interest rate swaps generally offset the changes in the fair value of the interest-only strips.

Our participation in the CMB program may be reduced in the future, as discussed below in "Risk Management".

RISK MANAGEMENT

We operate in changing regulatory and economic environments. As a result, our management and the Board of Directors are particularly diligent in their consideration of issues of risk. Our goal is not to eliminate risk, as this would result in significantly reduced earnings, but rather to be proactive in our assessment and management of risk, as a means to gain a strategic advantage and ultimately enhance shareholder value.

Our senior management is responsible for the quality of processes, policies, procedures and controls and for internal reporting on a day-to-day basis. The Board of Directors is actively involved in the risk management process, providing oversight and guidance on an ongoing basis and at least quarterly. Internal audit is involved in the risk management process to provide validation of its effectiveness, with reports provided to senior management and the Board of Directors.

In addition to the items listed below, for a discussion of the material risks that we are exposed to, please refer to the "Risk Factors" section of our 2009 Annual Information Form, which is incorporated herein by reference.

Changes in Laws and Regulations

Changes to current laws, regulations, regulatory policies or guidelines (including changes in their interpretation, implementation or enforcement), the introduction of new laws, regulations, regulatory policies or guidelines or the exercise of discretionary oversight by regulatory or other competent authorities including the Superintendent of Financial Institutions Canada ("OSFI"), could adversely affect us, including by limiting the products or services that we provide, restricting the scope of our operations or business lines, increasing the ability of competitors to compete with our products and services or requiring us to cease carrying on business. Our failure to comply with applicable laws and regulations could result in sanctions and financial penalties that could adversely impact our earnings and damage our reputation.

Changes in Accounting Standards and Accounting Policies

We may be subject to changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes may materially impact how we record and report our financial condition and results of operations and, in certain circumstances, we may be required to retroactively apply a new or revised standard that results in our restating prior period financial statements. We are required to adopt International Financial Reporting Standards ("IFRS") for the fiscal year commencing January 1, 2011. Among other things, the adoption of IFRS may impact our current accounting policies and critical accounting estimates, as well as the calculation of (and compliance with) our regulatory capital ratios, due to significant recognition and measurement differences between IFRS and current Canadian Generally Accepted Accounting Principles ("GAAP") which could in turn materially impact our financial condition and results of operations, as well as the scope of our operations and business lines. If the IFRS rules regarding securitization are implemented in the form currently proposed, MCAN's assets and liabilities that are subject to securitization will be considered on-balance sheet items. OSFI released a draft advisory in October 2009 with respect to the impact of the currently proposed IFRS rules regarding securitization on regulatory capital ratios. The draft advisory contemplates that the on-balance sheet assets and liabilities that are subject to securitization transactions undertaken after December 31, 2009 (including insured mortgages that are securitized through the CMB program) will be required to be included in the calculation of a regulated financial institution's regulatory capital ratios. Currently, we are not required to reflect securitized assets or liabilities on our balance sheet or include them in the calculation of our regulatory capital ratios. Pursuant to the measures contemplated by the draft advisory, if the IFRS rules regarding securitization are implemented in their proposed form, beginning with the fiscal year commencing on January 1, 2011, we will be required to include any assets and liabilities that were subject to securitization transactions undertaken as of January 1, 2010 in the calculation of our regulatory capital ratios. We are continuing to identify and assess the impact of the transition to IFRS on our consolidated financial statements and are working to develop a plan to minimize the effect of the transition on our business. However, if the IFRS rules regarding securitization are implemented in the proposed form and if the draft advisory is applied in the form proposed by OSFI, then MCAN's participation in securitization transactions, namely through our participation in the CMB program, may need to be significantly reduced in order for us to comply with our regulatory capital ratios. Although we are reviewing potential alternative structures and arrangements that may permit our continued participation in the CMB program, there can be no assurance that any such alternative structures or arrangements will be available on commercially reasonable terms, or can be implemented in a timely manner.

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 construction loans.

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 | \$ 340,930 | \$ 20,226 | \$ - | \$ 361,156 |
| Operating lease | 171 | 342 | - | 513 |
| Mortgage fundings | 74,805 | 8,312 | - | 83,117 |
| CMB obligations | 916 | 2,163 | - | 3,079 |
| | \$ 416,822 | \$ 31,043 | \$ - | \$ 447,865 |

FUTURE CHANGES IN ACCOUNTING POLICY

International Financial Reporting Standards

The Accounting Standards Board ("AcSB") will require Canadian public companies to prepare their interim and annual financial statements in accordance with IFRS relating to fiscal years beginning on or after January 1, 2011.

For the fiscal year commencing January 1, 2011, we will cease to use GAAP and will adopt IFRS. Financial results for the quarter ended March 31, 2011 will be presented using IFRS.

We have recognized that the conversion to IFRS is complex and requires a significant amount of company resources. As a result of this, we engaged a major accounting firm to advise and assist us with identifying accounting treatment differences between GAAP and IFRS and to provide education and training. We anticipate that this engagement will create efficiencies in MCAN's IFRS conversion process.

Our IFRS conversion plan consists of three key phases, as follows:

1. Scoping and diagnostic phase
2. Assessment of impact of IFRS differences
3. Implementation of conversion plan

The scoping and diagnostic phase, which involved a high-level impact assessment to identify key areas impacted by the conversion to IFRS, has been completed. We have completed the identification of differences between GAAP and IFRS in the areas identified by the scoping and diagnostic phase, and continue to analyze the impact of these differences. Once this task has been completed, we will establish changes to our accounting policies, financial reporting, control environment, information systems and business activities. Following the completion of the assessment of the impact of IFRS differences, we will begin the implementation of our conversion plan in the fourth quarter of 2009 and into 2010.

We are monitoring the potential impact of changes to financial reporting processes, internal controls over financial reporting and disclosure controls and procedures. We have not yet quantified the effects of the potential significant differences between GAAP and IFRS nor their materiality. As the implications of the conversion are identified, continual requirements for infrastructure, expertise, training and education will be assessed. We will continue to assess the impact of adopting IFRS and will update our MD&A disclosures on a quarterly basis to report on the progress of our IFRS plan.

The following table outlines certain elements of our IFRS conversion plan and an assessment of our progress towards the plan as at September 30, 2009. Changes in regulations, economic conditions, business activities or other circumstances could impact the IFRS conversion plan and result in changes to the key activities and deadlines. Our IFRS conversion plan is currently on schedule.

| Key Activity | Planned Completion Date | Status |
|---|--|---|
| Accounting Policies <ul style="list-style-type: none"> • Identify differences in Canadian GAAP and IFRS accounting policies • Select ongoing IFRS policies • Select IFRS 1 policies and exemptions • Quantify impact of transition to IFRS | Q2 2009 Q4 2009 Q4 2009 Q1 2010 | Differences identified and analyzed In progress, on schedule In progress, on schedule Currently unable to quantify |
| Financial Reporting <ul style="list-style-type: none"> • 2011 IFRS financial statement and note disclosure format • Identify additional financial statement disclosures • Prepare 2010 interim and annual reconciliations from GAAP to IFRS | Q3 2010 Q3 2010 Quarterly during 2010 | Analysis in progress, on schedule Analysis in progress, on schedule Analysis in progress, on schedule |
| Control Environment <ul style="list-style-type: none"> • Assess Internal Controls over Financial Reporting ("ICFR") design and effectiveness implications for all accounting policy changes • Implement changes to ICFR • Assess Disclosure Controls and Procedures ("DC&P") design and effectiveness implications for all accounting policy changes • Implement changes to DC&P | Q3 2010 Q4 2010 Q3 2010 Q4 2010 | Assessment to be completed Assessment to be completed Assessment to be completed Assessment to be completed |

| Key Activity | Planned Completion Date | Status |
|---|-------------------------|---|
| Information Systems | | |
| <ul style="list-style-type: none"> • Maintenance of 2010 general ledger for both GAAP and IFRS | Q4 2009 | On schedule, project in progress with IT department |
| <ul style="list-style-type: none"> • Program upgrades/modifications | Q4 2009 | On schedule, project in progress with IT department |
| <ul style="list-style-type: none"> • One-off calculations (IFRS 1) | Q4 2009 | Analysis in progress, on schedule |
| <ul style="list-style-type: none"> • Gathering data for disclosures | Q4 2009 | Analysis in progress, on schedule |
| Business Policies | | |
| <ul style="list-style-type: none"> • Assess impact on capital plan | Q2 2010 | Assessment to be completed |
| <ul style="list-style-type: none"> • Revise capital plan as needed | Q3 2010 | Assessment to be completed |

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

As at September 30, 2009, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of MCAN, along with the assistance of the Company's disclosure committee comprised of members of senior management, have designed disclosure controls and procedures to provide reasonable assurance that material information relating to MCAN is made known to the CEO and CFO, and have designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

There were no changes in our internal controls over financial reporting that occurred during the interim period ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

OUTLOOK

The disruption in the financial markets has afforded us with opportunities to acquire mortgages on a profitable basis. While these transactions are opportunistic and cannot be planned, we expect that future acquisition opportunities may present themselves. We plan to retain investment capacity so that we can take advantage of these opportunities.

The decreases in the prime rate from 2008 and early 2009 will continue to have an adverse effect on net investment income over the next few quarters. 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 order to minimize this compression. For new and existing floating rate mortgages, we are establishing minimum rates whenever possible to protect our spread income.

Arrears in our single family mortgage portfolio remain high due to job losses. Property values have stabilized in several markets on rising sales volume. We have not experienced material loan losses resulting from these arrears.

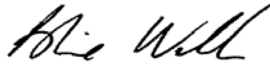
Arrears in our construction loan portfolio also remain high. The large size of these loans causes them to skew our arrears statistics. The nature of these loans also usually results in a more protracted resolution period.

While economic conditions remain weak, the Canadian economy appears to be stabilizing. This is evidenced by the fact that employment increased in both August and September. Should this job creation continue, then we would expect lower arrears in our mortgage portfolio.

Management does not believe that the continuing disruption in the financial markets has materially affected the capital or liquidity of the Company.

DIVIDENDS

The Board of Directors declared a fourth quarter dividend of \$0.26 per share (increased from \$0.25 per share) to be paid January 4, 2010 to shareholders of record as of December 15, 2009.



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 2009 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 2009 | December 31 2008 | September 30 2008 |
|---|------|----------------------|---------------------|----------------------|
| Assets | | | | |
| Investments | | | | |
| Cash and cash equivalents | | \$ 41,269 | \$ 58,071 | \$ 20,764 |
| Mortgages | 2 | 343,458 | 393,010 | 460,428 |
| Loans and investments | 4 | 83,727 | 75,367 | 78,778 |
| Equity investment in MCAP Commercial LP | | 17,723 | 18,300 | 19,331 |
| | | 486,177 | 544,748 | 579,301 |
| Other assets | 7 | 14,068 | 25,406 | 8,491 |
| | | \$ 500,245 | \$ 570,154 | \$ 587,792 |
| Liabilities and Shareholders' Equity | | | | |
| Liabilities | | | | |
| Term deposits | | \$ 361,156 | \$ 426,663 | \$ 466,018 |
| Securitization liabilities | 5 | 5,005 | 7,095 | - |
| Accounts payable and accrued charges | | 7,718 | 12,186 | 9,432 |
| Future taxes payable | | 5,385 | 7,601 | 3,585 |
| | | 379,264 | 453,545 | 479,035 |
| Shareholders' Equity | | | | |
| Share capital | 6 | 98,490 | 97,493 | 97,493 |
| Contributed surplus | | 510 | 510 | 510 |
| Retained earnings | | 20,048 | 17,313 | 12,286 |
| Accumulated other comprehensive income (loss) | | 1,933 | 1,293 | (1,532) |
| | | 120,981 | 116,609 | 108,757 |
| | | \$ 500,245 | \$ 570,154 | \$ 587,792 |

See accompanying notes

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

| For the Quarters Ended September 30 | Note | 2009 | 2008 |
|---|------|-----------------|------------------|
| Investment Income | | | |
| Mortgage interest | | \$ 6,726 | \$ 9,742 |
| Interest on loans and investments | | 736 | 1,339 |
| Fees | | 1,219 | 1,598 |
| Equity income from MCAP Commercial LP | | 707 | 1,229 |
| Securitization income | 3 | 2,272 | 1,688 |
| Interest on cash and cash equivalents | | 33 | 255 |
| Gain on sale of mortgages | | - | 3,475 |
| Marketable securities | | - | (104) |
| | | 11,693 | 19,222 |
| Financial Expenses | | | |
| Term deposit interest and expenses | | 2,912 | 5,196 |
| Mortgage expenses | | 600 | 805 |
| Provision for losses | | 174 | 736 |
| | | 3,686 | 6,737 |
| Net Investment Income | | 8,007 | 12,485 |
| Operating Expenses | | | |
| Salaries and benefits | | 580 | 657 |
| General and administrative | | 830 | 1,431 |
| | | 1,410 | 2,088 |
| Income Before Income Taxes | | 6,597 | 10,397 |
| Provision for income taxes | | - | - |
| Net Income | | \$ 6,597 | \$ 10,397 |
| Basic and diluted earnings per share | | \$ 0.46 | \$ 0.73 |
| Dividends per share | | \$ 0.25 | \$ 0.25 |
| Weighted average number of basic and diluted shares (000's) | | 14,308 | 14,207 |

See accompanying notes

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

| For the Nine Months Ended September 30 | Note | 2009 | 2008 |
|--|-------------|------------------|------------------|
| Investment Income | | | |
| Mortgage interest | | \$ 20,007 | \$ 24,786 |
| Interest on loans and investments | | 2,968 | 4,484 |
| Fees | | 6,131 | 3,268 |
| Equity income from MCAP Commercial LP | | 933 | 2,237 |
| Securitization income | 3 | 5,757 | 4,996 |
| Interest on cash and cash equivalents | | 200 | 926 |
| Gain on sale of mortgages | | - | 3,475 |
| Marketable securities | | - | (97) |
| | | 35,996 | 44,075 |
| Financial Expenses | | | |
| Term deposit interest and expenses | | 10,608 | 15,783 |
| Mortgage expenses | | 2,146 | 2,647 |
| Provision for losses | | 657 | 1,034 |
| | | 13,411 | 19,464 |
| Net Investment Income | | 22,585 | 24,611 |
| Operating Expenses | | | |
| Salaries and benefits | | 1,654 | 1,544 |
| General and administrative | | 2,293 | 2,639 |
| | | 3,947 | 4,183 |
| Income Before Income Taxes | | 18,638 | 20,428 |
| Provision for income taxes | | - | - |
| Net Income | | \$ 18,638 | \$ 20,428 |
| Basic and diluted earnings per share | | \$ 1.30 | \$ 1.44 |
| Dividends per share | | \$ 1.18 | \$ 0.71 |
| Weighted average number of basic and diluted shares (000's) | | 14,284 | 14,181 |

See accompanying notes

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

| For the Quarters Ended September 30 | 2009 | 2008 |
|--|-------------------|-------------------|
| Share capital | | |
| Balance, beginning of period | \$ 98,333 | \$ 97,337 |
| Common shares issued | 157 | 156 |
| Balance, end of period | 98,490 | 97,493 |
| Contributed surplus | | |
| Balance, beginning of period | 510 | 510 |
| Changes to contributed surplus | - | - |
| Balance, end of period | 510 | 510 |
| Retained earnings | | |
| Balance, beginning of period | 17,413 | 8,238 |
| Net income | 6,597 | 10,397 |
| Income taxes charged to retained earnings | (384) | (2,797) |
| Dividends declared | (3,578) | (3,552) |
| Balance, end of period | 20,048 | 12,286 |
| Accumulated other comprehensive income (loss) | | |
| Balance, beginning of period | 889 | (43) |
| Other comprehensive income (loss) | 1,044 | (1,489) |
| Balance, end of period | 1,933 | (1,532) |
| Total shareholders' equity | \$ 120,981 | \$ 108,757 |

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

| For the Quarters Ended September 30 | 2009 | 2008 |
|---|-----------------|------------------|
| Net income | \$ 6,597 | \$ 10,397 |
| Other comprehensive income (loss), net of income taxes | | |
| Change in unrealized gain on available for sale mortgages | 601 | (716) |
| Change in unrealized gain on available for sale loans and investments | 441 | (847) |
| Change in cash flow hedges | 2 | 2 |
| Change in unrealized gain on available for sale marketable securities | - | (36) |
| Transfer of losses on sale of marketable securities to net income | - | 108 |
| Other comprehensive income (loss) | 1,044 | (1,489) |
| Comprehensive income | \$ 7,641 | \$ 8,908 |

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

| For the Nine Months Ended September 30 | 2009 | 2008 |
|---|-------------------|-------------------|
| Share capital | | |
| Balance, beginning of period | \$ 97,493 | \$ 96,370 |
| Common shares issued | 997 | 1,123 |
| Balance, end of period | 98,490 | 97,493 |
| Contributed surplus | | |
| Balance, beginning of period | 510 | 510 |
| Changes to contributed surplus | - | - |
| Balance, end of period | 510 | 510 |
| Retained earnings | | |
| Balance, beginning of period | 17,313 | 6,654 |
| Net income | 18,638 | 20,428 |
| Income taxes recovered (charged) to retained earnings | 943 | (4,722) |
| Dividends declared | (16,846) | (10,074) |
| Balance, end of period | 20,048 | 12,286 |
| Accumulated other comprehensive income (loss) | | |
| Balance, beginning of period | 1,293 | (527) |
| Other comprehensive income (loss) | 640 | (1,005) |
| Balance, end of period | 1,933 | (1,532) |
| Total shareholders' equity | \$ 120,981 | \$ 108,757 |

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

| For the Nine Months Ended September 30 | 2009 | 2008 |
|---|------------------|------------------|
| Net income | \$ 18,638 | \$ 20,428 |
| Other comprehensive income (loss), net of income taxes | | |
| Change in unrealized gain on available for sale mortgages | (145) | 782 |
| Change in unrealized gain on available for sale loans and investments | 779 | (1,827) |
| Change in cash flow hedges | 6 | 6 |
| Change in unrealized gain on available for sale marketable securities | - | (74) |
| Transfer of losses on sale of marketable securities to net income | - | 108 |
| Other comprehensive income (loss) | 640 | (1,005) |
| Comprehensive income | \$ 19,278 | \$ 19,423 |

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

| For the Quarters Ended September 30 | 2009 | 2008 |
|---|------------------|------------------|
| Cash Provided by (used for): | | |
| Operating Activities | | |
| Net income | \$ 6,597 | \$ 10,397 |
| Adjusted for non-cash items: | | |
| Equity income | (717) | (1,232) |
| Provision for losses | 174 | 706 |
| Securitization income | (944) | (970) |
| Amortization of other assets | 221 | 287 |
| Amortization of mortgage discounts | (1,524) | (1,622) |
| Gain on sale of mortgages | - | (3,475) |
| Decrease (increase) in accounts receivable | 1,390 | (788) |
| Increase (decrease) in accounts payable and accrued charges | 444 | (45) |
| Cash flows from operating activities | 5,641 | 3,258 |
| Investing Activities | | |
| Mortgage advances | (382,415) | (652,796) |
| Mortgage reductions | 108,599 | 86,316 |
| Proceeds on sale of mortgages | 325,769 | 549,878 |
| Increase in loans and investments | (20,145) | (5,438) |
| Additions to other assets | (135) | (1,043) |
| Marketable securities | - | 229 |
| Cash flows from (for) investing activities | 31,673 | (22,854) |
| Financing Activities | | |
| Issue of term deposits | 172,319 | 205,874 |
| Repayment of term deposits | (180,101) | (177,111) |
| Issue of common shares | 157 | 156 |
| Dividends paid | (3,578) | (3,552) |
| Cash flows (for) from financing activities | (11,203) | 25,367 |
| Increase in cash and cash equivalents | 26,111 | 5,771 |
| Cash and cash equivalents, beginning of period | 15,158 | 14,993 |
| Cash and cash equivalents, end of period | \$ 41,269 | \$ 20,764 |

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

| For the Nine Months Ended September 30 | 2009 | 2008 |
|---|------------------|------------------|
| Cash Provided by (used for): | | |
| Operating Activities | | |
| Net income | \$ 18,638 | \$ 20,428 |
| Adjusted for non-cash items: | | |
| Equity income | (960) | (2,228) |
| Provision for losses | 657 | 1,004 |
| Securitization income | (2,183) | (3,945) |
| Amortization of other assets | 716 | 740 |
| Amortization of mortgage discounts | (2,668) | (1,644) |
| Gain on sale of mortgages | - | (3,475) |
| Distributions from MCAP Commercial LP | 1,510 | - |
| Decrease (increase) in accounts receivable | 185 | (369) |
| Decrease in accounts payable and accrued charges | (6,532) | (1,378) |
| Cash flows from operating activities | 9,363 | 9,133 |
| Investing Activities | | |
| Mortgage advances | (1,665,334) | (2,037,086) |
| Mortgage reductions | 258,428 | 270,321 |
| Proceeds on sale of mortgages | 1,460,913 | 1,722,762 |
| Decrease (increase) in loans and investments | 5,121 | (5,408) |
| Additions to other assets | (381) | (1,448) |
| Marketable securities | - | 229 |
| Cash flows from (for) investing activities | 58,747 | (50,630) |
| Financing Activities | | |
| Issue of term deposits | 403,520 | 485,557 |
| Repayment of term deposits | (469,027) | (464,907) |
| Issue of common shares | 997 | 1,123 |
| Dividends paid | (20,402) | (13,316) |
| Cash flows (for) from financing activities | (84,912) | 8,457 |
| Decrease in cash and cash equivalents | (16,802) | (33,040) |
| Cash and cash equivalents, beginning of period | 58,071 | 53,804 |
| Cash and cash equivalents, end of period | \$ 41,269 | \$ 20,764 |

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 22.3% 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, 2008. 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, 2008 and the accompanying notes included on pages 19 to 41 of the Company's 2008 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. Mortgages

| As at September 30 | Principal | Allowance | | | 2009 Net |
|---|-------------------|-----------------|-----------------|-----------------|-------------------|
| | | General | Specific | Total | |
| Single family mortgages | | | | | |
| - Uninsured | \$ 122,793 | \$ 791 | \$ 74 | \$ 865 | \$ 121,928 |
| - Uninsured (completed inventory loans) | 21,877 | 144 | - | 144 | 21,733 |
| - Insured | 64,775 | - | - | - | 64,775 |
| Construction loans | | | | | |
| - Residential | 124,795 | 995 | 1,247 | 2,242 | 122,553 |
| - Non-residential | 21 | - | - | - | 21 |
| Commercial | | | | | |
| - Uninsured | 8,810 | 158 | - | 158 | 8,652 |
| - Insured | 494 | - | - | - | 494 |
| | 343,565 | 2,088 | 1,321 | 3,409 | 340,156 |
| Fair value adjustment | 1,840 | - | - | - | 1,840 |
| | 345,405 | 2,088 | 1,321 | 3,409 | 341,996 |
| Accrued interest | 1,462 | - | - | - | 1,462 |
| | \$ 346,867 | \$ 2,088 | \$ 1,321 | \$ 3,409 | \$ 343,458 |

| As at September 30 | Principal | Allowance | | | 2008 Net |
|---|-------------------|-----------------|--------------|-----------------|-------------------|
| | | General | Specific | Total | |
| Single family mortgages | | | | | |
| - Uninsured | \$ 171,210 | \$ 980 | \$ 72 | \$ 1,052 | \$ 170,158 |
| - Uninsured (completed inventory loans) | 25,884 | 175 | - | 175 | 25,709 |
| - Insured | 49,812 | - | - | - | 49,812 |
| Construction loans | | | | | |
| - Residential | 177,622 | 1,596 | - | 1,596 | 176,026 |
| - Non-residential | 7,644 | 69 | - | 69 | 7,575 |
| Commercial | | | | | |
| - Uninsured | 11,500 | 134 | - | 134 | 11,366 |
| - Insured | 17,115 | - | - | - | 17,115 |
| | 460,787 | 2,954 | 72 | 3,026 | 457,761 |
| Fair value adjustment | 415 | - | - | - | 415 |
| | 461,202 | 2,954 | 72 | 3,026 | 458,176 |
| Accrued interest | 2,252 | - | - | - | 2,252 |
| | \$ 463,454 | \$ 2,954 | \$ 72 | \$ 3,026 | \$ 460,428 |

MCAN does not invest in 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS / THIRD QUARTER REPORT 2009
MCAN MORTGAGE CORPORATION
 SEPTEMBER 30, 2009 (Dollar amounts in thousands except for per share amounts)

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.

There were no significant fluctuations in mortgage balances during the quarter.

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, 2009, the Company holds discounted mortgages with an aggregate discount of \$27,664 (2008 - \$35,770). Upon the payout of a mortgage, the remaining unamortized discount is recognized as income. The Company retains 50% of any recoveries of the discount and pays the remaining 50% to MCLP. In addition, the Company amortizes the portion of the discount that it expects to recover into income over the remaining term of the mortgage. 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 continue to be realized over the next few years.

The composition of the discount at September 30, 2009 is as follows:

| | Gross Discount | Amortized Discount | Net Discount |
|---------------|---------------------------|-------------------------------|-------------------------|
| Fixed rate | \$ 7,218 | \$ 46 | \$ 7,172 |
| Floating rate | 20,550 | 58 | 20,492 |
| | \$ 27,768 | \$ 104 | \$ 27,664 |

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 general provision is established by considering historical loss trends during economic cycles, the risk profile of the Company's current portfolio, estimated losses for the current phase of the economic cycle and historic industry experience.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS / THIRD QUARTER REPORT 2009
 MCAN MORTGAGE CORPORATION
 SEPTEMBER 30, 2009 (Dollar amounts in thousands except for per share amounts)

The geographical breakdown of mortgages by province is as follows:

| | Single Family | Construction | Commercial | 2009 Total | |
|------------------|-------------------|-------------------|-----------------|-------------------|---------------|
| Ontario | \$ 106,225 | \$ 59,362 | \$ 4,838 | \$ 170,425 | 49.6% |
| Alberta | 52,251 | 39,665 | 2,855 | 94,771 | 27.6 |
| British Columbia | 31,524 | 19,379 | - | 50,903 | 14.8 |
| Other | 21,077 | 4,714 | 1,568 | 27,359 | 8.0 |
| | \$ 211,077 | \$ 123,120 | \$ 9,261 | \$ 343,458 | 100.0% |

| | Single Family | Construction | Commercial | 2008 Total | |
|------------------|-------------------|-------------------|------------------|-------------------|---------------|
| Ontario | \$ 119,272 | \$ 50,873 | \$ 8,910 | \$ 179,055 | 38.9% |
| Alberta | 64,836 | 93,261 | - | 158,097 | 20.3 |
| British Columbia | 36,175 | 40,005 | 17,165 | 93,345 | 34.3 |
| Other | 26,939 | 360 | 2,632 | 29,931 | 6.5 |
| | \$ 247,222 | \$ 184,499 | \$ 28,707 | \$ 460,428 | 100.0% |

Outstanding commitments for future fundings of mortgages intended for the Company's portfolio at September 30, 2009 are \$83,117 (2008 - \$81,038). Substantially all of these commitments relate to floating rate construction loans.

The details of the mortgage allowances are as follows:

| | General | Specific | 2009 Total | | General | Specific | 2008 Total | |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|--------------|-----------------|---------------|--|
| Balance, beginning of quarter | \$ 2,521 | \$ 748 | \$ 3,269 | \$ 3,061 | \$ 47 | \$ 3,108 | | |
| Provisions (recoveries) | (375) | 573 | 198 | (106) | 25 | (81) | | |
| Write-offs | (58) | - | (58) | (1) | - | (1) | | |
| Balance, end of quarter | \$ 2,088 | \$ 1,321 | \$ 3,409 | \$ 2,954 | \$ 72 | \$ 3,026 | | |

At September 30, 2009, the Company had \$1,321 of specific allowances (2008 - \$72), as follows: uninsured single family - \$75 (2008 - \$72), residential construction - \$1,246 (2008 - \$nil).

Mortgages past due but not impaired are as follows:

| | 1 to 30 days | 31 to 60 days | 61 to 90 days | Over 90 days | 2009 Total | |
|---------------------------|-----------------|------------------|------------------|-----------------|------------------|--|
| Single family - uninsured | \$ 3,584 | \$ 4,793 | \$ 2,123 | \$ - | \$ 10,500 | |
| Single family - insured | 1,208 | 191 | 402 | - | 1,801 | |
| Residential construction | - | 1,673 | 376 | - | 2,049 | |
| | \$ 4,792 | \$ 6,657 | \$ 2,901 | \$ - | \$ 14,350 | |

| | 1 to 30 days | 31 to 60 days | 61 to 90 days | Over 90 days | 2008 Total | |
|---------------------------|------------------|------------------|------------------|-----------------|------------------|--|
| Single family - uninsured | \$ 10,111 | \$ 7,803 | \$ 6,047 | \$ - | \$ 23,961 | |
| Single family - insured | 842 | 109 | - | - | 951 | |
| Residential construction | - | - | - | - | - | |
| | \$ 10,953 | \$ 7,912 | \$ 6,047 | \$ - | \$ 24,912 | |

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Impaired loans (net of specific provisions) are as follows:

| | Single Family | Residential Construction | 2009 Total | Single Family | Residential Construction | 2008 Total |
|------------------|------------------|-----------------------------|------------------|------------------|-----------------------------|-----------------|
| Ontario | \$ 1,201 | \$ 10,718 | \$ 11,919 | \$ 1,422 | \$ - | \$ 1,422 |
| Alberta | 1,306 | 6,889 | 8,195 | 2,198 | - | 2,198 |
| British Columbia | 1,030 | - | 1,030 | 620 | - | 620 |
| Other | - | - | - | 104 | - | 104 |
| | \$ 3,537 | \$ 17,607 | \$ 21,144 | \$ 4,344 | \$ - | \$ 4,344 |

3. Securitization Income

| | For the Quarters Ended September 30 | | For the Nine Months Ended September 30 | |
|------------------------------------|--|-----------------|---|-----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Gain on securitization | \$ 1,668 | \$ 813 | \$ 5,940 | \$ 3,158 |
| Residual securitization income | 604 | 1,135 | 1,052 | 2,098 |
| Write-down of interest-only strips | - | (260) | (1,235) | (260) |
| | \$ 2,272 | \$ 1,688 | \$ 5,757 | \$ 4,996 |

During the quarter, the Company securitized \$191,260 (2008 - \$178,662) of insured mortgages through the Canada Mortgage Bonds ("CMB") program as follows: single family - \$148,652 (2008 - \$178,662), multi family - \$42,608 (2008 - \$nil). The current quarter securitization was the first in which insured multi family mortgages were included in the issuance. The Company participated in the securitization with MCAP Service Corporation ("MSC") and MCLP. For the nine months ended September 30, 2009, the Company has securitized \$777,557 (2008 - \$737,869) of mortgages.

Upon sale, the Company recognized an interest-only strip of \$3,451 (2008 - \$1,663), which is a retained interest in the securitized mortgages, included in securitization investments (note 4). The Company's interest-only strips consist of the discounted value of future mortgage interest income, principal reinvestment interest receipts and penalty income less coupon interest payments. In addition, the Company established a liability for future mortgage servicing and other costs totalling \$534 (2008 - \$227) that is included in accounts payable and accrued charges. The Company subcontracts CMB servicing obligations to MSC and MCLP. The net outstanding interest-only strip position at September 30, 2009 was an asset of \$10,231 (2008 - asset of \$9,732), while total outstanding CMB liabilities were \$3,022 (2008 - \$1,949).

Residual securitization income includes the net yield earned on the interest-only strips and the CMB liabilities, refinancing and renewal gains, interest rate swap receipts (payments) and fair value changes in the interest rate swaps and interest-only strips. Fair value changes had a negative impact of \$747 to income during the quarter (2008 - positive impact of \$738). In general, fair value changes in the interest rate swaps largely offset those in the interest-only strips, however significant fluctuations in the forward rate curve to date in 2009 have had an unexpected negative impact to income. Other components of residual securitization income were \$1,351 in the quarter compared to \$397 in the prior year. In 2009, there was a significant increase in refinancing and renewal gains and a larger CMB portfolio.

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 | |
|--|--|------------|---|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Proceeds from new securitizations | \$ 192,706 | \$ 180,018 | \$ 787,650 | \$ 744,069 |
| Net cash flows received (paid) on interest-only strips | \$ (123) | \$ 503 | \$ 631 | \$ 1,459 |
| Net cash flows paid on CMB servicing and other liabilities | \$ 212 | \$ 150 | \$ 574 | \$ 349 |

4. Loans and Investments

| | | 2009 | 2008 |
|--|-----|------------------|------------------|
| Securitization investments | (a) | \$ 62,360 | \$ 37,207 |
| Loans receivable and other investments | (b) | 21,367 | 41,571 |
| | | \$ 83,727 | \$ 78,778 |

(a) Securitization Investments

Investments in Securitization Programs

| As at September 30 | Principal | Allowance | 2009 Net | 2008 Net |
|--|------------------|------------------|---------------------|---------------------|
| Subordinated loan - residential mortgage securitization program | \$ 6,781 | \$ - | \$ 6,781 | \$ 7,881 |
| Asset-backed commercial paper | 4,580 | 2,000 | 2,580 | 2,122 |
| Deferred purchase price receivable - residential construction mortgage loan securitization program | | | | |
| - senior position | 3,839 | - | 3,839 | 6,820 |
| - first loss position | 1,671 | - | 1,671 | 3,020 |
| Bonds - commercial securitization program | - | - | - | 458 |
| | \$ 16,871 | \$ 2,000 | \$ 14,871 | \$ 20,301 |

The restructuring of Third Party Structured Asset-Backed Commercial Paper ("ABCP") by the Pan-Canadian Investors Committee (the "Montreal Accord") was finalized on January 21, 2009. The restructuring converted existing ABCP into a Master Asset Vehicle II ("MAV II") investment and the existing commercial securitization program investment into a Master Asset Vehicle III ("MAV III") investment. After performing a valuation of the new ABCP, the Company recorded a \$2,000 write-down on the MAV II investment.

Other Securitization Investments

| As at September 30 | 2009 | 2008 |
|---|------------------|------------------|
| CMB - interest-only strips | \$ 15,236 | \$ 9,732 |
| Insured mortgage-backed securities | 31,229 | 6,219 |
| Other securitization assets | 1,024 | 955 |
| | \$ 47,489 | \$ 16,906 |
| Total securitization investments | \$ 62,360 | \$ 37,207 |

(b) Loans Receivable and Other Investments

Loans receivable and other investments consist of loans to private entities and employees. Loans receivable and other investments are presented net of an allowance of \$242 (2008 - \$296).

5. Securitization Liabilities

| | 2009 | 2008 |
|----------------------------|-------------|-------------|
| CMB - interest only strips | \$ 5,005 | \$ - |

As at September 30, 2009, certain CMB interest-only strips were in a liability position, primarily due to a significant decrease in forward interest rates during 2008 and early 2009. CMB interest-only strips in an asset position at September 30, 2009 totalled \$15,236 (note 4). On a net basis, CMB interest-only strips were in an asset position of \$10,231 at September 30, 2009 (2008 - net asset position of \$9,732). The aforementioned decrease in forward interest rates significantly reduced the fair market value of all outstanding interest-only strips, as future estimated reinvestment income decreased significantly in line with the drop in forward interest rates. However, there was an increase in forward interest rates during the third quarter, which led to an increase in the fair value on the interest-only strips on an overall basis.

The Company's interest rate risk that arises from the reinvestment of CMB principal collections in primarily floating rate assets is hedged by interest rate swaps, which were in an asset position of \$12,748 at September 30, 2009 (2008 - asset position of \$5,422).

Certain interest-only strips were designated as available for sale financial assets at the time of their respective issuances, wherein all changes in the unrealized fair value of the interest-only strips were recognized through accumulated other comprehensive income. As at December 31, 2008, all of these interest-only strips were in liability positions. Since financial liabilities can only be designated as held for trading or other, the designation of interest-only strips previously designated as available for sale financial assets was revised to held for trading financial liabilities. All fair value changes previously recognized through accumulated other comprehensive income were reversed at December 31, 2008, and since that time have been recognized through income.

6. Share Capital

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

| Issued | Number of Shares | 2009 | Number of Shares | 2008 |
|-------------------------------|---------------------|------------------|---------------------|------------------|
| Balance, January 1 | 14,223,506 | \$ 97,493 | 14,097,994 | \$ 96,370 |
| Issued | | | | |
| Dividend reinvestment plan | 80,872 | 843 | 86,571 | 787 |
| Executive Share Purchase Plan | 16,602 | 154 | 38,941 | 336 |
| Balance, September 30 | 14,320,980 | \$ 98,490 | 14,223,506 | \$ 97,493 |

As at November 3, 2009, the Company had 14,320,980 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.

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 | 2009 Total | 2008 Total |
|--|-----------------------|----------------------|--------------------|---------------|---------------|
| CMB interest rate swaps - fair value | \$ - | \$ 12,748 | \$ - | \$ 12,748 | \$ 5,422 |
| CMB interest rate swaps - outstanding notional | \$ - | \$ 240,045 | \$ - | \$ 240,045 | \$ 81,632 |

The interest rate swaps are included in other assets if positive, and accounts payable and accrued liabilities if negative. At September 30, 2009, the interest rate swaps were in an asset position of \$12,748 (2008 - asset position of \$5,422). 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.

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The Company adopted the Basel II capital management framework effective January 1, 2008. 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.

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 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 | 2009 | 2008 |
|--|-------------------|-------------------|
| Tax Act Test | | |
| Income tax assets | \$ 481,768 | \$ 579,406 |
| Income tax capital | \$ 117,756 | \$ 105,465 |
| Income tax assets to capital ratio | 4.09 | 5.49 |
| Regulatory Tests (OSFI) | | |
| Tier 1 capital | | |
| Share capital | \$ 98,490 | \$ 97,493 |
| Contributed surplus | 510 | 510 |
| Retained earnings | 20,048 | 12,286 |
| Tier 1 capital deductions | (9,958) | (5,592) |
| | <u>109,090</u> | <u>104,697</u> |
| Tier 2 capital | | |
| Tier 2 capital deductions | (1,146) | (1,814) |
| | <u>(1,146)</u> | <u>(1,814)</u> |
| Total capital | <u>\$ 107,944</u> | <u>\$ 102,883</u> |
| Total regulatory assets | \$ 506,188 | \$ 595,681 |
| Capital ratios | | |
| Tier 1 capital to risk-weighted assets ratio | 27.19% | 20.68% |
| Total capital to risk-weighted assets ratio | 26.90% | 20.32% |
| Assets to capital multiple | 4.69 | 5.79 |

As of September 30, 2009, the Company was in compliance with the capital guidelines issued by OSFI under Basel II.

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

| As at September 30 | 2009 | | 2008 | |
|---|-------------------|----------------------|-------------------|----------------------|
| | Balance | Risk-Weighted | Balance | Risk-Weighted |
| On-Balance Sheet Assets | | | | |
| Cash and cash equivalents | \$ 41,269 | \$ 9,165 | \$ 20,764 | \$ 4,705 |
| Mortgages | 343,458 | 208,700 | 460,428 | 301,894 |
| Loans and investments | 83,727 | 57,367 | 78,778 | 83,869 |
| Equity investment in MCLP | 17,723 | 17,723 | 19,331 | 19,331 |
| Other assets | 14,068 | 1,320 | 8,491 | 3,069 |
| | <u>\$ 500,245</u> | <u>\$ 294,275</u> | <u>\$ 587,792</u> | <u>\$ 412,868</u> |
| Off-Balance Sheet Assets | | | | |
| Letters of credit | | 6,246 | | 6,267 |
| Mortgage funding commitments | | 41,558 | | 40,519 |
| | | <u>47,804</u> | | <u>46,786</u> |
| Derivative Financial Instruments | | | | |
| Interest rate swaps | | 2,790 | | 1,166 |
| | | <u>56,388</u> | | <u>45,438</u> |
| Charge for operational risk | | | | 45,438 |
| Total Risk-Weighted Assets | | <u>\$ 401,257</u> | | <u>\$ 506,258</u> |

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 fair value of the Company's mortgages considers the existing terms of the portfolio of mortgages (e.g. interest rate, term to maturity, risk rating) relative to the current market for similar mortgages.

The Company held certain securitization investments (see note 4) at September 30, 2009 that were restructured under the Montreal Accord, and as such there was no active market for these instruments at that time. The Company calculated the fair value of these investments by discounting the expected future cash flows using an average interest rate of 2.75% (the prevailing interest rate at that time on the restructured notes) with the assumption that no interest would be received for the first five years and incorporating a principal loss assumption of 7.6% related to the amount of unrated notes received as part of the restructuring. These cash flows were discounted at 10%, which is the yield that the Company would expect to receive on similar investments. The Company performed a sensitivity analysis on this calculation by adjusting the duration of the period for which the investments were held to create a scenario in which the investment was sold after three years and a 50% principal loss was sustained. Based on the valuations from this sensitivity analysis, the Company recorded a \$2,000 write-down in the first quarter of 2009 on the new commercial paper received upon the finalization of the Montreal Accord.

Risk Management

The types of risks to which the Company is exposed include interest rate, credit, liquidity and market risk. The Company's enterprise risk management framework includes policies, guidelines and procedures, with oversight by senior management and the Board of Directors. The policies are reviewed and approved annually by the Board of Directors.

Interest Rate Risk

The Company's exposure to interest rate risk is discussed in note 10.

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. In the current economic environment, the Company has increased its monitoring of real estate market values for single family mortgages, with independent assessments of value obtained as individual mortgages exceed 90 days in arrears. 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 monthly review involving senior management and a formal quarterly review involving the Investment Committee of the Board ("ICB"). Furthermore, the Company's exposure to credit risk is 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.

The Company has established a methodology for determining the adequacy of its general allowances. At September 30, 2009, the general allowance was \$2,088, equating to 0.63% of mortgage assets that do not have a specific allowance. Actual loss experience over the past 10 years has been 0.02% per annum. The adequacy of general allowances is assessed periodically, taking into consideration such factors as economic and housing market conditions.

The Company records a specific allowance to the extent that the estimated realizable value of a mortgage has fallen below its net book value. Specific allowances include all of the accumulated provisions for losses on a particular mortgage. At September 30, 2009, the Company has recorded \$1,321 of specific allowances on its mortgage portfolio.

The Company's maximum credit exposure on its individual financial assets is equal to the par value of the respective assets.

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 a standard level of liquid investments and credit facilities in excess of 20% of term deposits maturing within 100 days. In addition, single family mortgages are generally saleable 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. The Company's liquid investments and credit facilities were 74% of term deposits maturing within 100 days at September 30, 2009. For further details on the Company's liquid assets and ability to meet liability obligations, refer to note 10.

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The Company's sources and uses of liquidity are outlined in the table below. The Company manages its net liquidity surplus/deficit by raising term deposits as mentioned above.

| | Within 3 Months | 3 Months to 1 Year | 1 to 5 Years | Over 5 Years | 2009 Total | 2008 Total |
|--|----------------------------|-------------------------------|-------------------------|-------------------------|-----------------------|-----------------------|
| Sources of liquidity | | | | | | |
| Cash and cash equivalents | \$ 41,269 | \$ - | \$ - | \$ - | \$ 41,269 | \$ 20,764 |
| Mortgages | 155,127 | 111,618 | 32,003 | 44,710 | 343,458 | 460,428 |
| Loans and investments | 287 | 14,562 | 56,578 | 12,300 | 83,727 | 78,778 |
| | <u>196,683</u> | <u>126,180</u> | <u>88,581</u> | <u>57,010</u> | <u>468,454</u> | <u>559,970</u> |
| Uses of liquidity | | | | | | |
| Term deposits | 88,566 | 252,364 | 20,226 | - | 361,156 | 466,018 |
| Securitization liabilities | - | - | 5,005 | - | 5,005 | - |
| Accounts payable and accrued charges | 7,384 | - | - | - | 7,384 | 8,344 |
| | <u>95,950</u> | <u>252,364</u> | <u>25,231</u> | <u>-</u> | <u>373,545</u> | <u>474,362</u> |
| Unfunded mortgage commitments | 8,312 | 66,493 | 8,312 | - | 83,117 | 81,038 |
| | <u>104,262</u> | <u>318,857</u> | <u>33,543</u> | <u>-</u> | <u>456,662</u> | <u>555,400</u> |
| Net liquidity surplus (deficit) | \$ 92,421 | \$ (192,677) | \$ 55,038 | \$ 57,010 | \$ 11,792 | \$ 4,570 |

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.

10. Interest Rate Sensitivity

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.

An interest rate gap is a common measure of interest rate sensitivity. A positive gap occurs when more assets than liabilities reprice within a particular time period. A negative gap occurs when there is an excess of liabilities over assets repricing. The former provides a positive earnings impact in the event of an increase in interest rates during the time period. Conversely, negative gaps are positively positioned for decreases in interest rates during that particular time period. The determination of the interest rate sensitivity or gap position is based upon the earlier of the repricing or maturity date of each asset and liability, and includes numerous assumptions.

The interest rate sensitivity analysis is based on the Company's balance sheet as at September 30, 2009 and does not incorporate mortgage and loan prepayments. The analysis is subject to significant change in subsequent periods based on changes in customer preferences and in the application of asset/liability management policies.

Floating rate assets and liabilities are immediately sensitive to a change in interest rates while other assets are sensitive to changing interest rates periodically, either as they mature, as interest payments are collected or paid, or as contractual repricing events occur. Non-interest rate sensitive assets and liabilities are not directly affected by changes in interest rates.

The Company manages interest rate risk by matching the terms of invested assets and term deposits. To the extent that the two components offset each other, the risks associated with interest rate changes are reduced.

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The following table presents the assets and liabilities of the Company by interest rate sensitivity:

| | Floating Rate | Within 3 Months | 3 Months to 1 Year | 1 to 5 Years | Over 5 Years | Non- Interest Sensitive | 2009 Total | 2008 Total |
|---|-------------------|--------------------|-----------------------|------------------|------------------|-------------------------------|---------------|---------------|
| ASSETS | | | | | | | | |
| Investments | | | | | | | | |
| Cash and cash equivalents | \$ 41,269 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 41,269 | \$ 20,764 |
| Mortgages | 167,435 | 63,278 | 64,510 | 25,727 | 1,292 | 21,216 | 343,458 | 460,428 |
| Loans and investments | 45,486 | 287 | 100 | 22,467 | 10,866 | 4,521 | 83,727 | 78,778 |
| Equity investment in MCAP Commercial LP | - | - | - | - | - | 17,723 | 17,723 | 19,331 |
| | 254,190 | 63,565 | 64,610 | 48,194 | 12,158 | 43,460 | 486,177 | 579,301 |
| Other assets | - | - | - | - | - | 14,068 | 14,068 | 8,491 |
| Total Assets | \$ 254,190 | \$ 63,565 | \$ 64,610 | \$ 48,194 | \$ 12,158 | \$ 57,528 | \$ 500,245 | \$ 587,792 |
| Yield | 3.90% | 5.91% | 7.70% | 7.13% | 6.38% | | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | |
| Term deposits | \$ - | \$ 88,566 | \$ 252,364 | \$ 20,226 | \$ - | \$ - | \$ 361,156 | \$ 466,018 |
| Securitization liabilities | - | - | - | 5,005 | - | - | 5,005 | - |
| Accounts payable and accrued charges | - | - | - | - | - | 7,718 | 7,718 | 9,432 |
| Future taxes payable | - | - | - | - | - | 5,385 | 5,385 | 3,585 |
| Shareholders' equity | - | - | - | - | - | 120,981 | 120,981 | 108,757 |
| Total Liabilities and Shareholders' Equity | \$ - | \$ 88,566 | \$ 252,364 | \$ 25,231 | \$ - | \$ 134,084 | \$ 500,245 | \$ 587,792 |
| Yield | - | 3.10% | 2.09% | 3.20% | - | | | |
| GAP | \$ 254,190 | \$ (25,001) | \$ (187,754) | \$ 22,963 | \$ 12,158 | \$ (76,556) | \$ - | \$ - |
| YIELD SPREAD | 3.90% | 2.81% | 5.61% | 3.93% | 6.38% | | | |

An immediate and sustained 1% increase (decrease) to market interest rates at September 30, 2009 would have a positive (adverse) effect of \$1,171 (2008 - \$1,261) to net investment income over the following twelve month period.

An immediate 1% increase (decrease) to market interest rates at September 30, 2009 would have an adverse (positive) effect to accumulated other comprehensive income of \$2,412 (2008 - \$998).

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:

- guarantee of the performance of MFC and MCLP pursuant to various agreements with respect to MCLP's residential construction loan securitization program;
- 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
- 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.

Management does not expect any losses as a result of these guarantees.

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, 2009, the outstanding bank loan balances were \$7,339.

12. Comparative Amounts

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

13. 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 Company is currently in the process of assessing the impact of IFRS differences on the Company's accounting policies, financial reporting, control environment, information systems and business policies. Following the completion of the assessment, the Company will begin the implementation of its conversion plan in the fourth quarter of 2009. The impact of the transition to IFRS on the Company's consolidated financial statements is not yet determinable.