CANADA MORTGAGE AND HOUSING CORPORATION

ANNUAL REPORT

1996

OUR MISSION

Committed to housing quality, affordability and choice for Canadians

CMHC SCHL

Helping to house Canadians

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CHAIRMAN'S MESSAGE

Canada Mortgage and Housing Corporation marked a significant milestone in its history in 1996, celebrating 50 years of achievement in addressing the diverse housing needs of Canadians. I am pleased to report that CMHC has embarked on a course of renewal in 1996 that will enable it to continue to respond to the challenges of its rapidly changing operating environment.

In addition to modernizing its key business lines, the Corporation has launched a process of organizational renewal that will further enhance the efficiency of its operations and the quality of service to Canadians. Building on these efforts, the Board of Directors has established a Corporate Governance Committee that will ensure CMHC's governance arrangements continue to be effective and responsive to the organizational changes.

As we approach the 21st century, Canadians can be confident that the steps taken in 1996 will ensure that CMHC continues to be a dynamic and flexible organization, responsive to their evolving housing needs.

Peter R. Smith

REPORT OF THE PRESIDENT

NEW DIRECTIONS FOR CMHC

The Government of Canada is transforming the role it plays in all areas, focusing on what is required to ensure a vibrant Canadian society while clarifying and strengthening its partnerships with other levels of government and the private sector. As part of this commitment to "Getting Government Right", Canada Mortgage and Housing Corporation is also directing its efforts to those areas where it is best positioned to make a difference on behalf of Canadians. The first step in this process of modernizing the federal role in housing and renewing the Corporation's mandate began in 1996.

The initiatives being pursued will seek to renew the functions of the Mortgage Insurance Fund (MIF) and the Mortgage-Backed Securities Guarantee Fund (MBSGF), an area where the federal government has been instrumental in helping generations of Canadians achieve their dreams of homeownership. Consumers will benefit from more competitive pricing for mortgage financing, more efficient service, and more innovative housing finance products, while continuing to have access to these services in all regions of the country.

The orderly transfer of federal management responsibilities in social housing, on which discussions have promisingly ? begun with provinces and territories, is another important, tangible step in this new direction. Existing administrative arrangements in social housing will be greatly streamlined, thereby laying the groundwork for one-stop shopping for clients, and encouraging the best possible use of public funds. Reduced overlap will allow resources to be redirected to the extent possible to housing assistance for low-income Canadians. The first agreement was recently signed with Saskatchewan, and we expect several more to be concluded during 1997.

Under its renewed mandate, CMHC continues to support research and development, market analysis and information transfer, while pursuing effective partnerships in these areas. These activities have been instrumental in promoting improvements in the efficiency and competitiveness of housing markets, and in the affordability and quality of housing available to Canadians. As well, CMHC is furthering its efforts to promote the export of Canadian housing expertise abroad, to assist Canada's housing industry to take advantage of emerging opportunities in the global marketplace while increasing employment for Canadians at home.

Having clarified its key lines of business, CMHC embarked on a process of organizational renewal in 1996, to ensure that its resources are marshaled in such a way as to achieve the best possible results in those areas where it is active. To facilitate this renewal process, a Transition Team was established within the Corporation, charged with the task of developing a revised statement of CMHC's corporate mission, vision and values, and to explore organizational options in support of the new mandate. In recognition of the fact that CMHC's clients and employees are its life-line to success, their views have been solicited as part of this review process.

Throughout the process of change and renewal, the bottom line objective being pursued is to modernize the Corporation's business operations to address current fiscal realities, promote more efficient program delivery, and improve service to Canadians.

These developments, which are further described in this annual report, represent significant milestones in the Corporation's evolution. They exemplify CMHC's continuing commitment to excellence and its capacity to find innovative ways to better meet the housing needs of Canadians. Since becoming President, I have been consistently impressed by the high regard with which CMHC, and its talented and dedicated employees, are held in this country and internationally as well. Given these strengths, I am fully confident that the Corporation will be successful in implementing its new mandate, therefore improving housing affordability and choice for Canadians for generations to come.

Marc Rochon

Since its creation through the Canada Mortgage and Housing Corporation Act in 1946, Canada Mortgage and Housing Corporation (CMHC) has consistently responded to the challenges of helping meet Canadians' changing housing needs. Indeed, over the past half-century, CMHC has helped make Canada's housing sector one of the strongest in the world.

The Corporation has played a pivotal role in developing the standards and practices required by a growing housing industry, found new ways to help Canadians finance home purchases, introduced countless innovations in housing systems, and created social housing programs to help those most in need. As a result of this record of dedication and innovation, Canadians are among the best housed people in the world, and a majority own their homes.

In 1996, in response to changes in the Corporation's mandate announced by the federal government, CMHC began a process of corporate renewal that will continue into 1997. A transition team, in consultation with staff, clients and partners, formulated a new CMHC Vision, Mission Statement and related Corporate Values. This renewed focus will guide the Corporation in its re-engineering process as it becomes more client focused, flexible, innovative and entrepreneurial to fulfill its renewed mandate.

In 1996, falling interest rates, moderate economic growth, rising employment levels and a rising demand for housing all contributed toward creating a relatively strong year for Canadian housing markets. Housing starts rose 12 percent to 124 713 units, while sales of existing homes rose 27 percent to a record high of 321 190 units.

Canada's GDP growth slowed to 1.5 percent in 1996 from 2.3 percent in 1995. Job creation improved to 189 000 from 95 000 in 1995. Inflation remained low at 1.6 percent, compared to 2.2 percent in 1995.

However, other demographic factors restrained the rising demand for housing. Net migration was down to 199 000 in fiscal 1996, from 227 000 in 1995. In addition, concerns related to job prospects and employment security have caused some young adults to delay forming their own households, dampening this traditional source of demand for home purchases and rentals.

In 1997, low mortgage rates, combined with good economic growth and improved consumer confidence, should make for a more robust housing market. Housing starts are expected to rise in 1997.

CMHC'S NEW MISSION

Committed to housing quality, affordability and choice for Canadians.

A NEW VISION

"CMHC is a leader in housing. We meet or exceed client expectations through quality service and world-class products. We succeed through our employees who are valued and respected as individuals and recognized for their contribution."

In pursuing this new vision, CMHC is committed to values shared at every level: respect for employees and clients and a commitment to meeting the demands of providing services with an entrepreneurial focus.

Our vision will be realized through four key pillars:

HOUSING FINANCE

CMHC ensures availability, accessibility and choice of housing funding to Canadians by being creative, competitive and effective.

RESEARCH AND INFORMATION TRANSFER

CMHC improves housing and supports the housing market by being the key Canadian source of reliable and objective housing information.

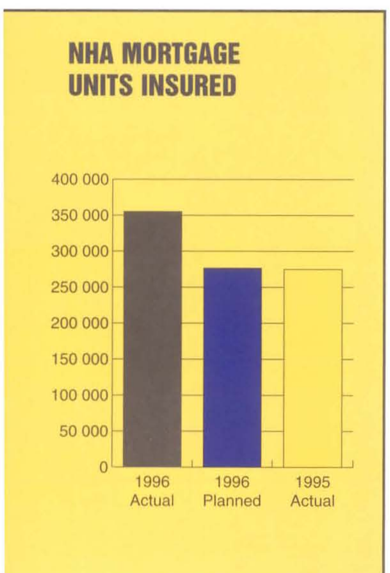
ASSISTED HOUSING

CMHC participates in assisted-housing initiatives as directed by the federal government with ongoing responsibility for federal social housing funding. In particular, CMHC supports Aboriginal communities in their efforts to become self-sufficient in developing and maintaining their housing.

INTERNATIONAL

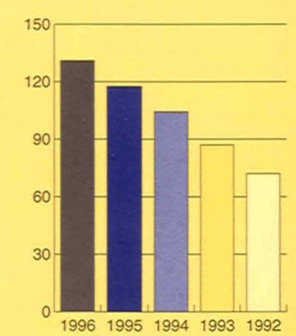
CMHC supports and promotes the export of Canadian housing products and expertise by identifying market opportunities and providing practical information and advice to the housing industry.

- As announced in the March 6, 1996 federal budget, CMHC began the process of renewing the operations of the Mortgage Insurance Fund (MIF) and the Mortgage-Backed Securities Guarantee Fund (MBSGF) to ensure that Canadians continue to benefit from competitively-priced mortgage financing, efficient service and innovative housing finance products.
- As part of the government's broader efforts to "Get Government Right", reduce overlap and make the country work better, provinces and territories have been offered the opportunity to assume a greater role in the management of existing federal social housing resources.
- CMHC took significant steps toward strengthening the role of Aboriginal peoples in housing program administration by signing the first Agency Agreement under the CMHC/Aboriginal Capital Corporations Pilot Project to help Aboriginal groups acquire housing finance expertise.
- CMHC helped a record number of households in all parts of Canada to achieve their dream of homeownership. A total of 355 009 units were purchased with the assistance of NHA Mortgage Insurance, accounting for 42 percent of all Canadian mortgages underwritten this year, compared to 41 percent in 1995.
- The First Home Loan Insurance (FHLI) Program continued to be popular, assisting 138 480 first-time homebuyers across Canada. Since inception, the FHLI Program has helped 478 868 Canadians purchase their first home much earlier, while supporting economic growth in the resale housing market and job creation in the residential construction sector.
- CMHC officially introduced **emili**, its automated mortgage underwriting system. **emili** provides CMHC's Approved Lenders with an electronic tool that accurately assesses mortgage risk, enhances the quality of NHA insured loans, and improves the responsiveness of CMHC's already highly efficient client service.



- To ensure the long-term viability of the rental loan insurance product, CMHC adjusted its rental loan policy and insurance premium structure. During the year, CMHC provided NHA Mortgage Insurance for 60 percent of the multiple unit residential mortgage market.
- CMHC responded to housing industry needs by initiating a 1-800 information service that provides housing exporters with one-stop shopping for information on export-related programs.
- CMHC's Healthy House opened in the heart of Toronto. This self-sufficient house was developed by a range of public and private sector partners, and is the culmination of fifteen years of research on incorporating Healthy Housing principles in residential design and construction.
- CMHC's FlexHousing Competition inspired designers from across the country to submit innovative house plans that are adaptable to the changing needs of all Canadians, and particularly to seniors and persons with disabilities.
- As part of the government's job creations efforts, several short-term housing initiatives were extended that will also result in tangible improvements in housing conditions for needy Canadians. The initiatives included the Residential Rehabilitation Assistance Program (RRAP), to assist low-income homeowners and persons with disabilities address health and safety problems in their homes, the Home Adaptations for Seniors Independence (HASI) initiative to help low-income seniors live independently for longer periods of time in their own homes, the Shelter Enhancement initiative to upgrade existing shelters for victims of family violence, and the Remote Housing initiative to assist in the construction of new homes for low income households in small, remote communities and reserves.

MORTGAGE LOAN INSURANCE IN FORCE ($B)



	1996 Actual	1996 Planned	1995 Actual
Corporate Account			
Net Income (Loss) ($m)	(6.6)	1.8	(8.6)
Real Estate Sales ($m)	17.0	56.8	11.8
Gain on Real Estate ($m)	(5.2)	18.7	1.6
Direct Lending Assets			
(Net increase in current year) ($m)	2 015.0	2 530.7	2 092.8
Minister's Account			
Social Housing Units Committed	13 967	17 080	16 427
Units under Administration	656 587	671 007	664 235
Grants, Contributions, Subsidies ($m)	1 944.6	1 956.4	2 001.9
Insurance and Guarantee Funds			
Mortgage Insurance Fund			
Units Insured	355 009	276 477	274 834
Net Income (Loss) ($m)	10.0	79.0	86.1
Surplus (Deficit) ($m)	18.1	7.2	8.1
Insurance in Force ($b)	131.0	125.4	117.6
Mortgage-Backed Securities Guarantee Fund			
Securities Issued ($b)	1.7	3.2	1.6
Corporate Resources			
Staff Years	2 565	2 601	2 824
Operating Budget ($m)	268.7	272.6	249.2

MORTGAGE LOAN INSURANCE & MORTGAGE-BACKED SECURITIES — MAKING HOUSING FINANCE ACCESSIBLE

CMHC's National Housing Act (NHA) Mortgage Loan Insurance assists Canadians across the country to access home-ownership or rental accommodation at the lowest possible down payment and cost by guaranteeing mortgage loans issued by banks and trust companies. As well, NHA Insurance helps the mortgage market to adjust to changing economic conditions, supports other government initiatives and encourages the provision of mortgage funds at favorable interest rates.

The Corporation's National Housing Act Mortgage-Backed Securities (NHA-MBS) program promotes the development of a secondary mortgage market by offering investors guarantees of timely payments on pools of residential mortgages insured by CMHC and backed by the Government of Canada. In addition to offering investors high interest rates and security, NHA-MBS benefit homebuyers by increasing the amount of private capital available for mortgages, thereby helping keep interest rates competitive and encouraging lenders to offer mortgages renewable at longer terms.

In 1996, the Government of Canada approved new policy directions for the Mortgage Insurance Fund (MIF) and the Mortgage-Backed Securities Guarantee Fund (MBSGF). These changes will further promote housing affordability and choice; improve access to housing finance and make the housing finance market more competitive and efficient; protect the availability of adequate funding for housing at low cost; and generally contribute to the well-being of the housing sector in the national economy. The renewal of CMHC's operations in this area will benefit consumers by bringing about more competitive pricing, more efficient service, and more innovative mortgage insurance products, while ensuring that mortgage financing is available in all regions of Canada.

OBJECTIVE

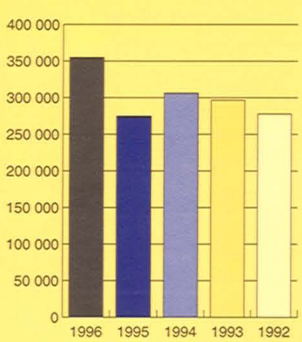
To promote an effective mortgage market by delivering CMHC's NHA Mortgage Loan Insurance products and services all across Canada, while continuing to meet or exceed client expectations and effectively managing the Mortgage Insurance Fund.

KEY STRATEGIES

To deliver competitive and responsive mortgage insurance products and services through focused research and development.

To demonstrate commitment to client satisfaction by continuing to streamline and improve the delivery and cost-effectiveness of products and service to clients.

MORTGAGE LOAN UNITS INSURED



MORTGAGE LOAN INSURANCE

RECORD NUMBER OF MORTGAGES INSURED IN 1996

During 1996, CMHC helped Canadians across the country access a record 355 009 housing units with the use of NHA Mortgage Insurance, including 11 893 social housing units. The continuing popularity of the First Home Loan Insurance (FHLI) Program resulted in 138 480 first-time homebuyers achieving their dream of homeownership in 1996. Without programs like FHLI and the existence of NHA Mortgage Insurance, most of these Canadians would not have been able to purchase their home as early as they did. The FHLI program reduces the minimum downpayment requirement from ten percent to five percent for first-time homebuyers. Since 1992, when the FHLI program was introduced, 478 868 Canadians have used the program to purchase their first home.

CMHC clients expect the Corporation to be flexible and responsive to changes in the mortgage insurance market. CMHC's annual client consultations and surveys, as well as a record level of mortgage loan issuance this year, again affirmed that the Corporation was consistently meeting its objectives.

IMPROVED MARKET CONDITIONS

With Canadians purchasing a record number of homes in 1996 with NHA Mortgage Insurance, related industries such as new construction, renovations and housing-related sales also improved. The recovery in new construction, underway since the second half of 1995, continued throughout 1996. New units accounted for approximately 12 percent of housing insured by CMHC in 1996. Increasing consumer confidence in the resale housing market, particularly in Ontario and British Columbia, added to the economic growth of 1996.

ENHANCED UNDERWRITING, DEFAULT MANAGEMENT AND CLAIMS PROCESS

This year, CMHC officially launched its new computer-based underwriting system for homeowner mortgage loans. Called **emili**, the on-line system allows CMHC to give its Approved Lenders faster and more cost-effective service, while reducing paper transactions. As well, **emili** is expected to improve the overall quality of the Approved Lenders' mortgage portfolio by reducing risk and ensuring that the quality of mortgage insurance applications that are approved is consistently high.

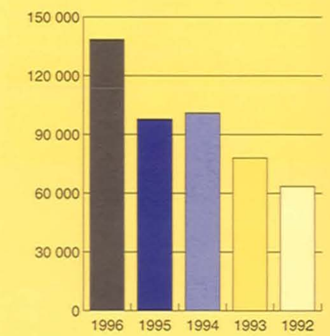
CMHC's mortgage loan insurance makes it easier for Canadians to buy homes by reducing the size of the downpayment to as little as ten percent of the purchase price, or just five percent for first-time buyers. These purchases have contributed significantly to job creation in construction and related industries.

The Accelerated Claims Payment Plan (ACPP) was substantially expanded in 1996. An ACPP project to enhance the deficiency sales process of real estate acquired as a result of foreclosures was successfully piloted with five major NHA Approved Lenders. The project allowed lenders to establish their own listing and sale prices within CMHC criteria. CMHC will fully implement the process in 1997, increasing the Corporation's flexibility and efficiency, while reducing costs and increasing control for Approved Lenders. Already, about 87 percent of homeownership claims are processed with ACPP.

In 1996, CMHC insured 60 percent of the multiple unit housing mortgage market. As part of its continuing efforts to minimize risk and improve portfolio quality, the Corporation introduced several improvements to underwriting, default management and claims processes for multiple unit housing. One such enhancement was the establishment in all regions of the country of the Centres for Default Management.

In 1996, CMHC adjusted its rental loan policy and insurance premium structure to ensure that NHA Mortgage Insurance will continue to be made available to facilitate the continued construction, purchase and/or repair of rental housing. The new premiums encourage a market of low-risk rental business while ensuring the provision of cost-effective mortgage insurance for multiple unit residential projects at higher loan-to-value levels.

FIRST HOME LOAN INSURANCE (UNITS INSURED)



As well as giving Approved Lenders faster and more cost-effective service, CMHC's new computer-based **emili** *underwriting system for homeowner mortgage loans has helped ensure the consistent quality of CMHC's Mortgage Loan Insurance portfolio.*

Enhanced mortgage loan insurance flexibility and cost-effectiveness are just a few of the results achieved through CMHC's continuous research on the needs of Canadian home buyers, and its consultations with Approved Lenders and other stakeholders.

LENDERS APPROVE OF CMHC'S SERVICE QUALITY

The Corporation's annual survey of Approved Lenders this year affirmed that responsiveness and high-quality service, such as same-day application processing, are long-standing achievements of CMHC's mortgage loan insurance operations.

Effective service continues to be one of the most important qualities CMHC clients expect. In 1996, 90 percent of all mortgage loan insurance applications were processed in one day or less. Additional Approved Lenders are linking up with **emili**, and CMHC expects to continue enhancing its already excellent mortgage insurance process.

CLIENT-FOCUSED MORTGAGE INSTRUMENTS

To continue to meet changing client needs, CMHC introduced several new mortgage instruments in 1996. CMHC Portable Mortgage Insurance allows eligible NHA homeowner borrowers to transfer their mortgage insurance premium to a subsequently purchased property. CMHC also revised its underwriting policy to meet Approved Lender requests for amendments to the fee collection process. As a result, Approved Lenders who submit underwriting fees and premiums to CMHC in a single payment can now reduce the cost of mortgage loan insurance delivery.

MORTGAGE LENDING TRAINING CENTRE

In its continuing effort to develop partnerships in the industry while improving the quality of underwriting, CMHC, through its Mortgage Lending Training Centre, entered into a training agreement with the Real Estate Institute of Canada (REIC).

NHA MORTGAGE-BACKED SECURITIES

CHANGES TO NHA MBS

CMHC's National Housing Act Mortgage-Backed Securities (NHA-MBS) are a secure investment in a pool of residential insured mortgages, offering a timely payment guarantee of principal and interest to investors. To ensure the quality and effectiveness of its MBS products and services, CMHC regularly consults with NHA-MBS stakeholders on desired changes.

CMHC this year received several recommendations from a strategic analysis of the NHA-MBS program performed by a team including the Corporation, investors, issuers, investment dealers and members of the housing industry. Some of these recommendations, currently under development, include the introduction of multi-issuer pools and the use of conventional mortgages, both of which will increase funds to the mortgage market, making it more efficient and competitive.

Also in 1996, CMHC introduced streamlined administrative procedures, resulting in reduced costs for MBS issuers.

ISSUANCE STEADY

NHA-MBS issuance was $1.72 billion, up from $1.56 billion in 1995 but below the target of $3.20 billion — a result of the continuing small interest rate differential between equivalent-term Government of Canada bonds (on which MBS are priced) and mortgage rates, which makes securitization generally unprofitable for issuers. Alternative sources of funds resulted in a liquid market, therefore limiting the use of MBS in 1996.

RENTAL GUARANTEE FUND CLOSED

In 1996, after the final project of the Rental Guarantee Program (RGP) was sold, CMHC closed the Rental Guarantee Fund. The RGP guaranteed the rental returns of private investors for moderate-cost rental housing projects. CMHC has not provided new guarantees since 1954.

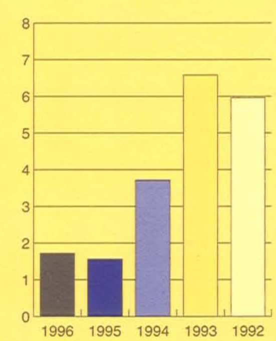
OBJECTIVE

To promote a healthy, liquid secondary mortgage market that supports lower mortgage interest rates and longer-term mortgages.

KEY STRATEGY

To implement industry team recommendations based on the recent strategic analysis of the NHA-MBS program.

NHA MBS ISSUANCE ($B)



To reduce overlap and streamline existing administrative arrangements in social housing, CMHC began negotiations in 1996 to transfer the management of existing federal resources to provinces and territories.

CMHC's social housing programs are aimed at helping those Canadians who most need assistance: people with disabilities, victims of family violence, low-income households, seniors and Canada's aboriginal peoples.

Unilaterally or in partnership with the provinces and territories, CMHC subsidizes, on behalf of the federal government, Canada's stock of more than 655 000 units of social housing. The stock is operated through long-term administrative and funding agreements between CMHC and the provinces or territories, and between CMHC and locally-based housing organizations.

MODERNIZING THE FEDERAL ROLE IN SOCIAL HOUSING

As part of the government's broader efforts to "Get Government Right", provinces and territories have been offered an opportunity to take over the management of existing federal social housing resources, with the exception of housing programs for Aboriginal people living on reserves. The federal government will continue to meet its existing financial obligations related to social housing under the new arrangements. Provinces and territories will gain additional flexibility in the management of these resources, subject to national principles and an accountability framework that will ensure that federal subsidies are used for housing and are targeted to low-income households.

Once implemented, these new directions will deliver important benefits to Canadians, to provinces and territories, to social housing clients and to taxpayers. Administrative arrangements in social housing will be streamlined as a result, thereby laying the groundwork for one-stop shopping for clients and more efficient use of taxpayers' dollars.

OBJECTIVE

To strengthen partnerships with provinces and territories in social housing.

KEY STRATEGY

To streamline existing administrative arrangements by offering to transfer responsibilities for the management of existing federal social housing resources to provinces and territories.

PROGRAM DELIVERY/SPECIAL INITIATIVES

IMPROVING HOUSING CONDITIONS

In 1996, the federal government announced strategic housing initiatives to assist persons in the greatest need: low-income families, aboriginal and remote communities, the aged, children and youth, and victims of family violence. As well as improving housing conditions for these groups, the initiatives created approximately 2 300 jobs across the country.

The Residential Rehabilitation Assistance Program (RRAP) was extended from 1 January 1996 to 31 March 1997. The program helps low-income homeowners bring their houses up to health and safety standards. It also helps persons with disabilities make their homes accessible. Through the Rental and Rooming House component, the program also helps upgrade rental accommodations for low-income tenants. The government also allocated funds for the Emergency Repair Program (ERP), which funds urgently required repairs of housing in rural areas. Altogether, $35 million was approved under the RRAP and ERP programs, permitting the renovation of more than 7 700 housing units.

In 1996, CMHC's Home Adaptations for Seniors Independence (HASI) initiative, delivered on a demonstration basis from 1992 to 1994, assisted 1 722 low-income seniors to make minor home adaptations.

The Corporation launched a Remote Housing initiative for low-income households living in small, remote communities. CMHC grants paid for home construction, with client households providing volunteer labor. More than 270 units were built under this program.

OBJECTIVE

To support social housing through new partnership arrangements with the provinces and territories, private non-profit organizations and sponsors.

KEY STRATEGY

To explore opportunities for new program delivery and new partnership arrangements.

PROGRAM DELIVERY	NUMBER OF UNITS		
	1996(1)		1995
	ACTUAL	PLAN	ACTUAL
SUBSIDY PROGRAMS			
On-Reserve Non-profit	1 324	899	1 100
REPAIR PROGRAMS			
Residential Rehabilitation Assistance Programs (RRAP)			
Homeowner	3 601	4 783	7 241
Disabled Homeowner	650	862	1 308
Rental and Rooming House	2 090	3 669	4 983
On-Reserve	773	576	842
Emergency Repair Program	599	857	953
REMOTE HOUSING			
Off-Reserve	272	238	–
On-Reserve	310	254	–
Home Adaptations for Seniors Independence (HASI)	1 722	3 221	–
Shelter Enhancement(2)	2 626	1 721	–
TOTAL	13 967	17 080	16 427

(1) The On-Reserve RRAP and Non-Profit units are reported for calendar year 1996 whereas the remaining actual units represent units committed as at 31 December, 1996 against plans for fiscal 1996/1997.
(2) An additional 1488 bed units were committed in early 1996 against the 1995/1996 fiscal budget.

The Shelter Enhancement Initiative funded new and renovated shelter facilities for victims of family violence. Approximately $5 million financed the capital cost requirements of bringing existing shelters to acceptable standards of health, safety and security, and of addressing the special needs of children, persons with disabilities and older clients.

OBJECTIVES

To seek approval of a new approach to on-reserve housing for First Nations.

To strengthen the role of Aboriginal peoples (on and off reserve) in the planning, delivery and administration of housing programs.

KEY STRATEGIES

To develop housing proposals for Aboriginals living on reserves.

To continue to work with Aboriginal peoples (on and off reserve) toward self-sufficiency in housing, and toward greater community control of housing.

To explore new ways of securing financing for Aboriginal housing on reserve.

To expand agreements with Aboriginal housing agencies to manage existing Rural and Native Housing (RNH) stock, and assist in implementing land entitlement agreements.

ABORIGINAL HOUSING

FEDERAL ON-RESERVE POLICY CHANGES

The federal government announced changes to its on-reserve housing policy, including approval to modify the existing non-profit program. Under the new policy, First Nations will receive full subsidies to cover the difference between project costs and project revenues, allowing them to assist low-income households. CMHC met with a number of First Nations representatives during the second half of the year to explain the implications of the new policy and to discuss program design.

STRENGTHENING ABORIGINAL ROLE IN HOUSING ADMINISTRATION

In 1996, CMHC took significant steps toward strengthening the role of Aboriginal peoples in housing program administration by expanding agreements and training initiatives.

CMHC signed and implemented 13 new Rural and Native Housing (RNH) Property Management Agreements (PMAs) to further strengthen the role of Aboriginals off reserve in the management of RNH stock portfolios. There are now 26 agreements in place in six provinces. RNH Property Management groups are administering approximately 90 percent of the RNH portfolio in these six provinces.

The Corporation also began implementing land entitlement agreements, transferring 26 former RNH units to First Nations in Saskatchewan. CMHC is discussing similar transfers with other Bands in Manitoba.

In February 1996, CMHC signed the first Agency Agreement under the CMHC/Aboriginal Capital Corporations Pilot Project. The Pilot Project will help Aboriginal groups build housing finance expertise by allowing them to finance or refinance subsidized Urban Native and On-Reserve social housing projects through CMHC's Direct Lending initiative.

CMHC'S new On-Reserve Remote Housing initiative resulted in more than 310 units built. This one-year initiative funds home construction through capital grants, and involved Bands in all phases of planning, delivery, construction and property management. First Nations maximized the impact of their funding allocation by contributing personal time and skills in building their units.

OBJECTIVE

To improve the efficiency and effectiveness of social housing administration and ensure that subsidies are used effectively to serve intended clients of the programs.

KEY STRATEGIES

To pursue opportunities to simplify administrative and reporting requirements through the harmonization of programs and the transfer of responsibilities. The Corporation will implement improved mechanisms, including quality indicators, to assess the physical condition of the existing stock.

PORTFOLIO MANAGEMENT

MAXIMIZING EXISTING RESOURCES

In 1996, CMHC's streamlining and harmonization effort focused on negotiating transfer of management responsibilities with the provinces and territories. In other areas, CMHC implemented a streamlined claim process, eliminated project level data, and harmonized budgets.

CMHC continued to act on opportunities for improving management of the social housing portfolio. For example, some measures were introduced to assess the condition of projects and their potential to enter into difficulty. These opportunities were identified by the Corporation's Quality Assurance Review, introduced in 1995.

Direct Lending, implemented in 1993, continued to provide low-cost financing in 1996, with 2 088 loans approved, for a total amount of $2 079.4 million financed for new commitments and renewals. Under Direct Lending, CMHC acts as a break-even lender to non-profit and cooperative projects and to provincially and privately financed public housing projects, thus lowering the federal government's cost of subsidizing social housing.

CMHC PORTFOLIO MANAGEMENT	Number of Units		
Category	CMHC-administered	Provincially-Territorially-administered	Total
Social Housing			
Public	1 075	204 401	205 476
Rent Supplement	1 061	46 363	47 424
Non-profit	59 992	107 856	167 848
Low Rental	105 956	–	105 956
Cooperative	38 865	5 459	44 324
On-Reserve	18 022	–	18 022
Urban Native	9 437	1 232	10 669
Rural and Native	8 476	14 913	23 389
Rental Residential Rehabilitation Assistance	13 667	5 117	18 784
Market Housing			
Federal Cooperative	14 695	–	14 695
Total	271 246	385 341	656 587

ASSET ADMINISTRATION AND SERVICES TO OTHERS

With an asset portfolio worth over $14 billion (including land holdings), CMHC is a major mortgage and loan administrator. The Corporation earns its profits from the margin on its financing operations and from gains on the disposal of land. CMHC also offers services to government departments and agencies on a cost-plus basis. These fee-for-services activities include the development of surplus lands, inspections and appraisals, and mortgage administration.

LENDING AND LOANS ADMINISTRATION

CMHC's loans administration includes the Corporation's own mortgage portfolio, specifically mortgages resulting from CMHC's Direct Lending initiative for social housing projects, and mortgages administered for others, for which CMHC has agreements with investors.

CMHC's mortgage portfolio, with the exception of mortgages recently acquired through Direct Lending, has been declining since the late 1970s. As the older segment of the portfolio declines and ages, the profit margin, which covers the cost of administration and contributes to the Corporation's income, decreases.

OBJECTIVE

In consultation with communities, to market, develop and dispose of land to support government objectives of partnership, job creation, deficit reduction and sustainable development.

KEY STRATEGY

To deliver high-quality communities and enhanced financial returns through CMHC land development activities.

LAND MANAGEMENT

REVIEWING LAND MANAGEMENT

In the 1970s, CMHC began to offer land management services, helping develop lands to create well-planned communities, while optimizing financial returns. Some of these lands were owned by CMHC itself, and some were surplus lands from other federal departments.

Over the years, CMHC has developed new communities on its own lands in partnership with provinces, and on surplus federal lands on a fee-for-service basis. In 1995, the federal government gave the Canada Lands Corporation (CLC) the responsibility of managing the disposal of large surplus real estate assets. In 1996, CMHC reached an agreement with CLC — the Corporation will continue to manage three fee-for-service projects, reporting to CLC rather than Treasury Board. CMHC is reviewing its Land Management project portfolio to determine which of its existing profitable projects it will complete, and to propose appropriate disposal options for the remaining projects. At the end of 1996, the Corporation's portfolio comprised 1 822 hectares.

CORPORATE OWNED REAL ESTATE

The Corporate Owned Real Estate (CORE) portfolio was acquired as a result of defaults on uninsured CMHC loans and former NHA programs. In 1996, 253 CORE units were sold, compared to a plan of 177 units. Negotiations for disposal of some of the other and larger projects have been unsuccessful.

CMHC helps to ensure that Canadians are well housed by pursuing innovative housing approaches in concert with federal government departments and agencies, provincial and territorial partners, the housing industry, non-profit groups and communities.

HOUSING RESEARCH — ENCOURAGING INNOVATION

CMHC's housing research and information transfer efforts improve the technical, economic, environmental and social aspects of housing. Working with the National Housing Research Committee and many private and public sector partners, CMHC identifies priority issues and ensures that the results of this work are widely shared.

CMHC is a leader in advancing sustainable development. In 1996, the Corporation's Healthy House in Toronto opened to the public. Five major public agencies and over 80 private industry sponsors partnered in the construction of this house, which has no connections to municipal electrical, water or sewer services.

ADDRESSING CRITICAL ISSUES

This year, the Corporation conducted groundbreaking research on collecting data on homelessness. CMHC also conducted two major studies — the first of their kind in Canada — on the housing and living conditions of Canada's Aboriginal population. The Corporation also worked with Aboriginal groups to develop training materials for builders and housing managers on-reserve to help them meet the housing challenges of reserve communities. A series of CMHC publications was developed to provide planners, municipal administrators and builders with practical solutions to the challenges of sustainable development. Working with industry and government, CMHC undertook field tests, simulations and research on high-rise residential construction in Canada.

OBJECTIVE

To conduct and foster effective research and information transfer initiatives that are timely and relevant to our clients.

KEY STRATEGIES

To focus on priority issues such as improving the efficiency of the marketplace, addressing the housing needs of special groups such as seniors, Aboriginal peoples and persons with disabilities, promoting the competitiveness and innovative capability of the Canadian housing industry, and improving access to quality housing.

To develop and disseminate information products appropriate to a range of audiences, sharing research results and encouraging innovative approaches to housing and community planning.

CMHC'S RESEARCH PRIORITY AREAS

- Encouraging Affordable Housing
- Promoting Viable Rental Markets
- Supporting the System of Housing Finance
- Understanding Housing in the Canadian Economy
- Managing and Preserving the Existing Stock
- Improving the Technical Performance of Housing
- Promoting Healthy Housing and Communities
- Assisting Groups with Distinct Needs — Aboriginals, the Homeless, Persons with Disabilities and Seniors.
- Promoting Health and Well-being Through Housing
- Addressing Consumer Concerns

NEW APPROACHES TO HOUSING

Several CMHC initiatives encouraged innovative approaches to meeting housing challenges. In partnership with the Canadian Home Builders' Association (CHBA) and l'Association provinciale des constructeurs d'habitation du Québec (APCHQ), CMHC and Natural Resources Canada initiated six renovation projects that demonstrate how healthy housing principles and an energy retrofit can be integrated into a renovation. In partnership with the Yukon Housing Corporation, CMHC completed two houses in Dawson City that have innovative foundations and heating/ventilating systems optimized for northern climates.

ACT PROGRAM EXTENDED

After a comprehensive evaluation, CMHC's Affordability and Choice Today (ACT) Program was extended for three years. In communities throughout Canada, ACT has encouraged regulatory innovations leading to lower housing costs and an improved range of housing choices.

SHARING SOLUTIONS

Throughout the year, CMHC provided crucial information to a range of audiences in a variety of ways. Tours, publications, an Internet site, museum exhibits and media coverage—these are just some of the ways that CMHC informed Canadians about subjects such as the benefits of healthy housing and innovation in high-rise technology. Seminars and presentations to both industry and consumers promoted innovative approaches to construction and renovation by presenting the results of research in areas such as acoustics, rain penetration, heating and ventilating systems and indoor environments.

CMHC's FlexHousing Design Competition encouraged housing that can be affordably adapted to changing needs, offering advantages to all Canadians — and particularly to seniors and persons with disabilities. The winning projects will be open to the public in 1997.

MARKETING AND COMMUNICATIONS

MARKET ANALYSIS

CMHC's Market Analysis Centre helps improve decision-making in Canada's housing markets by providing timely and accurate information, analysis and forecasts through publications, press releases and presentations.

In 1996, CMHC offered a Canada-wide series of Housing Outlook Conferences in 17 centers, attracting a significant paid attendance. This new approach to information disseminating was a resounding success.

NEW PRODUCTS

The Corporation is developing a suite of new local products that will be available by subscription. The *Housing Market Outlook,* which presents housing market outlooks for 27 metropolitan areas, is one of these; another is a fax product on rental market surveys for over 150 centres across the country. The suite will be launched in 1997.

CMHC also developed *Housing Facts,* a monthly fax product on trends and related housing analyses. Designed for easy reading, *Housing Facts* was sent to few subscribers in 1996 on a pilot basis and will be sent to all subscribers of national publications in 1997.

CMHC worked in partnership with the Conference Board of Canada to disseminate housing information and sell CMHC survey data and market analysis reports on the Canadian Housing Markets On-line Service (CHMOS) Web site.

OBJECTIVE

To assist the Canadian housing sector internationally.

KEY STRATEGIES

To increase the housing industry's awareness of export opportunities, work with the industry to improve its export readiness and heighten the international presence of the housing industry and CMHC.

CMHC'S INTERNATIONAL ROLE

PURSUING CANADA'S INTERNATIONAL HOUSING INTERESTS

In 1996, CMHC was conferred a mandate to further stimulate the export of Canadian housing services, products, and expertise, including authority to charge for products and services. These changes are aimed at increasing employment in Canada's housing industry.

In response to the housing industry's call for one-stop shopping, CMHC inaugurated a 1-800 housing exporter service in 1996. The Corporation also moved on industry-identified priorities by initiating in-depth research into export opportunities worldwide; results will be released in 1997. As well, the Corporation made progress on developing the Canadian Housing Exporter Sourcing System (CHESS), a comprehensive database covering Canada's existing and prospective housing exporters.

FOSTERING EXPORT OPPORTUNITIES

In 1996, CMHC received over 30 foreign delegations investigating Canadian housing systems. To help foster positive export environments for Canadian housing and expertise, the Corporation led major trade missions to China, Korea and Chile, and participated in missions to Germany and Poland. CMHC's housing finance training helped Korea, China, Mali and Trinidad and Tobago develop their own housing finance systems.

The Corporation participated in intergovernmental economic summits with Russia and the Ukraine. Undertaken in partnership with the private sector, these high-level meetings helped establish relationships between the countries and identified joint-venture opportunities. Work under the Canada-Russia housing Memorandum of Understanding (MOU) progressed with a meeting of the joint steering committee. These bilateral efforts, in conjunction with ongoing research to address codes and standards issues, lead to increased export opportunities for the Canadian housing industry.

PUBLIC-PRIVATE PARTNERSHIPS

WORKING PARTNERSHIPS

At trade shows, conferences, lender seminars and meetings, CMHC's Centre for Public-Private Partnerships in Housing promotes the benefits of partnership in creating affordable housing. The Centre acts as a catalyst, initiator and source of best advice to advance and encourage partnership in the creation of affordable housing. It bridges the public and private sectors and ventures into untried areas to advance the cause of affordable housing that does not require any on-going government subsidies to operate. Innovative financing and tenure arrangements, including life-lease and equity co-operatives, continue to be supported.

In 1996, advice and direction on project planning and development as well as partnership opportunities were provided to community groups, other levels of government, the development industry and the financial sector throughout Canada. In addition, Proposal Development Funding (PDF) was provided to 52 non-profit groups to assist with the development of financing proposals. A total of 36 public-private partnership proposals were provided with NHA mortgage insurance, resulting in the creation of 1 856 affordable housing units that do not require on-going assistance.

HOMEGROWN SOLUTIONS

The National Enablement Demonstration Initiative, a two-year initiative introduced in 1995, provided developmental funding to grassroots community organizations to develop local solutions to housing needs. CMHC contracted with the Canadian Housing and Renewal Association (CHRA) to manage the initiative. A Proposal Call in 1996 resulted in 71 submissions. Thirteen were selected to develop "self-help" ideas through demonstration projects. These include new approaches to affordable housing, such as tenure options, financing and management alternatives. Reports will be available in 1997.

OBJECTIVE

To foster additional affordable housing options that do not require government assistance.

KEY STRATEGY

To increase interest from community-based groups by continuing targeted marketing and communication efforts.

ORGANIZATIONAL SUPPORT — MANAGING EFFECTIVELY

OBJECTIVES

To promote a working environment that keeps employees motivated, productive and healthy.

To foster an appropriately skilled and adaptable workforce to strengthen the organization's ability to manage change.

KEY STRATEGIES

To equip all employees to work in a continuously improving learning culture and explore alternative ways to compensate and motivate them.

To assess and adapt organizational structures and management practices to help create an appropriate infrastructure for meeting business, corporate and employee needs.

To create systems that are responsive to current and future needs of employees, including succession and career planning.

CMHC's ability to adapt to change and to manage its human resources in the most efficient and cost-effective way is determined, in part, by its success in developing and fostering a skilled and flexible workforce, and in creating a working environment that promotes and sustains motivated, productive and healthy employees.

The Corporation continues to demonstrate its commitment to operate within fiscal frameworks established by the government. To effect staff-year changes required to address federal budget reductions, the Corporation this year continued to implement workforce realignment measures that were introduced in 1995.

TRANSITION TEAM FACILITATES CHANGE

In 1996, CMHC established a Transition Team to assist the Corporation in its renewal process. In consultation with staff, clients and partners, the transition team formulated a new CMHC Vision, Mission, and a set of Corporate Values, all of which will guide the Corporation as it re-engineers itself to become more client focused, flexible, innovative and entrepreneurial to fulfill its renewed mandate.

HUMAN RESOURCES MANAGEMENT

In 1996, CMHC developed a more comprehensive set of workforce adjustment measures to facilitate downsizing as the organization restructures to pursue its new directions. The revised program includes early departure and retirement packages, a self-identification departure program, and expanded career transitional support services for impacted employees.

To help prepare senior managers to implement CMHC's new directions, the Corporation offered special training on leadership in a restructuring / downsizing organization. At the same time, training on change and transition was initiated for all employees.

The Corporation adopted a new approach to management development. The approach includes individual assessment against a leadership capabilities profile, which sets out key competencies expected of managers at CMHC. The increasing application of the competencies approach to human resources management will help ensure that CMHC has the skills required to meet its current and future business needs.

In response to its changing business environment, the Corporation began a formal human resources planning system. The system will promote a better integration between human resource and career management processes and business planning processes.

INTEGRATING DIVERSITY INTO CMHC OPERATIONS

The Corporation took action to better integrate diversity management into its business operations and to establish a more representative structure to support diversity management. The changes will help CMHC advance its employment equity objectives.

To support employees in balancing their work/family/personal lives, CMHC implemented two new alternative working arrangement programs across the organization — telework and compressed work weeks. Moreover, it approved two new leave programs — leave with income averaging, and pre-retirement transition leave.

Lastly, CMHC this year began a basic review of its total compensation system, which includes classification, compensation, performance management, flexible benefits, and pension plan. The object of the exercise is to realign the system with CMHC's changing culture, values, and business directions.

Management Discussion and Analysis — Financial Conditions and Results of Operations

The Corporate Accounting Framework

CMHC maintains separate accounting records for each of its three areas of responsibility.

Corporate Account

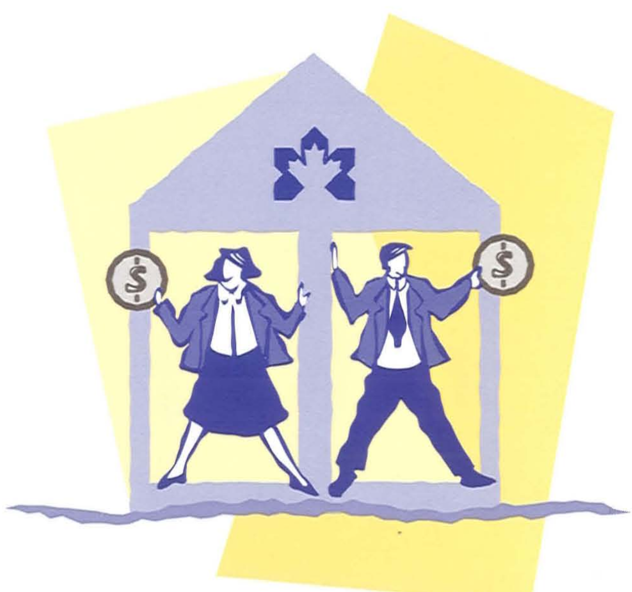
Within this responsibility, the Corporation makes loans and other investments under various provisions of the National Housing Act (NHA), develops and sells land holdings and provides services in housing-related areas. Funding is provided by borrowings from the Government of Canada and capital markets.

Minister's Account

The Corporation administers housing programs under provisions of the NHA, with funding from the Government of Canada through annual parliamentary appropriations. The Corporation is reimbursed for subsidies and losses relating to these programs in addition to the related operating expenses.

Insurance and Guarantee Funds

The Corporation administers insurance and guarantee funds under provisions of the NHA. The Mortgage Insurance Fund provides insurance against borrower default on residential mortgages. The Mortgage-Backed Securities Guarantee Fund guarantees the principal and interest for investors of securities based on insured mortgages.



CORPORATE ACCOUNT

CORPORATE ACCOUNT RESULTS

In 1996, the Corporate Account recorded a net loss of $6.6 million, compared to a planned net income of $1.8 million. This variance was primarily due to losses on real estate of $5.2 million, which were significantly higher than plan. These losses were mitigated somewhat by the margin on financing operations being $4.4 million higher than plan and operating expenses being $7.2 million less than plan.

The real estate variance from plan was due to anticipated land sales that did not materialize and revaluation adjustments of some properties in Ontario and Quebec due to soft market conditions.

The margin on financing operations was slightly higher than plan, primarily due to lower interest rates than anticipated. In 1991, CMHC assumed the interest rate risk exposure from the Government of Canada on all loans financed with borrowings from the Government of Canada. Cumulative reduced interest earnings due to these negotiations amounts to $90 million since 1993. The Corporation continues to discuss this material interest rate risk exposure with the Government of Canada.

CMHC's Direct Lending initiative added just over $2 billion to the loans and investment portfolio in 1996. CMHC entered the capital markets to fund these loans, raising medium-term financing at spreads averaging approximately 4 basis points in 1996 over Government of Canada bonds with similar maturities.

By the year 2001, CMHC expects to refinance $12.4 billion of the social housing mortgage portfolio originally financed privately. Direct Lending mortgages are non-prepayable, and each mortgage pool is fully funded with fixed-rate Canadian dollars or other currencies converted to Canadian dollars on a matched maturity basis. Interest rate swaps and cross-currency swaps are used to manage any difference in asset and liability cash flows, to reduce interest-rate risk on this portfolio to a negligible amount and to eliminate any foreign currency conversion loss exposure.

MINISTER'S ACCOUNT

Expenditures on grants, contributions and subsidies (including related administration and delivery costs) were $1 944.6 million, 99.3 percent of plan. In 1995, these expenditures were $2 001.9 million.

Expenditures were lower than plan as a result of CMHC's contribution to deficit reduction under Program Review and the funding of an interest and inflation reserve to cover future cost increases. These reductions were achieved through efficiency measures including lower interest rates from Direct Lending, refinancing of public housing loans, and management and operating efficiencies in the operation of the housing portfolio.

In 1996, CMHC delivered several short-term housing initiatives as part of the government's job creation efforts. The initiatives, which will also result in tangible improvements in housing conditions for needy Canadians, were funded from savings achieved from within CMHC at a cost of approximately $105 million. The initiatives included: the Residential Rehabilitation Assistance Program (RRAP) and the Emergency Repair Program (ERP), the Home Adaptations for Seniors Independence (HASI) initiative, the Remote Housing initiative, the On-Reserve Remote Housing initiative, and the Shelter Enhancement initiative.

FISCAL IMPACTS

In the second phase of Program Review, the federal budget of March 6, 1996 called for spending reductions to overall government operations, and outlined specific measures that apply to CMHC.

In 1997/98, CMHC will be required to contribute $78 million to the federal government's deficit-reduction program. In 1998/99, the Corporation will contribute $102.8 million.

INSURANCE AND GUARANTEE FUNDS

The combined assets of the Insurance and Guarantee Funds increased by $0.2 billion in 1996 to $2.5 billion. Income of $154.8 million was generated through return on investments.

MORTGAGE INSURANCE FUND

Mortgage Insurance Fund (MIF) operations resulted in pre-tax earnings of $17.5 million, compared to a plan of $137.7 million. An actuarial valuation of the MIF as of September 30, 1996 has confirmed its long-term solvency.

Insurance policies in force totaled $131.0 billion. Under the NHA, as amended in December 1995, the aggregate outstanding amount of all loans for which insurance policies are issued may not exceed $150 billion.

Proceeds from sales of MIF real estate acquired through mortgage default were $314.5 million, compared to a plan of $341.5 million.

Interest rates in Canada trended lower during the second half of 1996. The Corporation achieved an annual return of 7.49 percent on the MIF investment portfolio. The market value of the portfolio as of December 31, 1996 exceeded book value by $174 million.

The average annual total return on the MIF investment portfolio from January 1990 to December 1996 was 10.91 percent, compared to 10.19 percent for the benchmark market index. This benchmark index, which is used as a performance measurement tool, represents the ScotiaMcLeod bond market index modified to more closely match the policy objectives and constraints that apply to CMHC's portfolio.

MORTGAGE-BACKED SECURITIES GUARANTEE FUND

The Mortgage-Backed Securities Guarantee Fund (MBSGF) is a fund distinct from the Mortgage Insurance Fund (MIF). Financial transactions related to Mortgage-Backed Securities include revenue from guarantee and application fees and expenses from operations. In 1996, MBS net earnings were $6.4 million compared to a plan of $6.9 million.

RENTAL GUARANTEE FUND

CMHC disposed of the last remaining rental project in the Rental Guarantee Fund in 1995. The Fund's surplus of $12.9 million was paid to the Government of Canada in July 1996.

TREASURY OPERATIONS

Treasury policies, processes and core systems are in place and continuously under review for enhancements. Treasury management objectives are to finance the Corporation, ensure liquidity, manage interest-rate risk exposure, enhance investment performance and safeguard the Corporation's assets through effective and prudent treasury management.

RISK MANAGEMENT

The Corporation manages its Treasury Operations through well-established policies and processes. Treasury activities encompass several levels of risk:

Credit/Counter-Party Risk

The Corporation follows credit risk management policies as approved by its Board of Directors. The policies are consistent with the Department of Finance guidelines.

Liquidity Risk

The Corporation ensures that it maintains a liquidity level sufficient to cover cash requirements and contingencies.

Operational Risk

The Corporation mitigates the risk that deficiencies in information systems or internal controls will result in unexpected losses by requiring segregation of duties, providing training programs and ensuring that back-up systems and recovery plans are in place.

Market Risks

The Corporation generally matches the term and interest rate structure of its assets and liabilities. It enters into funding and interest rate hedging transactions to minimize interest rate risk. Specifically, the Corporation's interest rate risk position is subject to internal and Department of Finance guidelines. It is also CMHC's policy to have no foreign exchange exposure. Presently, all Canadian dollar assets are either funded with Canadian dollar borrowings or fully hedged into Canadian dollars.

RESOURCE REQUIREMENTS

OPERATING BUDGET

To accommodate the costs of workforce adjustment decisions taken in 1996, the Corporation received Treasury Board approval to amend its 1996 operating budget to $272.6 million from $234.6 million.

Provision for workforce adjustment has also been made in CMHC's approved 1997 budget. This will allow CMHC to deal with the revitalization of the Corporation's insurance and guarantee activities and with changes resulting from the organizational review undertaken by CMHC's transition team.

Operating expenses in 1996 were $268.7 million, $3.9 million lower than the amended budget. The 1995 operating expenses were $249.2 million.

CAPITAL EXPENDITURES

The 1996 capital budget for furniture, equipment and business premises, planned at $5.5 million, was fully committed by year-end.

FIVE-YEAR FINANCIAL HIGHLIGHTS

AT AND FOR THE YEARS ENDED 31 DECEMBER

in millions of dollars	1996	1995	1994	1993	1992
CORPORATE ACCOUNT					
Total Assets	15 098	13 849	11 769	10 014	8 943
Portfolio of Loans and Investments:					
Loans	6 642	5 832	5 034	4 257	3 912
Federal-Provincial Agreements	7 386	6 443	5 332	4 691	4 496
Real Estate	127	126	111	90	75
Total Loans and Investments	14 155	12 401	10 477	9 038	8 483
Government of Canada Borrowings	7 094	7 505	7 958	8 295	8 486
Capital Market Borrowings	7 573	5 966	3 410	1 309	–
Margin on Financing Operations	24	20	15	33	45
Gain (Loss) on Real Estate	(5)	2	14	8	(3)
Net Income (Loss)	(7)	(9)	(6)	6	12
MINISTER'S ACCOUNT					
Expenditures for CMHC-Administered Housing Programs on Behalf of the Government of Canada:					
Grants, Contributions and Subsidies	1 815	1 896	1 751	1 804	1 807
Fees Paid to Delivery Agents	12	14	19	26	29
Operating Expenses	118	92	98	105	114
INSURANCE AND GUARANTEE FUNDS					
Mortgage Insurance Fund					
Units Insured	355 009	274 834	306 356	296 560	277 747
Net Income (Loss)	10	86	(93)	(63)	(16)
Surplus (Deficit)	18	8	(78)	15	78
Insurance in Force ($b)	131	118	104	87	72
Mortgage-Backed Securities Guarantee Fund					
Securities Issued ($b)	2	2	4	7	6

BOARD OF DIRECTORS AND PRINCIPAL OFFICERS

CMHC is headed by a Board of Directors consisting of the Chairman of the Board, the President, five members of the public at large and two senior public servants — all appointed by the Governor in Council.

BOARD OF DIRECTORS

(as at 31 December 1996)

Peter R. Smith
Brampton, Ontario
Chairman of the Board
President, Andrin Ltd.

Marc Rochon
Ottawa, Ontario
President and Chief Executive Officer

Renate Bublick
Vancouver, British Columbia
President, Cypress Consultants

Janice Cochrane
Ottawa, Ontario
Deputy Minister, Citizenship and Immigration

Claude Hallé
Québec, Quebec
Vice-President, Market Development
Groupe TS Inc.

Cuckoo Kochar
Ottawa, Ontario
President and CEO
DCR/Phoenix Development Corporation Ltd.

Gerald I. Norbraten
Regina, Saskatchewan
President, Norbraten Architects

Ranald A. Quail
Hull, Quebec
Deputy Minister, Public Works and Government Services Canada

Patricia Toner
Grand Falls, New Brunswick
Supervisor, Grand Falls Public Library

CORPORATE OFFICERS

(as at 31 December 1996)

Marc Rochon
President and Chief Executive Officer

Karen A. Kinsley
Vice-President, Corporate Services and Chief Financial Officer

William G. Mulvihill
Vice-President, Insurance

Claude Poirier-Defoy
Vice-President, National and International Housing Support

Douglas A. Stewart
Vice-President, Strategy

Robert Lajoie
General Manager, Human Resources and Organizational Development

Joan Dalrymple
General Manager, Atlantic Regional Office

Peter Friedmann
General Manager, Ontario Regional Office

James T. Lynch
General Manager, British Columbia and Yukon Regional Office

Denis St.Onge
General Manager, Quebec Regional Office

Berta Zaccardi
General Manager, Prairie and Northwest Territories Regional Office

Brian Dornan
Special Advisor to the President

AUDITORS' REPORT

To the Minister of Public Works and Government Services

We have audited the balance sheets of the Canada Mortgage and Housing Corporation for the Corporate Account and Insurance and Guarantee Funds as at December 31, 1996, and the related statements of operations and reserve fund, operations and surplus (deficit), and changes in financial position, and the Minister's Account statement of expenses and recoveries for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31,1996 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles. As required by the Financial Administration Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Corporation that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with Part X of the Financial Administration Act and regulations, the Canada Mortgage and Housing Corporation Act, the National Housing Act and the by-laws of the Corporation.

Jacques Champagne, CA
Mallette Maheu
Associated with Arthur Andersen

Ottawa, Canada
March 5, 1997

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada

Corporate Account
Balance Sheet
As at 31 December

in thousands of dollars

Assets	**Notes**	**1996**	1995
Loans and Investments	3, 4, 23	**14 154 626**	12 400 774
Cash and Short-term Investments	5, 23	**227 980**	722 083
Deferred Recoveries from the Minister's Account		**252 961**	254 711
Due from the Minister's Account	7	**278 122**	301 605
Assets Under Capital Lease	8	**27 003**	28 892
Business Premises and Equipment	9	**34 065**	32 236
Accounts Receivable	23	**87 776**	71 923
Deferred Income Taxes		**20 493**	14 810
Other Assets	5	**14 962**	18 518
Due from Insurance and Guarantee Funds		**–**	3 882
		15 097 988	13 849 434
Liabilities			
Borrowings from the Government of Canada	3, 10, 23	**7 093 971**	7 504 816
Capital Market Borrowings	10, 23	**7 572 915**	5 965 875
Obligation Under Capital Lease	11	**32 592**	33 940
Accounts Payable and Accrued Liabilities	7, 23	**323 183**	301 801
Due to the Receiver General for Canada		**24 521**	7 854
Due to Insurance and Guarantee Funds		**22 229**	–
		15 069 411	13 814 286
Capital and Reserve Fund			
Capital Authorized and fully paid by the Government of Canada		**25 000**	25 000
Reserve Fund	12	**3 577**	10 148
		15 097 988	13 849 434

The accompanying notes are an integral part of the financial statements

Corporate Account

Statement of Operations and Reserve Fund
Year Ended 31 December

in thousands of dollars

	Notes	1996	1995
Interest Earned	3, 13	**1 128 243**	1 022 731
Interest Expense	10	**1 103 952**	1 002 401
Margin on Financing Operations		**24 291**	20 330
Real Estate Sales		**16 961**	11 775
Cost of Real Estate Sold		**(2 089)**	(4 286)
Holding Costs	4	**(20 061)**	(5 885)
Gain (Loss) on Real Estate		**(5 189)**	1 604
Other Income		**1 134**	1 099
Income before Operating Expenses		**20 236**	23 033
Operating Expenses	14	**29 614**	35 538
Loss before Taxes		**9 378**	12 505
Taxes	15	**2 807**	3 923
Net Loss		**6 571**	8 582
Reserve Fund, Beginning of Year		**10 148**	18 730
Reserve Fund, End of Year		**3 577**	10 148

The accompanying notes are an integral part of the financial statements

Corporate Account

Statement of Changes in Financial Position
Year Ended 31 December

in thousands of dollars

	1996	1995
Operating Activities		
Net Loss	**(6 571)**	(8 582)
Add (Deduct)		
Amortization	**4 705**	4 769
Deferred Income Taxes	**(5 683)**	(2 947)
	(7 549)	(6 760)
Changes in		
Due to/from		
the Receiver General for Canada	**16 667**	(6 672)
Insurance and Guarantee Funds	**26 111**	(7 952)
the Minister's Account	**23 483**	(49 334)
Accounts Receivable	**(15 853)**	(31 299)
Accounts Payable and Accrued Liabilities	**21 382**	(2 461)
Accrued Interest Payable	**7 134**	35 346
Accrued Interest Receivable	**(5 333)**	(8 514)
Other Assets	**3 556**	14 776
	69 598	(62 870)
Investment Activities		
Loans and Investments		
Repayments	**397 600**	298 742
Additions	**(2 146 119)**	(2 214 254)
Change in Deferred Recoveries from the Minister's Account	**1 750**	70 823
Additions to Business Premises and Equipment	**(4 645)**	(3 051)
	(1 751 414)	(1 847 740)
Financing Activities		
Repayments of Borrowings from the Government of Canada	**(409 913)**	(447 372)
Capital Market Borrowings	**1 598 974**	2 515 514
Repayment of Obligation Under Capital Lease	**(1 348)**	(1 204)
	1 187 713	2 066 938
Increase (Decrease) in Cash Position	**(494 103)**	156 328
Cash and Short-term Investments		
Beginning of Year	**722 083**	565 755
End of Year	**227 980**	722 083

The accompanying notes are an integral part of the financial statements

Minister's Account

Statement of Expenses and Recoveries
Year Ended 31 December

in thousands of dollars

	Notes	1996	1995
Expenses			
Market Housing		**57 185**	47 924
Social Housing		**1 746 725**	1 839 089
Housing Support		**11 003**	8 296
Fees Paid to Delivery Agents		**12 071**	14 448
Operating Expenses	14	**117 606**	92 102
Expenses Recoverable	7	**1 944 590**	2 001 859

The accompanying notes are an integral part of the financial statements

Insurance and Guarantee Funds
Balance Sheet
As at 31 December

in thousands of dollars

Assets	Notes 22	1996	1995
Investment in Securities	3, 19, 23	**2 187 385**	1 976 982
Real Estate		**298 719**	306 398
Mortgages	23	**14 019**	15 791
Accounts Receivable and Other Assets	23	**847**	4 397
Deferred Income Taxes		**24 964**	14 262
Due from Corporate Account		**22 229**	–
		2 548 163	2 317 830
Liabilities			
Unearned Premiums and Guarantee Fees		**1 740 915**	1 525 888
Provision for Claims		**742 733**	721 807
Due to Receiver General for Canada		**–**	13 308
Accounts Payable and Accrued Liabilities	23	**16 887**	8 959
Due to Corporate Account		**–**	3 882
		2 500 535	2 273 844
Surplus	20	**47 628**	43 986
		2 548 163	2 317 830

The accompanying notes are an integral part of the financial statements

Insurance and Guarantee Funds

Statement of Operations and Surplus (Deficit)
Year Ended 31 December

in thousands of dollars

	Notes 22	1996	1995
Revenues			
Earned Premiums and Guarantee Fees		**358 956**	352 559
Application Fees		**41 144**	36 324
Income from Investments	19	**154 835**	152 924
Other		**2 053**	3 093
		556 988	544 900
Expenses			
Loss on Claims		**386 308**	305 280
Operating Expenses	14	**121 510**	120 403
Adjustment to Provision for Claims		**20 926**	71 998
		528 744	497 681
Income before the Undernoted		**28 244**	47 219
Adjustment to Premium Deficiency		**–**	55 062
Income before Taxes		**28 244**	102 281
Taxes	15	**11 690**	9 497
Net Income		**16 554**	92 784
Surplus (Deficit)			
Balance, Beginning of Year		**43 986**	(48 798)
Assets Returned to the Government of Canada		**(12 912)**	–
Balance, End of Year		**47 628**	43 986

The accompanying notes are an integral part of the financial statements

Insurance and Guarantee Funds

Statement of Changes in Financial Position
Year Ended 31 December

in thousands of dollars

	Note 22	1996	1995
Operating Activities			
Premiums and Guarantee Fees Received		**573 983**	447 522
Application Fees Received		**41 144**	36 324
Investment Income Received		**148 496**	154 043
Net Claims		**(350 802)**	(308 283)
Operating Expenses Paid		**(112 320)**	(120 403)
Taxes Paid		**(36 061)**	11 047
Other		**(22 633)**	(12 885)
		241 807	207 365
Investment Activities			
Investment in Securities		**(202 784)**	(215 317)
Assets Returned to the Government of Canada		**(12 912)**	–
Increase (Decrease) in Due from Corporate Account		**26 111**	(7 952)

The accompanying notes are an integral part of the financial statements

Notes to Financial Statements
Year Ended 31 December 1996

1. BASIS OF PRESENTATION

Canada Mortgage and Housing Corporation was incorporated as a Crown Corporation 1 January 1946. The Corporation is regulated by the Canada Mortgage and Housing Corporation Act. The Corporation's mandate, as stated in the National Housing Act, is "to promote the construction of new houses, the repair and modernization of existing houses and the improvement of housing and living conditions." The Corporation is for all purposes an agent of Her Majesty in the right of Canada.

The Corporation has three separate responsibilities under its mandate and maintains separate accounting records for each. Separate financial statements are presented in order to preserve the separate identities of the assets, liabilities, capital, reserve fund, surpluses or deficits.

Together, these statements constitute the financial statements of the Corporation and reflect all of the transactions of the Corporation for the year ended 31 December 1996.

Corporate Account

Within this responsibility, the Corporation makes loans and other investments under various provisions of the National Housing Act, develops and sells land holdings, and provides services in housing related areas. Funding is provided by borrowings from the Government of Canada and capital markets.

Minister's Account

The Corporation administers housing programs under provisions of the National Housing Act with funding provided by the Government of Canada through annual Parliamentary appropriations. The Corporation is reimbursed for subsidies and losses relating to these programs in addition to the related operating expenses.

Insurance and Guarantee Funds

The Corporation administers insurance and guarantee funds under provisions of the National Housing Act. The Mortgage Insurance Fund provides insurance against borrower default on residential mortgages. The Mortgage-Backed Securities Guarantee Fund guarantees the principal and interest for investors of securities based on insured mortgages.

In total, the Corporation manages:

in thousands of dollars	**1996**	1995
Assets	**17 623 922**	16 163 382
Liabilities	**17 547 717**	16 084 248
Portion Payable to Government of Canada	**7 093 971**	7 504 816
Minister's Account Expenses Recoverable from Parliamentary Appropriations	**1 944 590**	2 001 859
Operating Expenses	**268 730**	248 043

Operating Expenses are allocated to the three separate areas of responsibility as disclosed in Note 14.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with generally accepted accounting principles in Canada.

a. Loans

Corporate Account

Loans are valued at cost plus accrued interest. As they are intended to be held until maturity, their carrying value is not adjusted to reflect any temporary decline in fair value.

Losses on insured loans are recoverable through the Mortgage Insurance Fund and losses on uninsured loans are recoverable from the Government of Canada through the Minister's Account.

Because the Corporate Account is assured full collection of principal and interest and will not incur any losses on these loans due to uncollectibility, no loss provisions for loan impairment are made.

If loans contain forgiveness clauses, such forgiveness is recorded and recovered from the Government of Canada through the Minister's Account when the loans are advanced.

Loans under certain programs give rise to interest rate losses unrelated to defaults that are recoverable from the Government of Canada through the Minister's Account.

Insurance and Guarantee Funds

Mortgages are valued at cost less a provision for estimated loss based on appraised property values.

b. Federal-Provincial Agreements

Loans and investments in housing projects were made under various cost-sharing agreements with the provinces and territories to encourage the development of rental housing, land assembly, co-operative housing, rural and native housing, and housing rehabilitation.

The Corporation's share of costs plus capitalized interest are reflected in these statements. The Corporation's share of subsidies and losses related to these agreements is recovered from the Government of Canada through the Minister's Account.

Gains on the sale of land assembly projects are recognized in the Corporate Account.

c. Real Estate

Corporate Account

Real estate is comprised of: vacant land, direct acquisitions, property acquired through default of uninsured loans and capitalized costs for fee for service projects undertaken on behalf of the Government of Canada.

All real estate is recorded at acquisition cost plus any modernization and improvement costs incurred.

Holding costs, including interest, on vacant land and direct acquisitions by the Corporation, excluding Social Housing projects, are capitalized up to appraised value after which the costs are expensed in the Corporate Account. Gains or losses on disposal are recognized in the Corporate Account.

Holding costs, including interest, on properties acquired as the result of default on uninsured loans, and for directly acquired Social Housing projects, are capitalized. Gains or losses on the disposal of these properties are paid to or recovered from the Government of Canada through the Minister's Account. All net operating losses, including amortization on buildings calculated on a straight-line basis over the remaining term of the corresponding debt, are recovered from the Government of Canada through the Minister's Account.

All costs incurred related to the projects administered for the Government of Canada on a fee for service basis are captialized and netted against proceeds from disposal, with all excess monies returned directly to the Consolidated Revenue Fund of the Government of Canada.

Insurance and Guarantee Funds

Real estate acquired upon the payment of a claim resulting from a loan default is valued at the lower of cost or net realizable value. Net realizable value is calculated as the current appraised value of the property, as determined by the Corporation, less the discounted value of estimated holding and disposal costs. Amortization is not recorded on the real estate.

d. Deferred Recoveries from the Government of Canada through the Minister's Account

Effective 1 April 1991, expenditures to modernize and improve certain properties are recovered from the Government of Canada through the Minister's Account over a period not exceeding ten years.

e. Amortization

Assets under Capital Lease, Business Premises and Equipment are amortized on a diminishing balance basis over the estimated useful life of the asset. Leasehold improvements are amortized on a straight-line basis.

f. Derivative Financial Instruments

The Corporation enters into interest rate and cross currency swaps to manage the interest rate and foreign currency exposures arising from on-balance sheet positions. Gains and losses resulting from termination of these contracts are deferred and amortized on a straight-line basis to interest income or expense over the term of the exposure.

g. Short-term Investments / Investment in Securities

The Corporation has a policy of matching the maturity structure of its Corporate Account assets with that of its liabilities. In those cases where funds are raised in advance of the investment in loans, the Corporation holds Short-term Investments as hedges of the anticipated investment in loans. The term to maturity of the Short-term Investments matches the term of the borrowing so that the Corporation is hedged against movements in the interest rates between the date of borrowing and the date that the Short-term Investments are sold and loans made. For investments designated as hedges as part of the Corporation's asset/liability management strategy, gains and losses are deferred and amortized on a straight-line basis to interest expense over the term of the debit issue that generated the monies for investment. Deferred gains and losses are included in Other Assets.

Investments are purchased with the original intention to hold them to maturity or until market conditions render alternative investments more attractive. Such investments are carried at amortized cost plus accrued interest. Investments are written down to their fair value when declines in value are other than temporary. Premiums and discounts on investments are amortized to income over the period to maturity of the related investments. Gains and losses realized on disposal of investments and write downs to reflect other than temporary impairment in value are included in interest income from the investments in the year in which they occur. Gains and losses on disposal are based on the average cost of the securities sold.

h. Interest Earned

Interest Earned arising from Loans and Investments, Cash and Short-term Investments and Deferred Recoveries from the Minister is recognized on an accrual basis up to the date that the asset is retired. Certain interest revenue is obtained through the Minister's Account.

i. Capital Market Borrowing Costs

Issuance Costs and Premiums or Discounts on Capital Market Borrowings are deferred and amortized against Interest Expense on a straight-line basis over the term of the debt.

j. Pension Costs and Obligations

The cost of pension benefits earned by employees is charged to income as services are rendered. Adjustments arising from pension plan amendments, experience gains and losses, and changes in assumptions are amortized over the expected average remaining service life of the employee group.

k. Post-retirement Benefits

Post-retirement benefits are expensed as incurred and are included in Operating Expenses.

l. Provision for Claims

This provision represents the estimated loss on claims in process of payment and the estimated loss on loans, where defaults have occured, but for which claims have not yet been received by the Corporation.

m. Premiums

Premiums are deferred and are taken into income over the life of the related policies based on the risk of default in each year.

n. Premium Deficiency

Annually, the Corporation compares the amount of its unearned premiums by line of business to the discounted costs of claims that have not yet occurred on insurance policies in force. Whenever it is determined that the unearned premiums on a line of business are inadequate to meet the expected net costs of future claims, a premium deficiency is charged to operations. Subsequently, it is taken into income on the same basis as unearned premiums.

o. Guarantee Fees

Guarantee fees are deferred and are taken into income over the term of the relative Mortgage-Backed Security issue on a straight-line basis.

p. Application Fees

Application fees are recognized as income when received.

q. Insurance Issuance Costs

Issuance costs are expensed as incurred and are included in Operating Expenses

3. RISK MANAGEMENT

The Corporation manages risk through a comprehensive program of risk management policies and processes.

Credit Risk

Credit risk is the exposure to financial loss resulting from the possibility that counterparties may default on their obligations to the Corporation. The Corporation mitigates credit risk through the use of prudent investment policies, active portfolio management and diversification. A credit risk management function exists at the Corporation, separate from the dealing function, where credit limits are established and reviewed on an ongoing basis. The Corporation adheres to Department of Finance guidelines with respect to credit risk.

The following tables provide details of the credit ratings assigned to the Corporation's investments based upon internationally accepted ratings:

Short-term Investments

in thousands of dollars	**1996**	1995
Credit Rating	**Book Value**	Book Value
AAA	**90 505**	581 831
AA	**136 267**	115 452
Total	**226 772**	697 283

Investment in Securities

in thousands of dollars	1996	1995
Credit Rating	**Book Value**	Book Value
AAA	**1 544 291**	1 447 031
AA	**480 708**	366 776
AA low	**17 444**	17 460
A high	**144 942**	145 715
Total	**2 187 385**	1 976 982

As with balance sheet assets, off-balance sheet derivative instruments are subject to credit risk. The credit exposure associated with derivatives is normally a small fraction of the notional amount of the derivative instrument. Credit exposure of derivatives is represented by the positive market value of the instrument.

The following table summarizes the Corporation's derivative portfolio and related credit exposure. The amounts do not take into consideration the legal contracts which permit offsetting of positions or any collateral which may be obtained.

Derivative Financial Instruments

in thousands of dollars	1996		1995	
	Notional Amount	**Maximum Credit Risk**	Notional Amount	Maximum Credit Risk
Interest Rate Swaps	**7 280 806**	**139 359**	5 427 492	92 495
Cross Currency Swaps	**410 000**	**–**	410 000	–
Total	**7 690 806**	**139 359**	5 837 492	92 495

Master netting agreements reduce the Corporation's credit risk exposure by allowing the offsetting of amounts due to/from each counterparty. As at 31 December 1996, the potential impact of master netting agreements reduced credit risk to $121 million (1995 – $86 million).

The following table provides details of the credit ratings assigned to the Corporation's counterparties for derivative instruments based upon internationally accepted ratings:

Derivative Financial Instruments

in thousands of dollars	1996	1995
Counterparty Credit Rating	**Notional Amount**	Notional Amount
AAA	**1 160 618**	246 587
AA	**2 719 608**	2 292 851
AA low	**2 676 894**	3 298 054
A high	**1 133 686**	–
Total	**7 690 806**	5 837 492

At 31 December 1996, a total of $15 million Government of Canada bonds, market value $16 million, had been lodged with the Corporation as collateral for those derivative financial instruments of the counterparty with the A high credit rating covering the marked-to-market exposure.

Market Risk

Market risk is the risk of loss in market value or future cash flows due to adverse changes in financial markets. Market risk can be divided into interest rate risk and foreign exchange risk.

• Interest Rate Risk

In 1991 the Government of Canada discontinued the Corporation's right to prepayment without penalty on its borrowings from the Consolidated Revenue Fund. Of these borrowings, $3 billion funded loans made by the Corporation prior to 1986 under various sections of the National Housing Act which have prepayment without penalty privileges.

The Corporation assumed the interest rate risk from the Government of Canada as a result of this arrangement. Interest rate risk is the risk that net interest income will decrease because of an adverse movement in interest rates.

Interest rate risk is measured by the extent to which changes in market interest rates impact on margins and net interest income. The Corporation measures this risk through the use of a number of analytical methodologies including gap reporting, duration analysis and simulation modelling.

During 1993 and 1994 some borrowers renegotiated loans at lower rates of interest. No further renegotiations have occurred and only minimal prepayments of loans have taken place since then. The following table indicates the annual reductions on margin occurring as a result of these renegotiations.

Reductions to Interest Earnings

in thousands of dollars	1995	1996	1997	1998	1999	2000
	28 800	28 900	29 000	22 300	3 600	900

Because of the reductions to interest earnings, a consequential pre-tax loss of $9 million was recorded (1995 – $13 million loss).

This transfer also exposes the Corporation to potential losses in future years which could be material and significant in relation to the Corporate Account Capital and Reserve Fund.

The renegotiated loans have resulted in a cumulative reduction in interest earnings of $90 million to 31 December 1996 and will result in a further reduction in interest earnings of $56 million between 1 January 1997 and the next repricing date.

Management estimates that the potential additional reduction on margin on loans not yet renegotiated, depending on prevailing interest rates, will be approximately $23 million per annum during each of the next five years.

The renegotiated loans together with the others which may yet be renegotiated could result in an accumulated reduction of interest earnings of approximately $261 million for the period to the next repricing date.

The fact that some of the loans renegotiated in 1993 are eligible for repricing in 1998 and the uncertainty in forecasting future interest rates precludes reasonable estimation of impacts beyond those quoted above.

The Corporation continues to discuss this interest rate risk issue with the Government of Canada.

• Foreign Exchange Risk

Foreign exchange risk is the risk that net interest income will fluctuate due to changes in exchange rates. It is Corporation policy to match the currencies of assets and liabilities to avoid any and all foreign exchange exposure.

Liquidity Risk

Liquidity risk is the risk of loss due to the inability to unwind financial transactions at or near current market value or the risk that a firm does not have sufficient cash flows to meet obligations from financial transactions. The Corporation practices sound and prudent liquidity management, ensuring funds are available at all times to honour cash requirements and contingencies.

Operational Risk

Operational risk is the risk that a loss will be incurred as a result of deficiencies in information systems or internal controls. Operational risk is managed by: a system of internal controls that requires segregation of duties, recording of transaction details and notification, where appropriate, of parties to transactions for verification purposes, training programs, back-up systems and a recovery plan regarding systems failure or catastrophic events, pre-testing and parallel implementation of new systems and internal audit reviews.

Legal Risk

Legal risk is the risk of loss arising if the Corporation is unable to enforce a financial obligation of a borrower or counterparty. The Coproration's legal department in conjunction with external legal agents plays a key role in all Treasury negotiations, reviewing and approving documentation as required.

4. LOANS AND INVESTMENTS

in thousands of dollars	1996	1995
Loans	**6 642 143**	5 832 205
Federal-Provincial Agreements		
Loans	**5 665 602**	4 694 032
Investments in Housing Projects	**1 672 085**	1 712 134
Land Assembly Projects	**47 583**	36 327
	7 385 270	6 442 493
Real Estate		
Vacant Land	**51 163**	55 036
Direct Acquisitions	**29 882**	23 815
Acquired through Default on Uninsured Loans	**33 471**	26 062
Capitalized Costs of Projects Administered for the Government of Canada	**12 697**	21 163
	127 213	126 076
Total Loans and Investments	**14 154 626**	12 400 774

Any default or disposal losses incurred relating to 53% of the Loans and Investments portfolio are recoverable through the Minister's Account. A further 46% of the portfolio is insured by the Mortgage Insurance Fund.

Of the total Loans and Investments portfolio, 88% (1995 – 86%) relates to Social Housing programs which are supported with subsidies from the Government of Canada through the Minister's Account.

The amount of interest capitalized on real estate in 1996 was $3 million (1995 – $2 million). Holding costs of $20 million (1995 – $6 million) on land acquired directly by the Corporation have been expensed in the Corporate Account.

The following table provides the maturity structure of the Loans:

in thousands of dollars	
1997	**370 600**
1998	**427 800**
1999	**421 500**
2000	**405 200**
2001	**405 500**
Thereafter	**10 277 145**
Total	**12 307 745**

The fair value of Loans is included in Note 23.

5. CASH AND SHORT-TERM INVESTMENTS

in thousands of dollars	1996		1995	
	Book Value	**Market Value**	Book Value	Market Value
Cash	**1 208**	**1 208**	24 800	24 800
Securities issued or guaranteed by Canada	**226 772**	**226 756**	697 283	702 492
Total	**227 980**	**227 964**	722 083	727 292

The Short-term Investments have maturities which range up to five years.

Net gains of $8 million (1995 – nil) on sale of Short-term Investments used as hedges have been deferred and are included in Other Assets.

Cash and Short-term Investments produced a yield of 6% (1995 – 6.5%).

The fair value of Cash and Short-term Investments is included in Note 23.

6. OFF-BALANCE SHEET DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from underlying assets, or interest or exchange rates. Asset / liability management derivatives are entered into by the Corporation within guidelines set by the Department of Finance, to manage the interest rate and foreign currency exposures arising from on-balance sheet positions in order to ensure a consistent stream of earnings.

The following table provides the amortized notional amounts of derivative instruments outstanding by type and maturity. The notional amounts of these contracts represent the derivatives volume outstanding and do not represent the potential gain or loss associated with the market risk or the credit risk of such instruments.

in thousands of dollars	1996			1995
	Within 1 Year	**1 to 5 Years**	**Total Notional Amount**	Total Notional Amount
Interest Rate Swaps	**–**	**7 280 806**	**7 280 806**	5 427 492
Cross Currency Swaps	**–**	**410 000**	**410 000**	410 000
Total	**–**	**7 690 806**	**7 690 806**	5 837 492

The fair value of Derivative Financial Instruments is included in Note 23.

7. DUE FROM THE MINISTER

in thousands of dollars	1996	1995
Receivable, Beginning of Year	**301 605**	252 271
Minister's Account Expenses	**1 944 590**	2 001 859
Recovered from the Minister	**(1 968 073)**	(1 952 525)
Receivable, End of Year	**278 122**	301 605

Accounts Payable and Accrued Liabilities in the Corporate Account include $229 million (1995 – $217 million) which are also included in the receivable, Due from the Minister's Account. When paid, recovery will be made from the Government of Canada through the Minister's Account.

8. ASSETS UNDER CAPITAL LEASE

in thousands of dollars	1996				1995
	Amortization Rate	**Cost**	**Accumulated Amortization**	**Net Book Value**	Net Book Value
Building	4%	**29 810**	**6 476**	**23 334**	24 305
Leasehold Improvement	10%	**9 173**	**5 504**	**3 669**	4 587
Total		**38 983**	**11 980**	**27 003**	28 892

Amortization in 1996 was $2 million (1995 – $2 million).

9. BUSINESS PREMISES AND EQUIPMENT

in thousands of dollars	1996				1995
	Amortization Rate	**Cost**	**Accumulated Amortization**	**Net Book Value**	Net Book Value
Land	–	**166**	**–**	**166**	166
Buildings	4% or 5%	**37 943**	**11 522**	**26 421**	24 618
Leasehold Improvement	20%	**2 044**	**1 153**	**891**	672
Equipment	8%, 20% or 30%	**36 102**	**29 515**	**6 587**	6 780
Total		**76 255**	**42 190**	**34 065**	32 236

Amortization in 1996 was $3 million (1995 – $3 million).

10. BORROWINGS

The Corporation borrows from the Government of Canada (Consolidated Revenue Fund) and from capital markets under provisions of the Canada Mortgage and Housing Corporation Act and the National Housing Act to finance loans and investments.

The Corporation has authority to borrow a maximum of $15 billion from sources other than the government.

in thousands of dollars	1996			1995
	Fixed Interest Rate	**Term**		
Government of Canada	**2.00% to 17.96%**	**up to 2039**	**7 093 971**	7 504 816
Capital Market				
Commercial Paper	**average 3.08%**	**average 87 days**	**1 227 878**	987 017
Medium-term Borrowings	**5.34% to 8.92%**	**up to 2002**	**6 345 037**	4 978 858
Total			**14 666 886**	13 470 691

There were no Commercial Paper Borrowings in US dollars at year end (1995 – $25 million carried at $34 million Canadian). Medium-term borrowings include US $300 million carried at $410 million which matures on 1 December 2000 (1995 – US $300 million carried at $410 million). All foreign exchange exposure risk is fully hedged for the interest and principal repayments.

The following table provides the maturity structure of Corporate borrowings:

in thousands of dollars	Government of Canada	Capital Market		Total
		Commercial Paper	Medium-term Borrowings	
1997	**267 316**	**1 227 878**	**70 037**	**1 565 231**
1998	**200 984**	**–**	**1 000 000**	**1 200 984**
1999	**194 513**	**–**	**1 500 000**	**1 694 513**
2000	**187 114**	**–**	**1 910 000**	**2 097 114**
2001	**192 867**	**–**	**1 265 000**	**1 457 867**
Thereafter	**6 051 177**	**–**	**600 000**	**6 651 177**
Total	**7 093 971**	**1 227 878**	**6 345 037**	**14 666 886**

The interest paid to the Government of Canada in 1996 was $640 million (1995 – $680 million).

The fair value of Borrowings is included in Note 23.

11. OBLIGATION UNDER CAPITAL LEASE

The Corporation financed additions and improvements to the National Office building in 1990 with a long-term lease that is accounted for as a capital lease. The Corporation assumes ownership of the building for a cost of one dollar at the termination of the lease in 2015.

The annual lease payments are $5 million for the first 10 years and $4 million for the remaining 15 years.

The minimum lease payments are:

in thousands of dollars	
1997 to 2001	23 925
2002 to 2015	49 965
Total future minimum lease payments	73 890
Less interest at 11.77% and 11.57%	41 298
Present value of minimum lease payments	32 592

Interest expense in 1996 was $4 million (1995 – $4 million).

12. RESERVE FUND

The Reserve Fund is limited by Order-in-Council to $25 million.

13. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments, agencies and Crown corporations. The Corporation enters into transactions with certain of these entities in the normal course of business. All material related party transactions are either disclosed below or in relevant notes.

Losses on Loans and Real Estate, interest earnings, and the amortization of modernization and improvement expenditures, relating to certain Corporate Account Assets, are recovered from the Government of Canada through the Minister's Account. The total of such recoveries, which are not considered subsidies to others, amounted to $150 million (1995 – $239 million) of which $44 million (1995 – $51 million) is included in Interest Earned in the Corporate Account.

In accordance with fee for service agreements between the Corporation and Treasury Board, the Corporation is developing parcels of surplus government lands for residential housing projects. Development costs are capitalized and deducted from sales proceeds, the net of which is returned to the Government of Canada, nil in 1996 (1995 – $1 million). Fees capitalized in 1996 amounted to $2 million (1995 – nil).

14. OPERATING EXPENSES

The operating expenses of the Corporation are allocated on the basis of staff utilization as follows:

in thousands of dollars	1996		1995	
		%		%
Corporate Account	**29 614**	**11.0**	35 538	14.3
Minister's Account	**117 606**	**43.8**	92 102	37.1
Insurance and Guarantee Funds	**121 510**	**45.2**	120 403	48.6
Total	**268 730**	**100.0**	248 043	100.0

Included in Operating Expenses are estimated restructuring costs of $56 million for 1996 (1995 – $16 million) incurred in response to new Social Housing administrative arrangements with provincial and territorial governments and the need to achieve administrative efficiencies through a new underwriting system.

15. TAXES

Taxes include income tax and Large Corporations Tax (LCT).

The tax rate on income is 38%. The Large Corporations Tax levied on certain capital amounts was increased from a rate of 0.2% to 0.225% effective 28 February 1995.

Taxes are:

in thousands of dollars	1996			1995		
	Income Tax	**LCT**	**Total**	Income Tax	LCT	Total
Corporate Account	**(3 228)**	**421**	**(2 807)**	(4 358)	435	(3 923)
Insurance and Guarantee Funds	**10 649**	**1 041**	**11 690**	8 427	1 070	9 497
Total	**7 421**	**1 462**	**8 883**	4 069	1 505	5 574

16. COMMITMENTS

a. Loans and Investments

Commitments outstanding for Loans and Investments amounted to $126 million at 31 December 1996 (1995 – $163 million).

b. Operating Leases

Minimum rental payments scheduled over the next five years on business premises and equipment under long-term non-cancellable leases are:

in thousands of dollars	1997	1998	1999	2000	2001
Business Premises	**8 728**	**6 382**	**5 245**	**3 148**	**711**
Equipment	**14 180**	**3 632**	**669**	**155**	**–**
Total	**22 908**	**10 014**	**5 914**	**3 303**	**711**

Total Operating Lease commitments at the end of 1996 were $43 million (1995 – $62 million).

c. Future Contractual Obligations

Total financial obligations under contracts for the Minister's Account, Social Housing programs, extend for periods up to 40 years. Uncertainty in forecasting the economic factors used to calculate the financial obligations precludes reasonable estimation beyond five years.

Estimated obligations for the next five years are:

in millions of dollars	1997	1998	1999	2000	2001
	1 785	**1 761**	**1 785**	**1 782**	**1 783**

17. CONTINGENT LIABILITIES

There were legal claims against the Corporate Account of less than $1 million (1995 – nil).

There were other legal claims of $3 million at the end of 1996 (1995 – $3 million), which if successfully held against the Corporation, could result in charges to the Government of Canada through the Minister's Account.

Legal claims of $83 million (1995 – $82 million) are pending against the Mortgage Insurance Fund.

Due to the uncertainty of the outcome of these events, no provision for loss has been made.

18. PENSION PLAN

The Corporation maintains an indexed, defined benefit pension plan. Retirement benefits are based on the average salary in any best five-year period and the number of years of service.The accrued pension benefits are determined using the projected benefits method prorated on service.

The Corporation's funding policy is to contribute the amount required to provide for current benefits attributed to service and to pay the unfunded pension plan liabilities over periods permitted by regulatory authorities.

Based on an actuarial valuation at 1 January 1996, and using management's best estimates, the status of the plan is:

in thousands of dollars	1996	1995
Net assets available for benefits	**732 783**	653 773
Actuarial value of accrued pension benefits	**631 480**	589 676
Excess of net assets over actuarial value of accrued pension benefits	**101 303**	64 097
Annual Pension Cost		
Current service costs	**12 803**	10 436
Restructuring costs	**19 593**	8 041
Amortization of experience gains and losses	**(6 433)**	(692)
Government pension plans	**2 291**	2 386
Total	**28 254**	20 171

Although the Pension Fund financial position is determined by an independent actuary, changes in future conditions in the near term could require a material change in the recognized amounts.

19. INVESTMENT IN SECURITIES

in millions of dollars	1996						1995	
	Within 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	Book Value	Market Value	Book Value	Market Value
Mortgage Insurance Fund								
Securities issued or guaranteed by								
Canada	143	127	256	987	1 513	1 643	1 415	1 483
Provinces	–	119	–	243	362	391	273	286
Other	133	22	34	76	265	280	230	241
Total	276	268	290	1 306	2 140	2 314	1 918	2 010
Other Funds								
Securities issued or guaranteed by								
Canada	–	–	7	15	22	25	38	40
Provinces	–	–	–	13	13	14	20	21
Other	5	7	–	–	12	12	1	1
Total	5	7	7	28	47	51	59	62
Total	281	275	297	1 334	2 187	2 365	1 977	2 072

Sales to acquire more attractive alternative investments during 1996 resulted in a gain of less than $1 million (1995 – gain of $13 million). These totals are included in Income from Investments in the current year.

Investment in Securities yielded 7.5% (1995 – 8.4%).

The fair value of Investment in Securities is included in Note 23.

20. ACTUARIAL VALUATION OF THE MORTGAGE INSURANCE FUND

An actuarial study of the Fund as at 30 September 1996 disclosed that the Fund had a surplus of $2 million (30 September 1995 – $24 million deficit).

Although the Mortgage Insurance Fund financial position is determined annually by an independent actuary, changes in future conditiions in the near term could require a material change in the recognized amounts. It is not possible to determine the magnitude of any such changes as they relate to general economic conditions within Canada.

21. INSURANCE AND GUARANTEES IN FORCE

a. Mortgage Insurance Fund

Under Section 21 of the National Housing Act, the aggregate outstanding amount of all loans for which the insurance policies are issued may not exceed $150 billion. As at 31 December 1996, insurance policies in force totalled approximately $131 billion (1995 – $118 billion).

b. Mortgage-Backed Securities Guarantee Fund

At 31 December 1996, guarantees in force totalled approximately $14 billion (1995 – $17 billion).

22. INSURANCE AND GUARANTEE FUNDS

Balance Sheet

in thousands of dollars	Mortgage Insurance Fund		Mortgage-Backed Securities Guarantee Fund		Rental Guarantee Fund	
	1996	1995	**1996**	1995	**1996**	1995
Assets						
Investment in Securities	**2 140 442**	1 917 877	**46 943**	46 564	**–**	12 541
Real Estate	**298 719**	306 398	**–**	–	**–**	–
Mortgages	**14 019**	15 791	**–**	–	**–**	–
Accounts Receivable and Other Assets	**847**	4 397	**–**	–	**–**	–
Deferred Income Taxes	**24 821**	14 035	**143**	227	**–**	–
Due from (to) Corporate Account	**24 172**	–	**(1 943)**	–	**–**	–
	2 503 020	2 258 498	**45 143**	46 791	**–**	12 541
Liabilities						
Unearned Premiums and Guarantee Fees	**1 725 302**	1 505 839	**15 613**	20 049	**–**	–
Provision for Claims	**742 733**	721 807	**–**	–	**–**	–
Due to (from) the Receiver General for Canada	**–**	13 446	**–**	(125)	**–**	(13)
Accounts Payable and Accrued Liabilities	**16 887**	8 863	**–**	–	**–**	96
Due to (from) Corporate Account	**–**	436	**–**	3 734	**–**	(288)
	2 484 922	2 250 391	**15 613**	23 658	**–**	(205)
Surplus	**18 098**	8 107	**29 530**	23 133	**–**	12 746
	2 503 020	2 258 498	**45 143**	46 791	**–**	12 541

The Rental Guarantee program no longer exists. Residual cash assets of $13 million were returned to the Consolidated Revenue Fund during 1996.

22. INSURANCE AND GUARANTEE FUNDS

Statement of Operations and Surplus (Deficit)

in thousands of dollars	Mortgage Insurance Fund		Mortgage-Backed Securities Guarantee Fund		Rental Guarantee Fund	
	1996	1995	**1996**	1995	**1996**	1995
Revenues						
Earned Premiums and Guarantee Fees	**350 957**	344 092	**7 999**	8 467	**–**	–
Application Fees	**40 633**	35 895	**511**	429	**–**	–
Income from Investments	**151 094**	149 217	**3 367**	3 344	**374**	363
Other	**2 023**	2 563	**–**	–	**30**	530
	544 707	531 767	**11 877**	12 240	**404**	893
Expenses						
Loss on Claims	**386 345**	304 578	**(37)**	263	**–**	439
Operating Expenses	**119 888**	118 699	**1 486**	1 530	**136**	174
Adjustment to Provision for Claims	**20 926**	71 998	**–**	–	**–**	–
	527 159	495 275	**1 449**	1 793	**136**	613
Income before the Undernoted	**17 548**	36 492	**10 428**	10 447	**268**	280
Adjustment to Premium Deficiency	**–**	55 062	**–**	–	**–**	–
Income before Taxes	**17 548**	91 554	**10 428**	10 447	**268**	280
Taxes	**7 557**	5 479	**4 031**	3 897	**102**	121
Net Income	**9 991**	86 075	**6 397**	6 550	**166**	159
Surplus (Deficit)						
Balance, Beginning of Year	**8 107**	(77 968)	**23 133**	16 583	**12 746**	12 587
Assets Returned to the Government of Canada	**–**	–	**–**	–	**(12 912)**	–
Balance, End of Year	**18 098**	8 107	**29 530**	23 133	**–**	12 746

22. INSURANCE AND GUARANTEE FUNDS

Statement of Changes in Financial Position

in thousands of dollars	Mortgage Insurance Fund		Mortgage-Backed Securities Guarantee Fund		Rental Guarantee Fund	
	1996	1995	**1996**	1995	**1996**	1995
Operating Activities						
Premiums and Guarantee Fees Received	**570 421**	444 448	**3 562**	3 074	**–**	–
Application Fees Received	**40 633**	35 895	**511**	429	**–**	–
Investment Income Received	**145 426**	150 660	**2 648**	3 052	**422**	331
Net Claims	**(350 802)**	(316 983)	**–**	–	**–**	8 700
Operating Expenses Paid	**(110 698)**	(118 699)	**(1 486)**	(1 530)	**(136)**	(174)
Taxes Paid	**(32 151)**	14 943	**(3 821)**	(3 920)	**(89)**	24
Other	**(22 604)**	(13 060)	**37**	(263)	**(66)**	438
	240 225	197 204	**1 451**	842	**131**	9 319
Investment Activities						
Investment in Securities	**(215 617)**	(201 895)	**340**	(4 039)	**12 493**	(9 383)
Assets Returned to the Government of Canada	**–**	–	**–**	–	**(12 912)**	–
Increase (Decrease) in Due from Corporate Account	**24 608**	(4 691)	**1 791**	(3 197)	**(288)**	(64)

23. FAIR VALUE OF FINANCIAL INSTRUMENTS

The amounts set out below represent the fair values of on- and off-balance sheet financial instruments of the Corporation using the valuation methods and assumptions as referred to below. Fair value amounts are designed to represent estimates of the amounts at which instruments could be exchanged in a current transaction between willing parties.

Fair Value of Financial Instruments

in thousands of dollars	1996			1995		
	Book Value	**Fair Value**	**Fair Value over (under) Book Value**	Book Value	Fair Value	Fair Value over (under) Book Value
Corporate Account						
Assets						
Loans	**12 307 745**	**13 944 413**	**1 636 668**	10 526 237	11 973 409	1 447 172
Cash and Short-term Investments	**227 980**	**227 964**	**(16)**	722 083	727 292	5 209
Accounts Receivable	**87 776**	**87 776**	**–**	71 923	71 923	–
Liabilities						
Borrowings from the Government of Canada	**7 093 971**	**7 014 648**	**(79 323)**	7 504 816	6 871 114	(633 702)
Captial Market Borrowings	**7 572 915**	**7 892 387**	**319 472**	5 965 875	6 085 146	119 271
Accounts Payable and Accrued Liabilities	**323 183**	**323 183**	**–**	301 801	301 801	–
Off-balance Sheet						
Derivative Financial Instruments						
In a net receivable position		**139 359**			92 495	
In a net payable position		**114 386**			46 019	
Insurance and Guarantee Funds						
Assets						
Investment in Securities	**2 187 385**	**2 364 895**	**177 510**	1 976 982	2 071 800	94 818
Mortgages	**14 019**	**14 019**	**–**	15 791	15 791	–
Accounts Receivable and Other Assets	**847**	**847**	**–**	4 397	4 397	–
Liabilities						
Accounts Payable and Accrued Liabilities	**16 887**	**16 887**	**–**	8 959	8 959	–

Fair values are based on a range of valuation methods and assumptions.

The estimated fair value of the following assets and liabilities is equal to book value as the items are short-term in nature:

Corporate Account

- Cash
- Accounts Receivable
- Capital Market Borrowings (Short-term)
- Accounts Payable and Accrued Liabilities

Insurance and Guarantee Funds

- Accounts Receivable and Other Assets
- Accounts Payable and Accrued Liabilities

Fair value of the following assets and liabilities is determined from quoted market prices:

Corporate Account

- Short-term Investments
- Capital Market Borrowings (Medium-term)

Insurance and Guarantee Funds

- Investment in Securities
- Mortgages

Fair value of the following assets and liabilities is estimated using discounted cash flow analysis:

Corporate Account

- Loans
- Borrowings from the Government of Canada
- Off-balance Sheet Derivative Financial Instruments

Asset/Liability Management
The management and control, within set parameters, of the impact of changes in the volume, mix, maturity, quality and interest and exchange rate sensitivity of assets and liabilities.

Commercial Paper
A short-term unsecured promissory note issued in the open market that represents the obligation of the issuing entity.

Counterparty
A principal party to a derivative instrument agreement or transaction other than the Corporation.

Credit Risk
The risk of financial loss resulting from the failure of a financial counterparty, for any reasons, to fully honor financial or contractual obligations.

Cross-Currency Swaps
An agreement between two parties to exchange a series of cash flows for another series of cash flows denominated in a different currency over a specified period of time. An exchange of principal must occur at the maturity of the swap, whereas an initial exchange of principal is optional.

Derivative Financial Instrument
An off-balance sheet transaction with financial and economic characteristics which are determined by the price behavior of an underlying asset or liability or group of assets or liabilities.

Foreign Exchange Risk
The exposure of an institution to the potential impact of movements in foreign exchange rates. The risk that adverse fluctuations in exchange rates may result in a loss in Canadian dollar terms.

Foreign exchange risk arises when there are unhedged currency mismatches in an institution's assets and liabilities, and related cash flows (both on- and off-balance sheet) which are not subject to a fixed exchange rate vis-à-vis the Canadian dollar. The amount at risk is a function of the magnitude of potential exchange rate changes and the size and duration of the foreign currency exposure. This risk can be hedged by means of a hedging transaction.

Gap Analysis
An analysis of the difference between the amount of rate-sensitive assets and rate-sensitive liabilities (both on- and off-balance sheet) that reprice in a given period.

Hedging
A risk management technique used to reduce or eliminate price, interest rate or foreign exchange risk exposures. The elimination or reduction of such exposures is accomplished by entering into transactions that create off-setting risk positions. The concept is that when an institution has a risk that it wishes to avoid or minimize, the institution can undertake a further transaction which compensates for the risk and acts as a hedge. If the hedge is effective, any gain or loss on the hedged risk position will be offset by a loss or gain on the value of the hedge itself.

Interest Rate Risk

Interest rate risk is the potential impact on earnings and net asset values of changes in interest rates. Interest rate risk arises when principal and interest cash flows (including final maturities), both on- and off-balance sheet, have mismatched repricing dates. The amounts at risk are a function of the magnitude and direction of interest rate changes and the sizes, term and maturity structure of the mismatch position.

Interest Rate Swap

An agreement between two parties to exchange a series of cash flows for another series of cash flows over a specified period of time. The cash flow payments are usually determined by applying a fixed or floating interest rate to a notional amount which may vary over the term of the swap. Unlike financial assets or liabilities, there are no principal payments under an interest rate swap.

Legal Risk

Legal risk is the risk of loss due to the unenforceability of a financial obligation.

Liquidity Risk

The risk of loss due to the inability of a firm to unwind financial transactions at or near current market value, or the risk that it does not have sufficient cash flow to meet obligations from financial transactions.

Marked-to-Market

The valuation of securities and off-balance sheet instruments, such as interest and foreign exchange rate contracts, at market prices.

Market Risk

The risk of loss in market value or future cash flows due to adverse changes in financial markets.

Notional Principal Amount

The contract or principal amounts used in determining payment for certain off-balance sheet instruments, such as interest rate and cross currency swaps. The amounts are termed "notional" because they are not usually exchanged themselves, and serve only as the basis for calculating other amounts that do change hands.

Off-Balance Sheet

When financial instruments are not reflected in an institution's balance sheet. Often, such instruments are disclosed in the notes to the financial statements.

Operational Risk

The risk that a loss will be incurred as a result of incorrect processing of transactions and information due to fraud, error, system failure or adverse changes in cost or volumes.