

CANADA MORTGAGE AND HOUSING CORPORATION

# Quarterly Financial Report

**SECOND QUARTER**

June 30, 2012

(Unaudited)

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# MANAGEMENT'S DISCUSSION & ANALYSIS

June 30, 2012

## INTRODUCTION

For over 65 years, Canada Mortgage and Housing Corporation (CMHC) has been Canada's national housing agency. Established as a federal Crown Corporation in 1946 to help address post-war housing shortages, our role has evolved as Canadians' needs have changed.

Today, we work closely with provinces, territories and the private and not-for-profit sectors to help lower-income Canadians access affordable, better quality housing. We also support Aboriginal Canadians on-reserve to help improve their living conditions.

Through our housing research, information transfer and market analysis activities, CMHC promotes sound decision making by consumers and the housing industry.

Our role in housing finance — providing mortgage loan insurance, providing securitization guarantee products and administering the covered bond framework — contributes to the health and stability of Canada's housing finance system and housing markets and facilitates access to financing for housing across the country. This includes housing in small and rural communities, rental housing and nursing and retirement homes.

CMHC's prudent underwriting standards and market presence contribute to the resilience and stability of the Canadian housing finance system and housing markets and serve to minimize risk to Canadian taxpayers. The quality of CMHC's insured mortgage portfolio remains strong and the rate of arrears of insured loans remains historically low and in line with the industry trend.

CMHC is governed by a Board of Directors and is accountable to Parliament through the Minister of Human Resources and Skills Development. As a Crown Corporation, CMHC is also required to meet a number of governance and accountability requirements under the *Financial Administration Act* and the *CMHC Act*.

Management is responsible for ensuring that all information in the quarterly financial report is consistent with the unaudited Quarterly Consolidated Financial Statements. The information is intended to provide readers with an overview of CMHC's performance for the three months and six months ended 30 June 2012, including comparatives against the same period in 2011. The Management's Discussion and Analysis (MD&A) includes explanations of significant deviations in actual financial results from the targets outlined in the Corporate Plan Summary that may impact the current and future quarters of CMHC's fiscal year.

The 2012 and 2011 financial information contained herein, as well as the unaudited Quarterly Consolidated Financial Statements and related Notes have been prepared in accordance with International Financial Reporting Standards (IFRS) with the exception of the adoption of new or changed accounting policies within the quarter (see Note 2 of the unaudited Quarterly Consolidated Financial Statements). CMHC's unaudited Quarterly Consolidated Financial Statements for period ended 30 June 2012 have not been reviewed nor audited by CMHC external auditors.

The MD&A should be read in conjunction with CMHC's unaudited Quarterly Consolidated Financial Statements and related Notes included in this report as well as with the CMHC 2011 Annual Report.

## Forward-looking Statements

*CMHC's Quarterly Financial Report contains forward-looking statements regarding objectives, strategies and expected financial results. There are risks and uncertainties beyond the control of CMHC that include, but are not limited to, economic, financial and regulatory conditions nationally and internationally. These factors, among others, may cause actual results to differ substantially from the expectations stated or implied in forward-looking statements.*

## THE OPERATING ENVIRONMENT AND OUTLOOK FOR 2012

### Ongoing Investments in Housing

The Government of Canada, through CMHC, provides approximately \$2 billion in federal funding each year to help reduce the number of Canadians in housing need. These investments are provided under various housing programs and initiatives on and off reserve.

Of the \$2 billion, approximately \$1.7 billion is provided annually in the form of ongoing subsidies in support of almost 605,000 households living in existing social housing, including some 29,600 households on-reserve. These subsidies help ensure that lower-income families and individuals living in these units do not pay a disproportionate amount of their income on housing.

In addition to the ongoing subsidies provided for the 29,600 households on-reserve mentioned above, CMHC continues to make new commitments on-reserve in support of First Nations housing needs. In 2011, these commitments included the construction of 604 new social housing units, the renovation of 1,015 existing homes and an investment in capacity building for First Nations people living on-reserve.

Moreover, the Government of Canada, through CMHC, continues to provide annual funding under the Investment in Affordable Housing 2011-2014 Framework Agreement announced on 4 July 2011, which also forms part of the overall \$2 billion annual federal investment. Nationally, the federal contribution is more than \$716 million for the 3-year period. Funding for the Framework Agreement relates to the final three years of the federal government's commitment in 2008 to a five-year investment of more than \$1.9 billion in housing and homelessness to address the needs of low-income Canadians, those at risk of homelessness and the homeless.

Under the new framework, provinces and territories have the flexibility to invest in a range of programs and initiatives designed to achieve the overall intended outcome of reducing the number of Canadians in housing need by improving access to affordable housing that is sound, suitable and sustainable. Initiatives under the Framework can include new construction, renovation, homeownership assistance, rent supplements, shelter allowances and accommodations for victims of family violence.

As of 31 March 2012, all provinces and territories (P/Ts) had signed bilateral agreements related to this new Framework.

### Mortgage Loan Insurance

On 21 June 2012, as part of continuous efforts to strengthen Canada's housing finance system, the Government of Canada announced further adjustments to the rules for government-backed insured mortgages.

The four measures for new government-backed insured mortgages with loan-to-value ratios of more than 80 per cent are:

- Reduce the maximum amortization period to 25 years from 30 years. The maximum amortization period was set at 35 years in 2008 and further reduced to 30 years in 2011.
- Lower the maximum amount Canadians can borrow when refinancing to 80 per cent from 85 per cent of the value of their homes.
- Fix the maximum gross debt service ratio at 39 per cent and the maximum total debt service ratio at 44 per cent.

- Limit the availability of government-backed insured mortgages to homes with a purchase price of less than \$1 million.

The new rules took effect on 9 July 2012 and are expected to reduce the size of the high ratio homeowner purchase market. The changes also effectively eliminate the high ratio refinance market.

In April 2012, the Financial Stability Board (FSB) of the G-20 nations finalized its Principles for Sound Residential Mortgage Underwriting Practices in the interest of international financial stability. In Canada, the Office of the Superintendent of Financial Institutions (OSFI) has implemented the FSB's principles by issuing its own Guideline for Mortgage Underwriting in Canada (B-20).

The finalized Guideline was published on 21 June 2012 and applies to all federally-regulated financial institutions (FRFIs) that are engaged in residential mortgage lending and/or the acquisition of residential mortgage loan assets in Canada. A separate Guideline will be published for mortgage loan insurers at a later date.

As part of the implementation of the June 2011 federal budget, legislation was passed focusing on the regulatory frameworks for private sector mortgage insurers and for CMHC, including the rules regarding loans eligible for government-backed mortgage insurance. On 23 June 2012, the Department of Finance pre-published in the Canada Gazette its proposed regulations to implement the *Protection of Residential Mortgage or Hypothecary Insurance Act* (related to private sector insurers) and the associated amendments to the *National Housing Act* (related to CMHC). Interested parties had until 23 July 2012 to provide comments on these regulations.

## The Jobs, Growth and Long-term Prosperity Act (Bill C-38)

The *Jobs, Growth and Long-term Prosperity Act* (the "Act") received Royal Assent on 29 June 2012.

### Enhancements to the Governance and Oversight Framework for CMHC

In the Act, the Government introduced legislative amendments to enhance the governance and oversight framework for CMHC, as part of continuous efforts to strengthen the housing finance system. Specifically, the following provisions have implications for CMHC:

- CMHC's mandate was enhanced to include financial stability as an objective of CMHC's commercial activities;
- The Minister of Finance has been provided with legislative and regulatory authorities in respect of CMHC's securitization programs and new commercial programs;
- The OSFI has been mandated to conduct examinations at least annually into whether CMHC's insurance and securitization businesses are conducted in a safe and sound manner with due regard to potential losses;
- CMHC's Board of Directors is to be increased to 12 voting members from 10, by adding the Deputy Minister of Human Resources and Skills Development Canada and the Deputy Minister of Finance as ex-officio members; and,
- Amendments to the *National Housing Act* to designate CMHC as administrator of the covered bond framework.

### Legislative Framework for Covered Bonds

Bill C-38 also included a legislative framework for covered bonds that is intended to support financial stability by helping lenders find new sources of funding and by attracting more investors to the market for Canadian covered bonds.

Under this legislative framework, CMHC is the administrator of the Canadian covered bond framework which will be available to regulated financial institutions in Canada. In this context, Bill C-38 provides for:

- The requirement for CMHC to establish and maintain a registry of registered issuers, registered programs and registered issuers whose right to issue covered bonds has been suspended and making such registry accessible to the public;
- Authorities for CMHC to establish conditions or restrictions applicable to registered issuers and the registered programs for covered bonds;
- The making of regulations relating to covered bonds.

In addition, under the legislative framework, insured mortgages will no longer be permitted to be held as covered bond collateral.

## Results of Deficit Reduction in Budget 2012

Efforts to reduce the federal deficit were undertaken by all federal departments and agencies, including CMHC. The focus was on decreased spending, requiring a review of CMHC's operations and government appropriation-based programs.

The global results of the spending review exercise were announced in Budget 2012. As noted in the Budget, CMHC will contribute \$102.4 million in ongoing annual savings by 2014-2015. These savings will have no impact on low-income Canadians receiving federal housing assistance delivered through federal or provincial/territorial agreements. They will be achieved through lower program administration costs, operating efficiencies, rationalizing research and information dissemination priorities, and discontinuing CMHC's housing export program.

## Economic Outlook (as at 22 August 2012)

The consensus among economic forecasters is that Canada's economy, as measured by Gross Domestic Product (GDP), will grow in the low 2 per cent range over 2012 and 2013. This moderate growth will help drive moderate employment gains and modest reductions in Canada's unemployment rate.

## Housing Starts

Consensus views among economic forecasters regarding future economic growth and interest rate trends help guide CMHC's views regarding housing market activity. Overall, Canadian housing markets are supported by economic and demographic fundamentals; however, CMHC continues to closely monitor activity.

Although there have been considerable swings in monthly estimates of housing starts activity, the trend of housing starts activity has been rising to 219,600 units as of July 2012. Some reduction of the current robust pace of housing starts is expected later this year and next year.

## Resale Market

Total residential sales through the Multiple Listings Service® (MLS®) are expected to remain relatively stable for the remainder of this year and next. This stability will help maintain balanced market conditions in most local housing markets of Canada. The average MLS® price decreased 0.8 per cent in July 2012 and future growth is expected to be somewhat subdued.



## SUMMARY OF UNAUDITED QUARTERLY CONSOLIDATED FINANCIAL RESULTS

CMHC reports on the following principal business activities and consolidates the accounts of Canada Housing Trust, a separate special purpose entity:

- **Housing Programs:** Expenditures and operating expenses are funded by Parliamentary appropriations.
  - **Lending:** Revenues are earned from interest income on the loan portfolio which is funded through borrowings.
- Housing Programs and the Lending Activity provide support for Canadians in need and are operated on a planned breakeven basis.*
- **Mortgage Loan Insurance:** Revenues are earned from premiums, fees and investment income. Expenses consist of operating expenses and net claim expenses. The Corporation's Net Income is primarily derived from this activity.
  - **Securitization:** Securitization revenues are earned from guarantee fees and interest income. Expenses consist primarily of interest expenses.

*Mortgage Loan Insurance and Securitization Activities facilitate access to more affordable and better quality housing and ensure an adequate supply of mortgage funds to the housing market. These activities are operated on a commercial basis.*

**Canada Housing Trust (CHT):** CHT revenue is earned primarily from investment income. Revenue derived from investment income is used to cover operating expenditures and Canada Mortgage Bonds (CMB) interest expense.

## BALANCE SHEET HIGHLIGHTS

(in millions)	As at		Variance
	30 June 2012	31 December 2011	
Total Assets	292,614	291,890	724
Total Liabilities	279,752	279,799	(47)
Contributed Capital	25	25	-
Accumulated Other Comprehensive Income (AOCI)	952	902	50
Retained Earnings Set Aside for Capitalization	10,875	9,727	1,148
Retained Earnings (other) <sup>1</sup>	1,010	1,437	(427)
<b>Total Equity of Canada</b>	<b>12,862</b>	<b>12,091</b>	<b>771</b>

<sup>1</sup> Includes Unappropriated Retained Earnings, Reserve Fund and inter-segment and inter-entity eliminations.

### Total Assets and Total Liabilities

Total Assets were \$293 billion and Total Liabilities were \$280 billion as of 30 June 2012. Total Assets increased by \$724 million from 31 December 2011 mainly as a result of an increase in Investment Securities and Cash and Cash Equivalent driven by the investment of year-to-date cash inflow from net operations.

Total Liabilities remained relatively stable when compared to 31 December 2011.

### Equity of Canada

The Equity of Canada is made up of three components:

- **Contributed Capital**  
The contributed capital of CMHC is determined by the Governor in Council. It is currently set at \$25 million.
- **Accumulated Other Comprehensive Income (AOCI)**  
AOCI is the accumulated unrealized gains or losses caused by the change in fair valuation of Available for Sale (AFS) investments in the Mortgage Loan Insurance and Securitization Activities. As at 30 June 2012, total AOCI was at \$952 million, a \$50 million increase from 31 December 2011. This increase is mainly caused by fair value fluctuations on Available for Sale financial instruments, supplemented by the reclassification of impairment losses on investment in equities, from OCI to Net Income. Further explanation is provided later in this section.
- **Retained Earnings**  
Total Retained Earnings were \$11,885 million of which \$10,875 million is set aside for the capitalization of both the Mortgage Loan Insurance and Securitization Activities in accordance with CMHC's Capital Management Framework. The residual \$1,010 million in Retained Earnings (other) is comprised of Unappropriated Retained Earnings from the Mortgage Loan Insurance and Securitization Activities as well as the Reserve Fund in the Lending Activity.

Total Appropriated Retained Earnings increased by \$1,148 million since 31 December 2011, mainly as a result of the increase in the amount set aside for capitalization from the Mortgage Loan Insurance Activity. This increase was mainly driven by the introduction of the margin for interest rate risk effective 1 January 2012, which had the impact of increasing the amount required to be capitalized for interest rate sensitive assets and liabilities.

Total Retained Earnings (other) decreased by \$427 million from 31 December 2011, mainly as a result of the amount set aside for capitalization, which was partially offset by the year-to-date Net Income. Further explanation is provided in the segmented financial results section.

Within the Public Accounts of Canada, CMHC's annual Consolidated Net Income reduces the Government's annual deficit, and the consolidated Retained Earnings and Accumulated Other Comprehensive Income reduces the Government's accumulated deficit. Over the last decade, CMHC has contributed over \$17 billion to reducing the Government's accumulated deficit through both its Net Income and Income Taxes.

The *CMHC Act* and *National Housing Act* (NHA) govern the use of the Corporation's Retained Earnings.

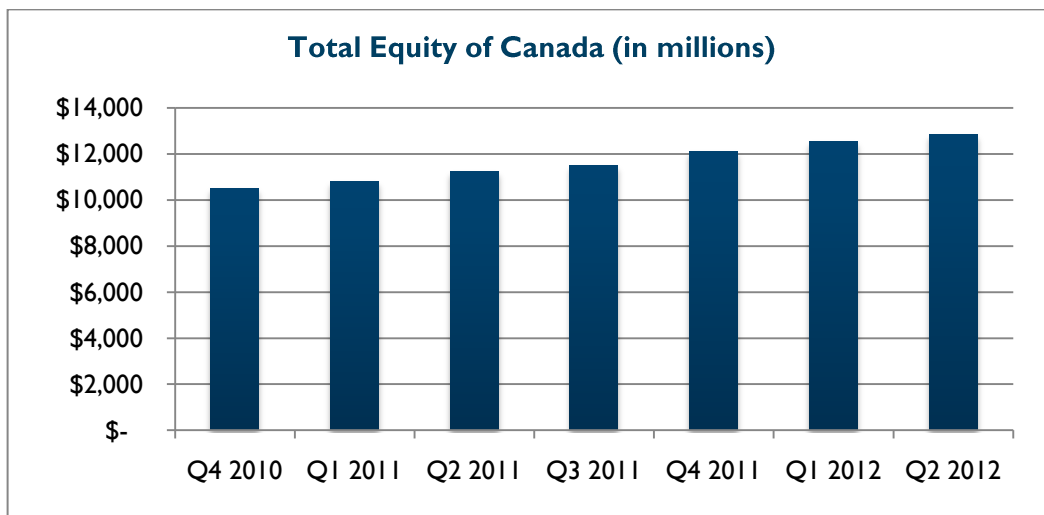
Retained Earnings related to the Mortgage Loan Insurance Activity are appropriated in accordance with the Capital Management Framework which is based on guidelines developed by OSFI. For its Mortgage Loan Insurance Activity, CMHC has Appropriated Retained Earnings as well as AOCI representing its capital holding target of 200% Minimum Capital Test (MCT). Mortgage Loan Insurance Capital Available resulted in a 214% MCT as at Q2 2012.

Retained Earnings related to the Securitization Activity are also appropriated based on regulatory and economic capital principles. For its Securitization Activity, CMHC has Appropriated Retained Earnings as well as AOCI representing 100% of its target capital.

Earnings in relation to CMHC's Lending Activity are retained to address interest rate risk exposures on pre-payable loans as well as credit risk exposure on the Municipal Infrastructure Lending Program loans. These Retained Earnings, referred to as the Reserve Fund, also include amounts representing unrealized fair market valuation changes of the Lending Activity investments as well as its portion of actuarial gains and losses from CMHC's defined post employment benefits.

The Reserve Fund for Lending is subject to a statutory limit of \$240 million. Should the limit be exceeded, CMHC would be required to pay any excess to the Government of Canada. Further information can be found under Objective 1, Lending Activity section.

As of 30 June 2012, Total Equity of Canada was \$12,862 million, an increase of \$771 million compared to 31 December 2011. This increase is primarily the result of the year-to-date Net Income of \$782 million. Additional details can be found under the Statement of Income and Comprehensive Income Highlights section.



## STATEMENT OF INCOME AND COMPREHENSIVE INCOME HIGHLIGHTS

(in millions)	Three months ended			Six months ended		
	30 June		Variance	30 June		Variance
	2012	2011		2012	2011	
Revenues	3,238	3,320	(82)	6,806	7,083	(277)
Expenses	2,798	2,799	(1)	5,771	6,048	(277)
Income Taxes	105	138	(33)	253	273	(20)
Net Income	335	383	(48)	782	762	20
Other Comprehensive Income (Loss)	3	(3)	6	(11)	(36)	25
Comprehensive Income	338	380	(42)	771	726	45
<b>RESOURCE MANAGEMENT</b>						
Total Operating Expenses (included in Total Expenses above)	104	101	3	226	211	15
Staff-Years (Full Time Equivalent)	474	500	(26)	940	992	(52)

### Revenues

#### Three months ended 30 June 2012

Revenues for the three months ended 30 June 2012 were \$3,238 million, a decrease of 2% (\$82 million) when compared to the same prior year period. This decrease is mainly a result of lower interest income from NHA MBS resulting from lower interest rates. This was further supplemented by a decrease in realized gains on financial instruments due to impairment losses recognized as a result of significant or/and prolonged losses experienced on some investment in equities from the Mortgage Loan Insurance Activity. These decreases were partially offset by an increase in Housing Program appropriations due to new funding under the Investment in Affordable Housing (IAH) Framework.

#### Six months ended 30 June 2012

Revenues for the six months ended 30 June 2012 were \$6,806 million, a decrease of 4% (\$277 million) when compared to the same prior year period. This decrease is mainly the result of lower interest income from NHA MBS and a decrease in realized gains from investment securities as mentioned above. There was also a decrease in Parliamentary Appropriations for Housing Programs due to the termination of Canada's Economic Action Plan (CEAP) in March 2011, which was partially offset by new spending under the IAH Framework. These decreases were somewhat offset by an increase in Premiums and Fees Earned in both the Mortgage Loan Insurance and Securitization Activities, which will be further discussed under Objective 2 of this report.

The variances in interest income from NHA MBS and Housing Programs Appropriations discussed above led to corresponding variances in Expenses (Interest Expenses and Housing Programs Expenses respectively) and therefore had no impact on Net Income.

## Expenses

### Three months ended 30 June 2012

Expenses for the three months ended 30 June 2012 were \$2,798 million, which is consistent with expenses recognized during the same prior year period. Although consistent, Interest Expenses decreased when compared to the same prior year period due to lower interest rates in the CMB program. This decrease was completely offset by an increase in Housing Program expenses as discussed above, as well as an increase in Net Claims. Further information regarding these variances can be found under Objective 1 and 2 of this report.

### For the six months ended 30 June 2012

Expenses for the six months ended 30 June 2012 were \$5,771 million, a decrease of 5% (\$277 million) when compared to the same prior year period. This decrease is mainly a result of lower CMB Interest Expense and a decrease in Housing Programs expenses as mentioned above.

## Net Income

For the three months ended 30 June 2012, reported Net Income (after taxes) decreased by \$48 million (13%) mostly as a result of impairment losses recognized on investment in equities as well as the increase in Net Claims. For the six months ended 30 June 2012, reported Net Income was \$782 million, which is relatively consistent with the reported Net Income recognized during the same prior year period. The \$20 million increase between the two periods is mostly driven by the decrease in Income Tax expenses due to a fluctuation in the corporate tax rate from 2011 (26.5%) to 2012 (25%).

## Other Comprehensive Income (Loss)

CMHC's Other Comprehensive Income (OCI) consists of unrealized gains or losses caused by changes in the fair valuation of AFS investments in the Mortgage Loan Insurance and Securitization Activities. As these investments are classified as "Available for Sale", their unrealized gains/losses on fair valuation are recorded in OCI. Also included in OCI are net actuarial gains/losses from CMHC's post-employment benefits.

### Three months ended 30 June 2012

Total Other Comprehensive Income for the three months ended 30 June 2012 was \$3 million, an improvement of \$6 million when compared to the same prior year period. This OCI improvement is mainly attributable to the reclassification of impairment losses on investment in equities from OCI to Net Income, which was partially offset by a decrease in unrealized gains from Available for Sale financial instruments due to lower bond and equity prices.

### Six months ended 30 June 2012

Total Other Comprehensive Income for the six months ended 30 June 2012 was negative \$11 million, an improvement of \$25 million when compared to the same prior year period. This OCI improvement is primarily the result of the reclassification of an impairment loss on investment in equities from OCI to Net Income, which was partially offset by higher net actuarial losses from post-employment benefits caused by a decline in the discount rate assumption for these benefits.

## Resource Management

Operating Expenses for the three months and six months ended 30 June 2012 were \$104 million and \$226 million, respectively, an increase of \$3 million and \$15 million, respectively when compared to the same prior year periods. This increase was mainly a result of higher pension expenses due to a decline in the assumption for the discount rate and the return on assets. The current pension expense is also higher than provided for in the 2012 plan.

For the three months and six months ended 30 June 2012, staff-years consumed decreased by 5% (26 staff-years and 52 staff-years respectively) compared to the same prior year periods. The decrease is primarily a result of lower Mortgage Loan Insurance Activities and the termination of funding for CEAP on 31 March 2011.

## DISCLOSURE OF CHANGES IN ACCOUNTING POLICIES

CMHC's significant accounting policies and changes in accounting policies are described in Note 2 of the unaudited Quarterly Consolidated Financial Statements.

The Corporation's significant accounting policies conform to IFRS effective as at 31 December 2011, with the exception of the adoption of new or changed accounting standards within the quarter. Treasury Board of Canada's Standard on Quarterly Financial Reports for Crown Corporations allows Management the option to only adopt new or changed policies for the first time at year end.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

### Judgments in Applying Accounting Policies

In the process of applying CMHC's accounting policies, management is required to make various judgments that can significantly affect the amounts recognized in the financial statements. The judgments having the most significant effects on the financial statements are disclosed in Note 4 of the unaudited Quarterly Consolidated Financial Statements.

### Critical Accounting Estimates

The preparation of the unaudited Quarterly Consolidated Financial Statements requires Management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, comprehensive income and related disclosure. These estimates and underlying assumptions are reviewed on an on-going basis. Where actual results differ from these estimates and assumptions, the impact will be recorded in future periods. For a description of CMHC's critical assumptions and estimates, see Note 4 of the unaudited Quarterly Consolidated Financial Statements.

## FUTURE ACCOUNTING CHANGES

The International Accounting Standards Board (“the IASB”) continues to develop and publish accounting standards in order to achieve high quality financial reporting. CMHC actively monitors the new standards and amendments to existing standards that have been issued by the IASB but are not yet effective on the date of issuance of these unaudited Quarterly Consolidated Financial Statements. The following pronouncements, listed by applicable annual accounting period effective date, have been identified as potentially having an impact on the Corporation’s results and Consolidated Financial Statements in the future.

New Standards		Impact to CMHC’s Consolidated Financial Statements on adoption	Effective for annual periods beginning on or after
IFRS 10	<i>Consolidated Financial Statements</i>	No material impact	1 January 2013
IFRS 11	<i>Joint Arrangements</i>	No material impact	1 January 2013
IFRS 12	<i>Disclosure of Interests in Other Entities</i>	Enhanced disclosure	1 January 2013
IFRS 13	<i>Fair Value Measurement</i>	Potential increase in the fair value of real estate properties as well as an increase to Net Income	1 January 2013
IFRS 9	<i>Financial Instruments</i>	Not yet determined	1 January 2015
Amended Standards			
IFRS 7	<i>Financial Instruments: Disclosures</i>	Not yet determined	1 January 2013
IAS 1	<i>Presentation of Financial Statements</i>	No material impact	1 January 2013
IAS 19	<i>Employee Benefits</i>	Overall change in pension expenses reflected in Net Income with a corresponding offset in actuarial gains and losses recognized in Other Comprehensive Income	1 January 2013
IAS 32	<i>Financial Instruments: Presentation</i>	Not yet determined	1 January 2014

For a more detailed description of future accounting changes and assessments made to date, see the annual management’s discussion and analysis, which is contained in CMHC’s 2011 Annual Report, as well as Note 3 of the attached unaudited Quarterly Consolidated Financial Statements.



## SEGMENTED FINANCIAL RESULTS

Financial analysis is provided for the following activities: Housing Programs and Lending Activity, Mortgage Loan Insurance Activity and Securitization Activity and the Canada Housing Trust which form CMHC's Objectives 1 and 2. These objectives and other performance measures are discussed in greater detail in CMHC's 2011 Annual Report.

### Objective 1 – Help Canadians in need

CMHC's authority to spend public funds under the Housing Programs is provided by the Government of Canada through annual Parliamentary appropriations. The majority of this funding supports programs to address the housing needs of Canadians living off-reserve and First Nations people living on-reserve. In addition, other housing-related activities supported by this funding include market analysis, and research and information transfer. Analysis of CMHC's Housing Programs expenses and Lending Activities are provided below.

#### HOUSING PROGRAMS

On an annual basis, the Corporation spends approximately \$2 billion (excluding CEAP) to assist Canadians in need. Approximately \$1.7 billion of the \$2 billion is related to on-going, long-term social housing commitments of which \$1 billion is paid to provinces and territories that administer the housing portfolio pursuant to Social Housing Agreements with CMHC.

CEAP, a temporary two-year initiative, which terminated 31 March 2011, increased Housing Programs expenses from 2009 to 2011. Under CEAP, CMHC fully delivered \$1.925 billion in social housing for the creation of new affordable housing and the renovation and retrofit of existing social housing.

Effective April of 2011, expenditures relating to the Investment in Affordable Housing (2011-2014) Framework began to flow under the Housing Programs appropriations. This funding will terminate 31 March 2014. The objective of this Framework is to improve the living conditions of Canadians in need by improving access to affordable, sound, suitable and sustainable housing.

(in millions)	Three months ended			Six months ended		
	30 June		Variance	30 June		Variance
	2012	2011		2012	2011	
Housing Programs Expenses	459	382	77	1,105	1,146	(41)
Operating Expenses	30	27	3	67	58	9
<b>Total Appropriations</b>	<b>489</b>	<b>409</b>	<b>80</b>	<b>1,172</b>	<b>1,204</b>	<b>(32)</b>

#### Three months ended 30 June 2012

Appropriation spending for the three months ended 30 June 2012 was \$489 million consisting of \$459 million in Housing Programs Expenses and \$30 million in Operating Expenses. For the three months ended 30 June 2012, Housing Programs Expenses increased by 20% (\$77 million) compared to the same prior year period. This increase is primarily due to new spending under the Investment in Affordable Housing (IAH) (2011-2014) Framework.

Related Operating Expenses have remained relatively stable when compared to the same prior year period.

**Six months ended 30 June 2012**

Appropriation spending for the six months ended 30 June 2012 was \$1,172 million consisting of \$1,105 million in Housing Programs Expenses and \$67 million in Operating Expenses. For the six months ended 30 June 2012, Housing Programs Expenses decreased by 4% (\$41 million) compared to the same prior year period. This decrease is mainly due to the termination of CEAP funding as at 31 March 2011 and lower spending under the two-year extension of the Affordable Housing Initiative (AHI) and renovation programs. This was partially offset by new spending under the Investment in Affordable Housing (IAH) (2011-2014) Framework which combines funding previously provided under the AHI and renovation programs under one funding envelope.

Related Operating Expenses increased by 16% (\$9 million) when compared to the same prior year period. This increase is mainly driven by higher pension expenses caused by the decline in the discount rate assumption and the return on assets.

## REPORTING ON USE OF APPROPRIATIONS

CMHC receives funds from the Government of Canada through parliamentary appropriations for Housing Programs expenditures, including operating expenses. Total appropriations recognized as of 30 June 2012 amounted to \$1,172 million (see Note 7 of the unaudited Quarterly Consolidated Financial Statements).

Housing Programs parliamentary appropriations and related expenses are recorded in CMHC's Consolidated Statement of Income and Comprehensive Income on an accrual basis not exceeding the maximum authorized by Parliament. Those expenses incurred but not yet reimbursed are recorded on the Consolidated Balance Sheet as Due from the Government of Canada.

The following table reconciles the amount of appropriations authorized by Parliament as available to the Corporation during the Government of Canada fiscal year (31 March) with the total amount recognized year-to-date by the Corporation in its calendar year.

(in millions)	Six months ended 30 June	
	2012	2011
Amounts provided for Housing Programs:		
Amounts authorized in 2011/12 (2010/11)		
Main estimates	1,907	3,131
Supplementary estimates A <sup>1,2</sup>	256	-
Supplementary estimates B <sup>1</sup>	-	-
Supplementary estimates C <sup>1</sup>	-	2
Unused Statutory Authorities	(1)	(1)
	<b>2,162</b>	<b>3,132</b>
Less: Portion recognized in calendar 2011 (2010)	(1,365)	(2,165)
Less: Appropriations lapsed for 2011/12 (2010/11)	(114)	(169)
<b>2011/12 (2010/11) portions recognized in 2012 (2011)</b>	<b>683</b>	<b>798</b>
Amounts authorized in 2012/13 (2011/12)		
Main estimates	2,140	1,907
Supplementary estimates A <sup>1,2</sup>	-	256
Supplementary estimates B <sup>1</sup>	-	-
Supplementary estimates C <sup>1</sup>	-	-
	<b>2,140</b>	<b>2,163</b>
Less: Portion to be recognized in subsequent quarters	(1,651)	(1,757)
<b>2012/13 (2011/12) portions recognized in 2012 (2011)</b>	<b>489</b>	<b>406</b>
<b>Total appropriations recognized - six months ended 30 June</b>	<b>1,172</b>	<b>1,204</b>

<sup>1</sup> Supplementary Estimates are additional appropriations voted on by Parliament during the government's fiscal year.

<sup>2</sup> In September 2008, a five-year investment, from 2009-2014, of more than \$1.9 billion in housing and homelessness was made to address the needs of low-income Canadians, those at risk of homelessness and the homeless. Of this amount, \$253.1 million per year was designated specifically for investments in affordable housing. The 2011/12 portion of this investment is included above.

Total appropriations for fiscal year 2012-2013 are \$2,140 million. The total spending against this fiscal year reference level as at 30 June 2012 was \$489 million (23%).

CMHC's recognized lapse for fiscal year 2011-2012 was \$114 million. The under-spending of appropriations for fiscal year ended 2011-2012 is primarily due to lower interest and inflation rates and revised spending patterns for various programs and initiatives funded under the Housing Programs.

## LENDING ACTIVITY

CMHC makes loans under the *National Housing Act* (NHA) to federally-subsidized social housing sponsors, First Nations, provinces, territories and municipalities. CMHC's loan portfolio is comprised of a mix of renewable and non-renewable loans for the purposes of both market and social housing. Where a loan is for social housing, it may be on-reserve or off-reserve. The majority of Lending Activity revenue is earned from interest income on the loan portfolio.

Through its lending activities, CMHC is able to lower the cost of government assistance required for social housing projects. These loans can be offered at lower interest rates because CMHC borrows funds through the Crown Borrowing Program and operates its social housing lending program at break-even levels.

In order to operate this program on a break-even basis, loans are generally closed to prepayment. Where prepayment is contractually available, CMHC applies the terms and conditions of its loan security documents including the application of early payout charges as applicable.

CEAP provided \$2 billion in direct low-cost loans to municipalities (MILP) through CMHC for housing-related infrastructure projects in towns and cities across the country. By the 31 March 2011 deadline, the full \$2 billion in available lending authority had been utilized by municipalities from across Canada.

## Net Income

(in millions)	Three months ended			Six months ended		
	30 June		Variance	30 June		Variance
	2012	2011		2012	2011	
Interest income	156	171	(15)	314	340	(26)
Net Unrealized Gains (Losses) from Financial Instruments	-	(9)	9	(6)	(9)	3
Other Income (Expense)	10	3	7	16	6	10
Interest Expense	151	165	(14)	304	327	(23)
Operating Expenses	5	4	1	10	9	1
Income Taxes	1	(1)	2	-	-	-
Net Income (Loss)	9	(3)	12	10	1	9

### Three months ended 30 June 2012

For the three months ended 30 June 2012, total Net Income from the Lending Activity was \$9 million, an increase of \$12 million compared with the second quarter last year. This increase was mainly driven by lower unrealized losses of \$9 million resulting from the fair valuation of Capital Market Borrowings due to a smaller decrease in interest rates in 2012 than 2011 and a lower outstanding debt balance as the portfolio is approaching and reaching maturity. In addition, Other Income increased by \$7 million in comparison to Q2 2011 due to higher recoveries of post-employment benefits. The reimbursement of these expenses is included in Other Income in the Lending Activity and recovered from the Government of Canada through Housing Programs appropriations.

### Six months ended 30 June 2012

On a year-to-date basis, total Net Income from the Lending Activity was \$10 million, an increase of \$9 million compared to the same period last year. Favourable results were mainly due to an increase in Other Income as previously noted.

### Capital Management

Earnings in relation to CMHC's Lending Activity are retained in a Reserve Fund. The Reserve Fund is subject to a statutory limit (refer to CMHC's 2011 Annual Report). The components of this Reserve Fund are shown in the table below.

(in millions)	As at		Variance
	30 June 2012	31 December 2011	
Reserve for Unrealized Gains (Losses)	(115)	(101)	(14)
Reserve for All Other Lending-Related Items	104	105	(1)
Reserve Fund for Lending	(11)	4	(15)

The objective of the Reserve for Unrealized Gains (Losses) is to absorb unrealized fair market valuation changes of financial instruments as well as other unrealized gains and losses incurred from the Lending Activity. This reserve has decreased over the last six months largely as a result of net actuarial losses on post-employment benefits.

The Reserve for All Other Lending-Related Items is kept by the Corporation as part of its strategy to address interest rate risk exposure on pre-payable loans as well as credit risk exposure on the MILP loans. This Reserve has remained relatively stable when compared to 31 December 2011.

## Objective 2 – Facilitate access to more affordable, better quality housing for all Canadians

### MORTGAGE LOAN INSURANCE ACTIVITY

In Canada, federally-regulated lenders and most provincially-regulated financial institutions are required by law to insure residential mortgage loans when borrowers have less than a 20% down payment. These mortgages are often referred to as high ratio loans. Mortgage loan insurance is available from CMHC and from private mortgage loan insurers.

The requirement for mortgage loan insurance on high ratio loans protects lenders in the event of borrower default, allowing qualified borrowers to obtain mortgage financing at rates comparable to those with higher down payments. This enables qualified borrowers to access a range of housing options and contributes to a strong and stable housing system.

CMHC's portfolio insurance on low ratio mortgage loans with down payments of 20% or more is not mandatory but supports lenders' risk and capital management strategies as well as mortgage market liquidity in Canada by providing lenders with securitization-ready assets.

CMHC operates its mortgage loan insurance business on a commercial basis. The premiums and fees collected and interest earned must cover related claims and other expenses, as well as provide a reasonable rate of return to the Government of Canada. Over the past decade, CMHC's insurance business has contributed more than \$14 billion to improving the Government's fiscal position.

Prudent underwriting practices and excellent client service have enabled the Corporation to maintain its position of strength in the marketplace in good economic times and bad. Economic and housing market stability are further reinforced by CMHC's work with industry partners to improve financial literacy through online tools and publications, helping to ensure that Canadians make informed and responsible decisions regarding their housing options.

## INSURANCE VOLUMES

Measures	Three months ended 30 June		Variance	Six months ended 30 June		Variance
	2012	2011		2012	2011	
Total Insured Volumes (units)	112,152	146,651	(34,499)	226,197	274,080	(47,883)
Total Insured Volumes (\$M)	19,542	22,437	(2,895)	38,496	43,469	(4,973)
Per cent of the total of rental and high ratio homeowner units approved to address less-served markets and/or to support specific government priorities	44.1%	45.6%	(1.5 pts)	43.5%	44.9%	(1.4 pts)

CMHC's insured loan volumes are influenced by the economy, housing markets, competitive pressures and the regulatory environment. Changes announced by the Government of Canada in early 2011 regarding the types of mortgages that can be insured reduced the size of the high ratio homeowner mortgage loan insurance market. The recent changes announced by the Government of Canada in June 2012 will further reduce the size of the high ratio homeowner mortgage loan insurance market going forward and as a result homeowner insurance volumes are expected to be lower than originally forecasted at the beginning of the year.

CMHC's overall insured volumes (units) for the six months ended 30 June 2012 were approximately 17% lower than the same period in 2011. Multi-unit volumes are approximately 30% lower in the same period due to favourable interest rates offered on an uninsured basis in the marketplace (spreads between insured and uninsured financing for multi-unit residential properties have narrowed).

Portfolio volumes are approximately 40% lower in the first six months ended 30 June 2012 compared to the same period last year as CMHC has reduced access to its portfolio product. The declines in both of these business lines resulted in the overall decline in insurance volumes.

## CMHC'S INSURANCE-IN-FORCE

(in billions)	As at		Variance
	30 June 2012	31 December 2011	
Total Insurance-in-Force	576.0	566.5	9.5
High Ratio Homeowner	292.0	285.5	6.5
Low Ratio Portfolio	244.8	242.8	2.0
Multi-unit Residential	39.2	38.2	1.0

CMHC's total insurance-in-force increased to \$576 billion at the end of the second quarter of 2012, nearly 2% higher than total insurance-in-force at year end 2011 and 1% higher than in the first quarter of 2012.

Approximately 43% of CMHC's current insurance-in-force results from low ratio portfolio activity consisting of loans with an original loan-to-value of 80% or less. Portfolio insurance provides lenders with the ability to purchase insurance on pools of previously uninsured low ratio mortgages. Once insured, these mortgages can be securitized providing lenders with liquidity. As mentioned above, CMHC has reduced access to its portfolio insurance product which is expected to reduce volumes going forward to levels consistent with those experienced prior to the liquidity crisis. Note that the increase in CMHC's insurance-in-force from 31 December 2011 to 30 June 2012 (\$9.5 billion) can be attributed in part to certain lenders taking advantage of their full yearly allocated portfolio amounts in the first half of the year.

As CMHC continues to provide mortgage loan insurance to qualified homebuyers, multi-unit borrowers and through allocated amounts of portfolio insurance, increases in the Corporation's insurance-in-force will continue to be off-set by insured mortgages being paid down. CMHC expects mortgage repayments to continue in the range of approximately \$60 to \$65 billion per year.

## FINANCIAL ANALYSIS

Revenues from the Mortgage Loan Insurance Activity are comprised of insurance premiums, application fees for insuring loans for multi-unit properties and income earned on its investment portfolio. Premiums and fees are received at the inception of the mortgage insurance policy and are recognized as revenue over the period covered by the insurance contract using actuarially determined factors that reflect the long-term pattern for default risk. These factors are reviewed annually by CMHC's appointed external actuary.

As CMHC is mandated to operate its mortgage loan insurance business on a commercial basis, the premiums and fees it collects and the interest it earns must cover the related claims and other expenses. They must also provide a reasonable rate of return to the Government of Canada. CMHC's Mortgage Loan Insurance Activity is operated at no cost to Canadian taxpayers.

## Net Income

(in millions)	Three months ended			Six months ended		
	30 June		Variance	30 June		Variance
	2012	2011		2012	2011	
Premiums, Fees and Other Income Earned	448	438	10	874	856	18
Investment Income	134	149	(15)	280	297	(17)
Net Unrealized Gains (Losses) from Financial Instruments	(24)	2	(26)	27	4	23
Net Realized Gains (Losses) from Financial Instruments	(31)	36	(67)	30	108	(78)
Interest Expense	1	-	1	2	1	1
Operating Expenses	48	49	(1)	104	97	7
Net Claims are comprised of:						
Losses on Claims	168	144	24	322	299	23
Change in Provision for Claims	(26)	(30)	4	(61)	(37)	(24)
Income Taxes	81	121	(40)	207	238	(31)
Net Income	255	341	(86)	637	667	(30)

**Three months ended 30 June 2012**

Mortgage Loan Insurance Net Income for the quarter ended 30 June 2012 was \$255 million, \$86 million (25%) lower than in the same period last year. This decrease is largely due to higher Net Claims expenses and an increase in net losses from financial instruments which was partially offset by lower Income Tax expenses.

Net Claims expense was \$142 million in Q2 2012; \$28 million (25%) higher than in the same period last year. Net Claims is comprised of two components, the Change in Provision for Claims and Losses on Claims. Regarding the first component, the Change in Provision for Claims, is an estimate of possible future losses on mortgages that are already in arrears but have not been reported as a claim by the lender. It is an estimate because many of these mortgages will benefit from CMHC work-outs allowing borrowers to remain in their homes. The second component, Losses on Claims, is intended to cover losses on current claims that have been reported by lenders.

Due to the improving economic outlook, the number of loans in arrears declined in the second quarter of 2012; accordingly, the forecast or provision for future claims on these arrears also declined. As a result, Provision for Claims declined by \$26 million in the second quarter; \$4 million less than the Change in provision of Claims in the same period last year.

The Losses on Claims were \$24 million (17%) higher in Q2 2012 in comparison to the same quarter in 2011 due to an increase in title transfer claim volumes, a decline in the sales activity of these title transfers and the corresponding growth in real estate inventories. An increase in expenses related to work-outs on loans in arrears was also a contributing factor to the increase in Losses on Claims.

There was a \$24 million Net Unrealized Loss from Financial Instruments in Q2 2012; this compares to a \$2 million Net Unrealized Gain in the same period last year. This loss is mainly the result of the consolidation of a foreign equity mutual fund investment in late 2011. The consolidation resulted in a reclassification of the investment from Available for Sale to Held for Trading in order to be consistent with the accounting policy of the underlying consolidated securities. This mutual fund generated unrealized losses during the quarter due to a decline in the International equity markets in Q2 2012.

Net Realized Losses from Financial Instruments were \$31 million; a variance of \$67 million over the Net Realized Gains of \$36 million in the second quarter of last year. These losses are primarily due to the classification of several equity securities as "impaired" resulting in an impairment-related realized loss of approximately \$68 million. An Available for Sale equity security is identified as impaired if it is determined that significant or prolonged losses have been experienced. Once an equity security has been identified as impaired, the change or decrease of its fair value compared to its book value is recorded as a realized loss.

Income Tax Expense was \$40 million (33%) lower in Q2 2012 compared to the same period in 2011 due to a decrease in net income before taxes and a decrease in the corporate tax rate from 26.5% in 2011 to 25% in 2012.

**Six months ended 30 June 2012**

Net Income for the first half of 2012 was \$637 million; \$30 million (4%) lower than in the same period last year largely due to a decrease in Net Realized Gains on Financial Instruments which were partially offset by an increase in Net Unrealized Gains from Financial Instruments and a lower Income Tax Expense.

Net Realized Gains from Financial Instruments were \$78 million (72%) lower in YTD 2012 versus YTD 2011 due to reduced realized gains from equities caused by lower prices in equities and the aforementioned classification of some equity securities as "impaired".



Net Unrealized Gains from Financial Instruments of \$27 million increased due to the consolidation of a foreign equity mutual fund investment in late 2011 as mentioned above. The fair value fluctuation on this Fund resulted in a gain as of 30 June 2012 due to strong rally of the International equity markets in Q1 2012 which was partially offset by a decline of these markets in Q2 2012.

Income Tax Expense was \$31 million (13%) lower in Q2 2012 compared to the same period ended in 2011 due to a decrease in net income before taxes and a decrease in the corporate tax rate from 26.5% in 2011 to 25% in 2012.

## Other Financial Measures

Measures	Three months ended		Variance	Six months ended		Variance
	30 June			30 June		
	2012	2011	2012	2011		
Premiums and Fees Received (total \$ millions):	471	435	36	775	775	-
Homeowner	90%	88%	2pts	87%	85%	2pts
Multi-unit Residential	10%	12%	(2pts)	13%	15%	(2pts)
Operating Expense Ratio (per cent)	11%	11%	-	12%	11%	1pt
Severity Ratio <sup>1</sup> (per cent)	29.4%	31.1%	(1.7pts)	31.1%	32.1%	(1pt)

<sup>1</sup> The Severity Ratio is the ratio of the loss on claim compared to the original insured loan amount for claims paid in the period.

### Three months ended 30 June 2012

Premiums and Fees received in Q2 2012 were \$36 million higher than in Q2 2011, despite lower insured volumes (units) quarter-over-quarter. This is due to increased volumes of higher premium Homeowner Purchase products combined with higher average house prices overall to produce higher average premiums per unit in Q2 2012, while the volume of lower premium portfolio business declined over the same period.

### Six months ended 30 June 2012

The same factors affecting average claims paid and the severity ratio apply for the 6 month period ending 30 June 2012.

For the six months ended 30 June 2012, all financial measures disclosed in the table above have remained relatively stable when compared to the same prior year period.

## Capital Management

(in millions) (unless otherwise indicated)	As at		Variance
	30 June 2012	31 December 2011	
Mortgage Loan Insurance Retained Earnings	10,902	10,299	603
Mortgage Loan Insurance Appropriated Capital:			
Appropriated Retained Earnings	10,120	9,028	1,092
Accumulated Other Comprehensive Income (loss)	937	884	53
Total Appropriated Capital	11,057	9,912	1,145
Unappropriated Retained Earnings	782	1,271	(489)
Total Equity	11,839	11,183	656
Capital Available to Minimum Capital Required (100% MCT)	214%	226%	(12pts)
CMHC's Internal Capital Target (% MCT)	175%	150%	25pts
CMHC's Capital Holding Target (% MCT)	200%	200%	-

Under its Capital Management Framework, CMHC follows prudent regulations as set out by OSFI to protect the Canadian taxpayer from potential future costs arising from mortgage insurance.

The percentage MCT is the ratio of capital available to capital required. Capital required is calculated by applying OSFI risk factors to the Mortgage Loan Insurance Activity's assets and liabilities.

Effective 1 January 2012, new elements have been introduced by OSFI to the capital management guidelines related to mortgage loan insurance companies. These elements include refining the asset risk factors applied to balance sheet assets and adding a new capital factor for interest rate risk related to interest rate-sensitive assets and liabilities. These new elements are estimated to have the effect of reducing the 31 December 2011 MCT level of 226% MCT to 211 % MCT as at 1 January 2012.

These new elements are also responsible for the increase in Appropriated Capital from \$9,912 million at 31 December 2011 to \$11,057 million at 30 June 2012. This led to a corresponding decrease in Unappropriated Retained Earnings offset by Net Income in the second quarter.

Total Mortgage Loan Insurance Available Capital, consisting of Total Insurance Equity adjusted for Deferred Acquisition Costs, resulted in a 214% MCT as at Q2 2012 (up from 211% MCT at the beginning of 2012). This is more than twice the minimum capital required by OSFI.

In the first quarter of 2012, CMHC's Board of Directors reviewed CMHC's capital targets and determined that while the capital holding target of 200% MCT remained a prudent and appropriate level for the Insurance business, the internal capital target should be increased from 150% MCT to 175% MCT.

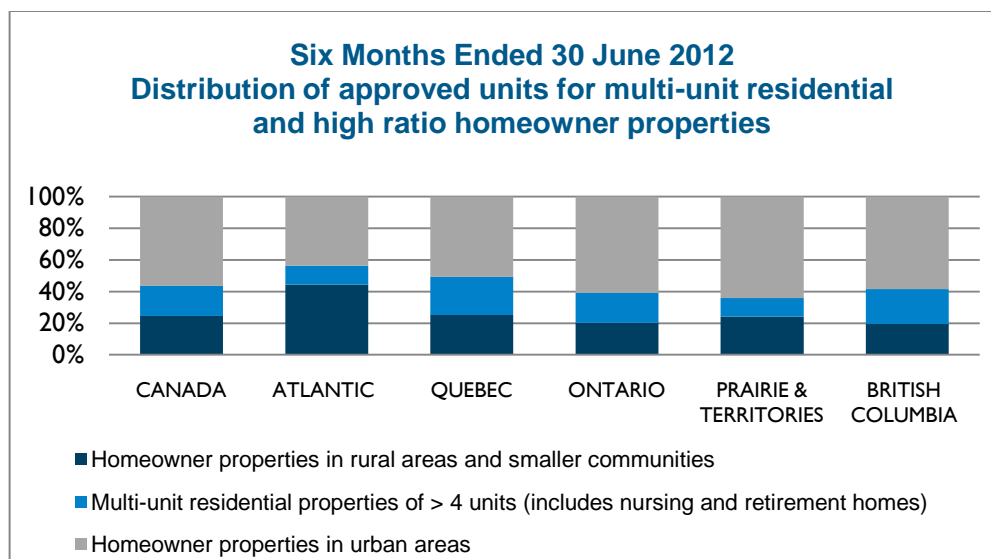
CMHC's Mortgage Loan Insurance Activity is fully capitalized with Appropriated Retained Earnings in Q2 2012 of \$10,120 million and AOCI of \$937 million. The new elements introduced by OSFI in January 2012, mainly the new capital factor for interest rate risk, gave rise to the majority of the \$1,145 million increase in total Appropriated Capital since 31 December 2011.

## **SERVING GAPS IN THE MARKETPLACE**

CMHC contributes to the stability of the financial system, including housing markets, by providing qualified Canadians in all parts of the country with access to a range of housing options. This sets CMHC apart from private sector competitors who have the ability to select the markets in which they operate. The 10% difference in the government guarantee between CMHC and private insurers compensates CMHC for this difference.

CMHC continues to be the only mortgage loan insurer for large multi-unit residential properties including nursing and retirement homes. The Corporation's support for these forms of housing is important to the supply and maintenance of a range of housing options in Canada.

CMHC is also the primary insurer for housing in rural areas and smaller Canadian markets. Close to 44% of CMHC's total rental and high ratio homeowner business in the first six months of 2012 was in markets or for housing options that are less well served or not served at all by the private sector.



## MANAGING RISK PRUDENTLY

The profile of CMHC's insurance-in-force at 30 June 2012 demonstrates the nature and level of risk associated with CMHC's mortgage loan insurance business. CMHC manages its mortgage loan insurance business in a financially prudent manner, including following OSFI guidelines in setting capital levels. In particular, CMHC targets holding twice the minimum capital required by OSFI.

CMHC carries out rigorous due diligence in assessing applications for mortgage loan insurance. All applications for mortgage loan insurance are initially reviewed and assessed by lenders prior to submission to CMHC. Upon receipt of an application for mortgage loan insurance, CMHC then independently assesses the application which includes an examination of borrower, property and market risk factors. CMHC also reviews the source of down-payment and the borrower's credit history to assess their ability to manage their financial obligations.

As shown in the following table, based on updated property values the majority of CMHC-insured mortgages currently have loan-to-value ratios of 80% or less. The average equity in CMHC's insured portfolio was 45% at 30 June 2012, 1 point higher than the average equity of 44% at December 31, 2011.

Distribution of homeowner insurance-in-force by loan-to-value (LTV) ratio based on updated property value <sup>1</sup> (%)	As at			
	30 June 2012		31 December 2011	
	High Ratio Homeowner	Low Ratio Portfolio	Overall	Overall
<=50%	9	37	23	22
>50.01% <=60%	5	18	12	12
>60.01% <=70%	12	22	17	16
>70.01% <=80%	28	22	24	25
>80.01% <=90%	31	1	16	17
>90.01% <=95%	13	0	7	7
>95.01%	2	0	1	1
<b>Average updated loan-to-value</b>	67	44	55	56
<b>Average updated equity</b>	33	56	45	44

<sup>1</sup> LTV based on the updated value of the property when using changes in local resale prices.

CMHC analysis shows that some 33% of CMHC-insured high ratio borrowers are consistently ahead of their scheduled amortization by at least one mortgage payment per year. The figure rises to 64% for those who are ahead of their payment schedule by any amount. Accelerated payments shorten the overall amortization period, reduce interest costs, increase equity in the home at a faster rate and lower risk over time.

While borrowers could choose an amortization period of up to 30 years prior to 9 July 2012, the average amortization period at the time of mortgage approval for all CMHC-insured homeowner and multi-unit residential loans was 25 years as at the end of 30 June 2012.

Distribution of Insurance-in-force by amortization (years)	As at			
	30 June 2012			31 December 2011
	High and Low Ratio Homeowner	Multi-unit Residential	Overall	Overall
<b>Average amortization period at origination</b>	25	25	<b>25</b>	25

As at 30 June 2012, the average outstanding loan amount for homeowners who took out high ratio loans above 80% loan-to-value at origination was \$175,061. This is approximately 14% higher than the average outstanding loan amount remaining on portfolio insured low ratio loans. The figures include the regular amortization of loan balances as well as accelerated payments by borrowers.

Distribution of Insurance-in-force by loan amount (\$)	As at				
	30 June 2012			31 December 2011	
	High Ratio Homeowner	Low Ratio Portfolio	Multi-unit Residential (per unit)	Overall	Overall
Over \$550,000	4%	7%	0%	<b>5%</b>	5%
Over \$400,000 to \$550,000	9%	8%	0%	<b>8%</b>	8%
Over \$250,000 to \$400,000	31%	25%	1%	<b>27%</b>	26%
Over \$100,000 to \$250,000	47%	46%	19%	<b>44%</b>	45%
Over \$60,000 to \$100,000	6%	9%	34%	<b>9%</b>	9%
\$60,000 or under	3%	5%	46%	<b>7%</b>	7%
<b>Average outstanding loan amount</b>	175,061	153,073	51,265	<b>143,101</b>	141,290

## MANAGING PORTFOLIO RISK THROUGH DIVERSIFICATION

Consistent with its mandate, CMHC provides mortgage loan insurance in all Canadian markets, spreading its insurance-in-force risk nationwide across all provinces and territories each with a distinct economic outlook.

Distribution of Insurance-in-force by Province (%)	As at				
	30 June 2012			31 December 2011	
	High Ratio Homeowner	Low Ratio Portfolio	Multi-unit Residential	Overall	Overall
Ontario	37.4	46.5	38.5	41.5	41.9
British Columbia	12.5	20.3	13.2	16.0	16.0
Alberta	16.8	14.6	11.6	15.5	15.6
Quebec	20.4	11.4	27.0	17.0	16.5
Nova Scotia	2.7	1.7	3.1	2.3	2.3
Saskatchewan	2.7	1.8	1.5	2.2	2.2
Manitoba	3.0	1.7	3.0	2.4	2.4
New Brunswick	2.2	0.8	1.0	1.5	1.5
Newfoundland	1.5	0.9	0.3	1.1	1.1
Prince Edward Island	0.3	0.2	0.2	0.2	0.2
Territories	0.5	0.1	0.6	0.3	0.3

## MANAGING PORTFOLIO QUALITY THROUGH PRUDENT UNDERWRITING

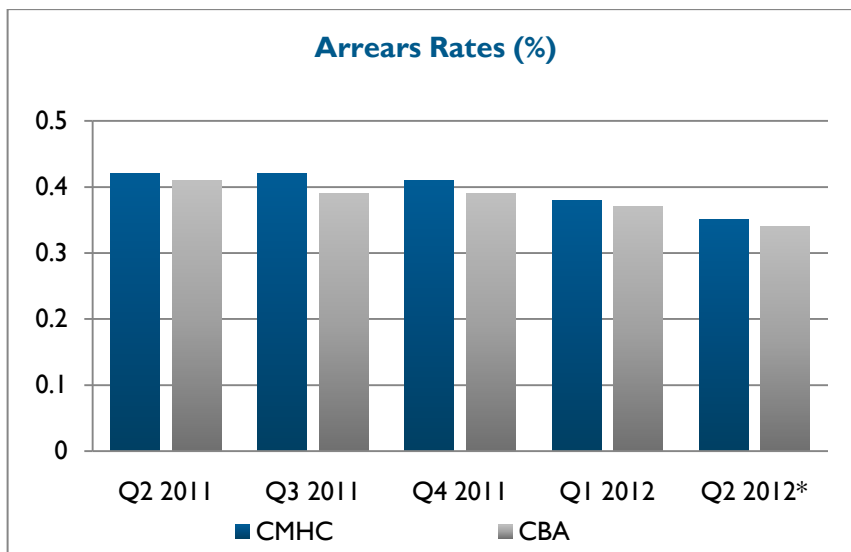
Canadian credit scores generally range between 300 and 900. The higher the score, the lower the risk of borrower default. In order to qualify for a CMHC-insured high ratio loan, the borrower/co-borrower must have a credit score of 600, consistent with the first round of government guarantee parameters introduced in October 2008. In accordance with these parameters, each lender is allowed "exceptional" loans (credit score  $\leq 600$ ) equal to 3% of their total high ratio homeowner (1-4 units) business.

Distribution of Insurance-in-force by Credit Score at Origination (%)	As at			
	30 June 2012		31 December 2011	
	High-Ratio Homeowner	Low-Ratio Portfolio	High-Ratio Homeowner	Low-Ratio Portfolio
No score	1	1	1	1
= 0 < 600	1	1	1	1
>=600 < 660	9	4	9	5
>=660 < 700	15	10	16	10
>=700	74	84	73	83
<b>Average Credit Score at Origination</b>	<b>725</b>	<b>754</b>	<b>724</b>	<b>752</b>

Distribution of Approved Loans by Credit Score at Origination (%)	Six months ended 30 June			
	2012		2011	
	High-Ratio Homeowner	Low-Ratio Portfolio	High-Ratio Homeowner	Low-Ratio Portfolio
No score	0	0	0	0
= 0 < 600	0	1	0	1
>=600 < 660	7	3	8	4
>=660 < 700	15	7	16	10
>=700	78	89	76	85
<b>Average Credit Score at Origination</b>	<b>736</b>	<b>760</b>	<b>735</b>	<b>753</b>

CMHC has been able to maintain its strong market position and manage its risks while applying prudent underwriting practices. This is demonstrated by an average credit score of 725 for CMHC’s high-ratio homeowner insurance-in-force at 30 June 2012. The high average credit score also demonstrates a strong ability among homebuyers with CMHC-insured mortgages to manage their debts.

The overall CMHC Arrears rates for June 2012 was 0.35%, improving on both the 0.38% level reported in Q1 2012 and the 0.40% rate as at the beginning of the year. Improving YTD trends have been noted in both the CMHC Homeowner arrears rates and the Portfolio component.



\* Latest available CBA arrears rate is for May 2012.

CMHC calculates the arrears rate as the ratio of all loans that are more than 90 days past due (i.e. no payments for 90 days on homeowner loans) to the number of outstanding insured loans. The ratio includes all arrears whether or not legal action has been initiated by the lender and whether or not work-outs have been approved by CMHC. The base represents outstanding insured loans. The CMHC ratio is the same as that used by the Canadian Bankers Association (CBA) for reporting arrears rates at an industry level.

## SECURITIZATION ACTIVITY AND CHT

CMHC's securitization programs contribute to a strong and stable Canadian housing finance system by providing lenders and in turn, borrowers access to low-cost funds for residential mortgages.

CMHC's securitization programs guarantee the timely payment of interest and principal of NHA Mortgage-Backed Securities (NHA MBS) issued by financial institutions and of Canada Mortgage Bonds (CMB) issued by the Canada Housing Trust (CHT). These activities are commercial in nature and do not receive Parliamentary appropriations.

Under the NHA MBS program, Approved Issuers pool insured residential mortgages into marketable NHA MBS which provide investors with the opportunity to hold high-quality, secure investments in Canadian residential mortgages. This enhances efficiency and increases competition in the mortgage market which contributes to lower funding costs for mortgages.

Through the CMB program, CHT sells CMBs to domestic and international investors and uses the proceeds to purchase NHA MBS. This further enhances the supply of low-cost mortgage funds for Canadians.

The NHA MBS and CMB programs are important pillars of Canadian financial institutions' diversified mortgage funding platforms. The programs' reliable low-cost funding framework is especially beneficial to smaller mortgage lenders who lack the scale of their larger counterparts but whom, through CMHC's securitization programs, can access residential mortgage funding. The end result of these programs is that Canadians seeking mortgage financing benefit from enhanced competition in the mortgage market.

## SECURITIES GUARANTEED

Measures	Six months ended 30 June		Variance
	2012	2011	
Securities Guaranteed (\$M)	<b>66,428</b>	43,145	23,283
Market NHA MBS	<b>46,428</b>	21,145	25,283
CMB	<b>20,000</b>	22,000	(2,000)
IMPP	-	-	-
Operating expense ratio (ex IMPP)	<b>4.7%</b>	4.6%	0.1pt
Per cent of residential mortgages securitized (ex IMPP) <sup>1</sup>	<b>28.9%</b>	26.7%	2.2pts

<sup>1</sup>Information as at April 2012

For the six months ended 30 June 2012, a total of \$ 66.4 billion of low-cost mortgage funds were provided to mortgage lenders through securities guaranteed by CMHC. This is higher than the \$43.1 billion guaranteed as at 30 June 2011 and driven by increased issuance of Market NHA MBS by Issuers.

Under the NHA MBS program, financial institutions issued and CMHC guaranteed more than \$46.4 billion in market NHA MBS as at 30 June 2012. Under the CMB program, CMHC guaranteed \$20 billion in Canada Mortgage Bonds as at 30 June 2012.

The following table summarizes the CMB and IMPP issuances and maturities as at 30 June 2012.

(in billions)	CMB		IMPP <sup>1</sup>	
	As at		As at	
	30 June 2012	31 December 2011	30 June 2012	31 December 2011
Opening Balance	201	196	55	59
Issuances/ Purchases	20	41	0	0
Maturities	18	36	1	4
Closing Balance	203	201	54	55

<sup>1</sup>IMPP initiative period: from September 2008 to 31 March 2010.

CMHC's guarantees-in-force totalled \$377 billion as at 30 June 2012, 4% higher than total guarantees-in-force at year end 2011 and 1% higher than in the first quarter of 2012. CMHC's authorized guarantees-in-force limit is \$600 billion.

## Net Income

(in millions)	Three months ended			Six months ended		
	30 June		Variance	30 June		Variance
	2012	2011		2012	2011	
<b>SECURITIZATION</b>						
Interest Income from NHA MBS-Loans and Receivables	418	435	(17)	844	879	(35)
Fees and Other Income	66	52	14	127	105	22
Income from Investment Securities	8	11	(3)	17	21	(4)
Net Unrealized Gains (Losses) from Financial Instruments	(2)	-	(2)	1	-	1
Net Realized Gains (Losses) from Financial Instruments	11	6	5	46	11	35
Interest Expenses	418	435	(17)	844	879	(35)
Operating Expenses	3	2	1	6	5	1
Income Taxes	20	18	2	47	35	12
Net Income	60	49	11	138	97	41

For the three months and six months ended 30 June 2012, Securitization Net Income increased by 22% and 42%, respectively (\$11 million and \$41 million, respectively) compared to the same prior year periods. This increase is mainly attributable to higher realized gains on sales of investments as well as higher Earned Guarantee Fees due to a greater volume of guarantees-in-force.

## Capital Management

(in millions) (unless otherwise indicated)	As at		Variance
	30 June 2012	31 December 2011	
Securitization Appropriated Capital:			
Appropriated Retained Earnings	755	699	56
Accumulated Other Comprehensive Income	39	57	(18)
Total Appropriated Capital	794	756	38
Unappropriated Retained Earnings	332	252	80
Securitization Retained Earnings	1,087	951	136
Total Equity	1,126	1,008	118
% of Equity against Target Capital	142%	133%	9pts



CMHC's Securitization capitalization methodology is based on regulatory and economic capital principles. Total Securitization Retained Earnings at 30 June 2012 were \$1,087 million of which \$755 million was appropriated for capitalization. Target Capital increased from \$756 million as of 31 December 2011 to \$794 million as of 30 June 2012, due to the new capital factor for interest rate risk introduced by OSFI effective 1 January 2012, mainly the margin for interest rate risk. As at 30 June 2012, the Securitization Activity had Appropriated Retained Earnings and AOCI representing 100% of its Target Capital.

## Net Income

(in millions)	Three months ended 30 June			Six months ended 30 June		
	2012	2011	Variance	2012	2011	Variance
<b>CHT</b>						
Interest Income from NHA MBS/Loans Receivable	1,551	1,620	(69)	3,087	3,259	(172)
Fees and Other Income	40	45	(5)	85	93	(8)
Interest Expenses	1,549	1,618	(69)	3,082	3,254	(172)
Operating Expenses	42	47	(5)	90	98	(8)
Net Income	-	-	-	-	-	-

Interest Income and Interest Expense from CHT's NHA MBS and CMB, for the three months and six months ended 30 June 2012, decreased by 4% and 5%, respectively, compared to the same periods in 2011. This decrease was a result of lower interest rates in the NHA MBS and CMB programs.

## RISK ANALYSIS

### CMHC's Approach to Managing Risk

CMHC is exposed to a variety of risks in its operating environment that could have an impact on the achievement of its objectives. The ability to anticipate and respond to changing circumstances is critical to the organization's success. In this regard, the Corporation maintains a structured approach to Enterprise Risk Management (ERM).

### Enterprise Risk Management Framework

In March 2012, the Board approved a consolidated ERM policy. This ERM Framework ensures a coordinated structured approach to managing the Corporation's risk management governance and operating principles across all business activities at CMHC.

### Significant New Risks and Opportunities

The Government announced through Bill C-38 enhancements to the governance and oversight framework for CMHC. As part of these amendments, OSFI has been mandated to conduct examinations at least annually into whether CMHC's insurance and securitization businesses are conducted in a safe and sound manner with due regard to potential losses. These enhancements support continuous efforts to strengthen the housing finance system and Canada's housing market.

Bill C-38 also established a legislative framework for covered bonds. This will support financial stability by helping lenders access new sources of funding and by making the market for Canadian covered bonds more robust. CMHC will serve as the administrator of the covered bond framework. The requirements related to OSFI's examination of CMHC's activities and for CMHC's role as the administrator of the covered bond framework are expected to have some additional resourcing requirements as these changes are implemented.

The notes to the quarterly financial statements include details on market, credit and liquidity risks. Following are details of significant changes to risks reported in the 2011 Annual Report as well as significant new risks which may have emerged in the last quarter. These risks and related risk mitigation strategies associated with CMHC Lending, Mortgage Loan Insurance and Securitization Activities are described in further detail below.

### Lending Activity

Lending Activity has not experienced any significant changes to credit, prepayment and interest rate risk during the quarter.

### Mortgage Loan Insurance Activity

In the fall of 2011, OSFI announced revised MCT guidelines to be effective 1 January 2012. In the first quarter of 2012, CMHC's Board of Directors reviewed CMHC's capital targets and determined that while the capital holding target of 200% MCT remained a prudent and appropriate level for the mortgage loan insurance business, the internal capital target should be increased from 150% MCT to 175% MCT. Actual capital is currently in excess of the 200% capital holding target.

In June the Government of Canada announced further adjustments to the rules for government-backed insured mortgages to help strengthen Canada's housing market. These changes, which came into effect on 9 July 2012, will likely reduce insured mortgage volumes below volumes projected in the Corporation's Corporate Plan.

## Securitization Activity

There were no program changes or changes in liquidity and available capital that significantly impacted the risk exposures to the Securitization Activities during the quarter.

## CHANGES IN KEY PERSONNEL

The following changes occurred within CMHC's Board of Directors and senior management during the quarter:

- P. Marc Joyal, Vice-President Corporate Services and Chief Financial Officer will be leaving CMHC at the end of August 2012. Serge Gaudet, Chief, Audit and Evaluation will assume his responsibilities on an interim basis until staffing is complete.

Also, earlier this quarter CMHC announced changes designed to streamline senior management's reporting relationships, recognize changes in its operating environment and continued commitment to governance and risk management. Building on those advances the following new positions, reporting to the President, have been created:

- Senior Vice-President, Mortgage Loan Insurance
- Senior Vice-President, Corporate Services

CMHC will be undertaking staffing actions for the two Senior Vice-President positions as well as for the Chief Financial Officer role. The position of Chief Financial Officer, previously titled Vice-President Corporate Services and Chief Financial Officer, will retain responsibility for all finance functions and will continue to report directly to the President.

On 29 June 2012, Bill C-38 received Royal Assent. The Act amends the *Canada Mortgage and Housing Corporation Act* to increase the Board of Directors to 12 voting members from 10, by adding the Deputy Minister of Human Resources and Skills Development, Mr. Ian Shugart and the Deputy Minister of Finance, Mr. Michael Horgan, as ex officio members.

# UNAUDITED QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Period ended 30 June 2012

Management is responsible for the preparation and fair presentation of these unaudited Quarterly Consolidated Financial Statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations and for such internal controls as management determines are necessary to enable the preparation of unaudited Quarterly Consolidated Financial Statements that are free from material misstatement. Management is also responsible for ensuring all other information in this Quarterly Financial Report is consistent, where appropriate, with the unaudited Quarterly Consolidated Financial Statements.

Based on our knowledge, these unaudited Quarterly Consolidated Financial Statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Corporation, as at the date of and for the periods presented in the unaudited Quarterly Consolidated Financial Statements.



Karen Kinsley, FCA  
President and Chief Executive Officer



P. Marc Joyal, CA  
Vice-President, Corporate Services  
and Chief Financial Officer

21 August 2012

## Consolidated Balance Sheet

(in millions of Canadian dollars)	Notes	30 June 2012	31 December 2011
<b>ASSETS</b>			
Cash and Cash Equivalents		1,502	1,401
Securities Purchased Under Resale Agreements		54	-
Investment Securities:	5		
Designated at Fair Value through Profit or Loss		904	903
Held for Trading		411	397
Available for Sale		18,515	17,549
Investment in NHA Mortgage-Backed Securities:			
Loans and Receivables	6	256,699	256,655
Loans:			
Designated at Fair Value through Profit or Loss		6,866	7,132
Other		4,556	4,726
Investments in Housing Programs		778	808
Accrued Interest Receivable		928	983
Deferred Income Tax Assets		63	78
Derivatives		150	169
Due from the Government of Canada	7	392	403
Accounts Receivable and Other Assets		796	686
		<b>292,614</b>	<b>291,890</b>
<b>LIABILITIES</b>			
Securities Sold Under Repurchase Agreements		575	272
Borrowings:	9		
Canada Mortgage Bonds		200,892	199,373
Capital Market Borrowings		1,873	2,203
Borrowings from the Government of Canada:			
Designated at Fair Value through Profit or Loss		6,659	6,584
Other		59,394	60,963
Accrued Interest Payable		843	860
Derivatives		59	72
Accounts Payable and Other Liabilities		1,282	1,172
Provision for Claims	10	980	1,041
Unearned Premiums and Fees		7,195	7,259
		<b>279,752</b>	<b>279,799</b>
Commitments and Contingent Liabilities	19		
<b>EQUITY OF CANADA</b>			
Contributed Capital		25	25
Accumulated Other Comprehensive Income (Loss)		952	902
Retained Earnings		11,885	11,164
		<b>12,862</b>	<b>12,091</b>
		<b>292,614</b>	<b>291,890</b>

The accompanying notes to these Consolidated Financial Statements are an integral part of these statements.

## Consolidated Statement of Income and Comprehensive Income

(in millions of Canadian dollars)	Notes	Three months ended 30 June		Six months ended 30 June	
		2012	2011	2012	2011
<b>REVENUES</b>					
Interest Income from NHA Mortgage-Backed Securities – Loans and Receivables		1,969	2,055	3,931	4,138
Premiums and Fees		511	485	994	953
Interest Earned on Loans and Investments in Housing Programs		147	162	296	323
Income from Investment Securities		140	153	292	303
Net Realized Gains (Losses) from Financial Instruments	12	(21)	42	44	119
Net Unrealized Gains (Losses) from Financial Instruments	12	(26)	(11)	20	(8)
Other Income		29	25	57	51
		2,749	2,911	5,634	5,879
Parliamentary Appropriations for:	7				
Housing Programs		459	382	1,105	1,146
Operating Expenses		30	27	67	58
		489	409	1,172	1,204
		3,238	3,320	6,806	7,083
<b>EXPENSES</b>					
Interest Expense	9	2,093	2,202	4,179	4,429
Housing Programs	7	459	382	1,105	1,146
Net Claims		142	114	261	262
Operating Expenses		104	101	226	211
		2,798	2,799	5,771	6,048
<b>INCOME BEFORE INCOME TAXES</b>					
		440	521	1,035	1,035
<b>INCOME TAXES</b>					
Current		103	154	236	276
Deferred		2	(16)	17	(3)
		105	138	253	273
<b>NET INCOME</b>					
		335	383	782	762
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>					
Net Unrealized Gains (Losses) from Available for Sale Financial Instruments (net of tax)		67	102	120	93
Reclassification of Prior Years' Net Unrealized (Gains) Losses Realized in the Period in Net Income (net of tax)		(11)	(50)	(70)	(104)
Net Actuarial Gains (Losses) on Post-Employment Benefits (net of tax)		(53)	(55)	(61)	(25)
		3	(3)	(11)	(36)
<b>COMPREHENSIVE INCOME</b>					
		338	380	771	726

The accompanying notes to these Consolidated Financial Statements are an integral part of these statements.

## Consolidated Statement of Equity of Canada

Three months ended 30 June (in millions of Canadian dollars)	Contributed Capital	Unappropriated	Appropriated			Total Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Retained Earnings and Accumulated Other Comprehensive Income	Total Equity of Canada
			Mortgage Loan Insurance	Securitization	Reserve Fund for Lending				
<b>Balance, 1 April 2012</b>	25	977	9,856	783	(13)	11,603	896	12,499	12,524
Income Tax Benefit on Earnings Set Aside for Capitalization	-	-	-	-	-	-	-	-	-
Net Income (Loss)	-	326	-	-	9	335	-	335	335
Other Comprehensive Income (Loss)	-	(31)	-	-	(22)	(53)	56	3	3
Set Aside for Capitalization	-	(236)	264	(28)	-	-	-	-	-
<b>Balance at End of period 30 June 2012</b>	25	1,036	10,120	755	(26)	11,885	952	12,837	12,862
<b>Balance, 1 April 2011</b>	25	1,180	8,251	707	86	10,224	538	10,762	10,787
Income Tax Benefit on Earnings Set Aside for Capitalization	-	-	-	-	-	-	-	-	-
Net Income (Loss)	-	386	-	-	(3)	383	-	383	383
Other Comprehensive Income (Loss)	-	(31)	-	-	(24)	(55)	52	(3)	(3)
Set Aside for Capitalization	-	(34)	16	18	-	-	-	-	-
<b>Balance at End of period 30 June 2011</b>	25	1,501	8,267	725	59	10,552	590	11,142	11,167

The accompanying notes to these Consolidated Financial Statements are an integral part of these statements.



## Consolidated Statement of Equity of Canada

Six months ended 30 June (in millions of Canadian dollars)	Contributed Capital	Unappropriated	Appropriated			Total Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Retained Earnings and Accumulated Other Comprehensive Income	Total Equity of Canada
			Mortgage Loan Insurance	Securitization	Reserve Fund for Lending				
<b>Balance, 1 January 2012</b>	<b>25</b>	1,446	9,028	699	(9)	<b>11,164</b>	<b>902</b>	<b>12,066</b>	<b>12,091</b>
Income Tax Benefit on Earnings Set Aside for Capitalization	-	-	-	-	-	-	-	-	-
Net Income (Loss)	-	774	-	-	8	782	-	782	782
Other Comprehensive Income (Loss)	-	(36)	-	-	(25)	(61)	50	(11)	(11)
Set Aside for Capitalization	-	(1,148)	1,092	56	-	-	-	-	-
<b>Balance at End of period 30 June 2012</b>	<b>25</b>	1,036	10,120	755	(26)	<b>11,885</b>	<b>952</b>	<b>12,837</b>	<b>12,862</b>
<b>Balance, 1 January 2011</b>	<b>25</b>	839	8,201	707	68	<b>9,815</b>	<b>601</b>	<b>10,416</b>	<b>10,441</b>
Income Tax Benefit on Earnings Set Aside for Capitalization	-	-	-	-	-	-	-	-	-
Net Income (Loss)	-	761	-	-	1	762	-	762	762
Other Comprehensive Income (Loss)	-	(15)	-	-	(10)	(25)	(11)	(36)	(36)
Set Aside for Capitalization	-	(84)	66	18	-	-	-	-	-
<b>Balance at End of period 30 June 2011</b>	<b>25</b>	1,501	8,267	725	59	<b>10,552</b>	<b>590</b>	<b>11,142</b>	<b>11,167</b>

The accompanying notes to these Consolidated Financial Statements are an integral part of these statements.

## Consolidated Statement of Cash Flows

(in millions of Canadian dollars)	Notes	Three months ended 30 June		Six months ended 30 June	
		2012	2011	2012	2011
<b>CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>					
Net Income		335	383	782	762
Items Not Affecting Cash or Cash Equivalents:					
Amortization of Premiums and Discounts on Financial Instruments		9	(15)	37	-
Deferred Income Taxes		(1)	(25)	15	(12)
Change in Fair Value of Financial Instruments Carried at Fair Value		26	11	(20)	8
Net (Gain) Loss on Investment Securities	12	21	(42)	(44)	(119)
Net Change in Non-cash Operating Assets and Liabilities					
Accounts Receivable and Other Assets		(41)	(10)	(106)	(264)
Accrued Interest Receivable		984	716	55	179
Due from the Government of Canada		136	266	11	198
Unearned Premiums and Fees		46	4	(64)	(68)
Provision for Claims		(26)	(30)	(61)	(37)
Accounts Payable and Other Liabilities		(60)	(153)	110	(119)
Accrued Interest Payable		(935)	(677)	(17)	(131)
Derivatives		(2)	12	(4)	16
Other		(24)	(39)	(57)	20
Net Change from Loans and Investments in Housing Programs		167	151	416	(399)
Net Change in NHA MBS Loans and Receivables		9,868	(9,754)	(41)	(7,575)
Repayments of Capital Market Borrowings	9	(300)	(100)	(300)	(100)
Borrowings from the Government of Canada Designated at Fair Value through Profit of Loss and Other:	9				
Issuances		737	581	1,179	2,399
Repayments		(1,444)	(1,406)	(2,649)	(3,581)
Canada Mortgage Bonds:	9				
Issuances		9,594	10,818	20,098	22,065
Repayments		(18,700)	-	(18,700)	(12,450)
		390	691	640	792
<b>CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>					
Investment Securities:					
Sales and Maturities		3,652	3,336	6,981	7,631
Purchases		(4,603)	(3,945)	(7,769)	(8,059)
Change in Securities Purchased Under Resale Agreements		(8)	(94)	(54)	(94)
		(959)	(703)	(842)	(522)
<b>CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>					
Change in Securities Sold Under Repurchase Agreements		78	7	303	225
		78	7	303	225
Increase (Decrease) in Cash and Cash Equivalents		(491)	(5)	101	495
<b>Cash and Cash Equivalents</b>					
Beginning of Period		1,993	1,485	1,401	985
End of Period		1,502	1,480	1,502	1,480
<b>Represented by:</b>					
Restricted Cash	16	125	-	125	-
Cash		(57)	13	(57)	13
Cash Equivalents		1,434	1,467	1,434	1,467
		1,502	1,480	1,502	1,480
<b>Supplementary Disclosure of Cash Flow from Operating Activities</b>					
Amount of Interest Received During the Period		3,483	2,981	4,656	4,643
Amount of Interest Paid During the Period		3,065	2,933	4,311	4,651
Amount of Dividends Received During the Period		14	10	29	22
Amount of Income Taxes Paid During the Period		177	334	352	508

The accompanying notes to these Consolidated Financial Statements are an integral part of these statements.

# NOTES TO UNAUDITED QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS

Three and six months ended 30 June 2012

## I. CORPORATE MANDATE

These unaudited Quarterly Consolidated Financial Statements include the accounts of Canada Mortgage and Housing Corporation (CMHC) and Canada Housing Trust (CHT), a special purpose entity. Within the Public Accounts of Canada, the Quarterly Consolidated Net Income reduces the Government's quarterly deficit; the Consolidated Retained Earnings and Accumulated Other Comprehensive Income reduce the Government's accumulated deficit.

CMHC was established in Canada as a Crown Corporation in 1946 by the *Canada Mortgage and Housing Corporation Act* (the "CMHC Act") to carry out the provisions of the *National Housing Act* (the "NHA"). It is also subject to Part X of the *Financial Administration Act* (the "FAA") by virtue of being listed in Part 1 of Schedule III, is wholly owned by the Government of Canada and is an agent Crown Corporation.

In September 2008, CMHC, together with a number of other Crown Corporations, was issued a directive (P.C. 2008-1598) pursuant to Section 89 of the FAA requiring due consideration by CMHC to the personal integrity of those to whom it lends to or provides benefits to. During 2009, the Corporation completed the implementation of the requirements of Section 89(6) of the FAA and notified the Minister of Human Resources and Skills Development that the directive has been met.

CMHC's mandate is to promote the construction, repair, and modernization of housing; to promote the improvement of housing and living conditions, housing affordability, and choice; to promote the availability of low-cost financing for housing; to promote the national well-being of the housing sector, and in addition and with respect to activities related to mortgage loan insurance and guarantee programs and as the administrator of the Canadian covered bond framework, to promote the efficient functioning and competitiveness of the housing finance market, and to promote and contribute to the stability of the financial system, including the housing market, with due regard to the Corporation's exposure to loss. The mandate is carried out through the following four activities:

**Mortgage Loan Insurance:** CMHC provides mortgage insurance against borrower default on residential mortgages.

**Securitization:** CMHC guarantees the timely payment of principal and interest for investors in securities based on insured mortgages. The CMHC guarantee is a direct and unconditional obligation of CMHC as an agent of Canada. It carries the full faith and credit of Canada, and constitutes a direct and unconditional obligation of and by the Government of Canada.

**Housing Programs:** CMHC receives Parliamentary appropriations to fund housing programs.

**Lending:** CMHC makes loans and investments in housing programs that are funded by borrowings from the Government of Canada and from Capital Markets. A significant number of these loans and investments are supported with housing program payments.

Canada Housing Trust was established in 2001 as a special-purpose trust, separate from CMHC. CHT's functions are limited to the acquisition of interests in eligible housing loans such as NHA Mortgage-Backed Securities (NHA MBS), the issuance of Canada Mortgage Bonds (CMB), as well as the purchase of highly rated investments, and certain related financial hedging activities. The CMB are guaranteed by CMHC under its Securitization Activity. The beneficiaries of the Trust, after payment of all obligations, are one or more charitable organizations.

## 2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

These unaudited Quarterly Consolidated Financial Statements have been prepared in accordance with the Treasury Board of Canada's Standard on Quarterly Financial Reports for Crown Corporations.

They are stated in millions of Canadian dollars, except where otherwise indicated, which is the consolidated entity's (Corporation's) functional currency. These unaudited Quarterly Consolidated Financial Statements should be read in conjunction with CMHC's audited Consolidated Financial Statements for the year ended 31 December 2011. These unaudited Quarterly Consolidated Financial Statements were approved and authorized for issue by CMHC's Audit Committee on 21 August 2012.

The significant accounting policies used in the preparation of these unaudited Quarterly Consolidated Financial Statements are summarized below and conform to IFRS effective as at 31 December 2011 as issued by the International Accounting Standards Board, with the exception of the adoption of new or changed accounting standards within the quarter. Treasury Board of Canada's Standard on Quarterly Financial Reports for Crown Corporations allows Management the option to only adopt new or changed policies for the first time at year end. As a result, the Corporation chose to follow the Treasury Board Standard on Quarterly Financial Reports which allow for such a departure from IFRS – IAS 34 *Interim Financial Reporting* with respect to the preparation of the unaudited Quarterly Consolidated Financial Statements.

### **Basis of Presentation**

These unaudited Quarterly Consolidated Financial Statements include the accounts of CMHC and, as required by *Standing Interpretation Committee Interpretation 12: Consolidation - Special Purpose Entities* (SIC-12), the accounts of CHT, a special purpose entity to which CMHC has exposure to its risks and rewards. The Nordea International Equity Fund (Nordea) is consolidated as required by IAS 27: *Consolidated and separate financial statements* on the basis that CMHC controls the fund and is included in the investment portfolio within the Mortgage Loan Insurance and Securitization Activities.

Inter-entity balances and transactions have been eliminated in the unaudited Quarterly Consolidated Financial Statements.

These unaudited Quarterly Consolidated Financial Statements have been prepared on a going concern basis using a historical cost basis except for the following material items in the Quarterly Consolidated Balance Sheet:

- Fair Value through Profit or Loss ("FVTPL") financial assets and liabilities are measured at fair value as are Available for Sale ("AFS") financial assets;
- Investment Property is measured at fair value; and
- Accrued benefit liabilities for post-employment benefit plans are recognized at the present value of the defined benefit obligations.

### **Seasonality**

CMHC's mortgage loan insurance business is exposed to some seasonal variation. While Premiums Earned and Income from Investment Securities vary from quarter to quarter as underlying balances change, premiums received for some insurance products vary each quarter because of seasonality in housing markets. Variations are driven by the level of mortgage originations and related mortgage policies written, which, for purchase transactions, typically peak in the spring and summer months. Losses on claims vary from quarter to quarter primarily as the result of prevailing economic conditions as well as the characteristics of the insurance in-force portfolio, such as size and age. All revenues and expenses are recognized in accordance with the accounting policies set out below.

The following are the significant accounting policies used in the preparation of these unaudited Quarterly Consolidated Financial Statements:

### Financial Instruments

The Corporation classifies its financial assets in the following categories: Financial Assets at Fair Value through Profit or Loss, Loans and Receivables, Held to Maturity and Available for Sale. Two classifications are used for financial liabilities: Financial Liabilities at Fair Value through Profit or Loss and Other Financial Liabilities.

The Corporation further categorizes financial instruments at Fair Value through Profit or Loss as either Held for Trading or Designated at Fair Value through Profit or Loss (refer to Note 12 for further information).

The classification is determined by Management at initial recognition based on intent.

Classification	Accounting Treatment
Designated at Fair Value through Profit or Loss	<p>International Accounting Standards (IAS) 39 Financial Instruments: Recognition and Measurement provides an entity the option of classifying a financial instrument as Designated at Fair Value through Profit or Loss when doing so results in more relevant information because either:</p> <ul style="list-style-type: none"> <li>a) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring the assets or liabilities or recognizing the gains or losses on them on different bases; or</li> <li>b) the financial instrument belongs to a group managed and evaluated on a fair value basis in accordance with documented risk management or investment strategies and information about the group is provided internally to Key Management Personnel.</li> </ul> <p>This designation is irrevocable.</p> <p>Financial instruments Designated at Fair Value through Profit or Loss are initially recognized at fair value. They are subsequently measured at fair value. Unrealized gains and losses arising from changes in the fair value are recorded in Net Unrealized Gains (Losses) from Financial Instruments. Gains and losses realized on disposition are recorded in Net Realized Gains (Losses) from Financial Instruments. Transaction costs are expensed as incurred.</p>
Held for Trading (HFT)	<p>HFT financial instruments are either derivatives or financial instruments acquired or incurred principally for the purpose of selling or repurchasing in the near term.</p> <p>HFT financial instruments are initially recognized at fair value. They are subsequently measured at fair value. Unrealized gains and losses arising from changes in the fair value are recorded in Net Unrealized Gains (Losses) from Financial Instruments. Gains and losses realized on disposition are recorded in Net Realized Gains (Losses) from Financial Instruments. Transaction costs are expensed as incurred.</p>
Available for Sale (AFS)	<p>AFS financial assets are non-derivative financial assets which are designated as such, or which have not been designated in any other classification.</p> <p>AFS financial assets are initially recognized at fair value plus transaction costs. They are subsequently measured at fair value. Unrealized gains and losses arising from changes in the fair value are recorded in Other Comprehensive Income (OCI) until the financial asset is sold, derecognized, or determined to be impaired at which time they are transferred to the Statement of Income and reported in Net Realized Gains (Losses) from Financial Instruments.</p> <p>Accumulated Other Comprehensive Income (AOCI) consists only of unrealized gains and losses for AFS financial instruments.</p>
Loans and Receivables	<p>Loans and Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market except for those that Management has the intent to sell in the near term, which must be Designated at Fair Value through Profit or Loss or those where there may not be a recovery of substantially all of its initial investment other than because of credit deterioration, which are classified as AFS.</p> <p>Loans and Receivables are initially recognized at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method. When Loans and Receivables are determined to be impaired, the changes in their estimated realizable value are recorded in Net Income.</p>
Held to Maturity (HTM)	<p>HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than Loans and Receivables, that Management has the positive intention and ability to hold to maturity.</p> <p>HTM financial assets are initially recognized at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method. Gains and losses arising from changes in fair value on HTM financial assets that are determined to be impaired are recorded in Net Realized Gains (Losses) from Financial Instruments with interest income recorded until they are determined to be impaired. Impairment charges and reversals of impairment charges are recorded in Other Income.</p>
Other Financial Liabilities	<p>Other Financial Liabilities are non-derivative financial liabilities which have not been Designated at Fair Value.</p> <p>Other Financial Liabilities are initially recognized at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method with interest expense recorded in Interest Expense.</p>

Settlement date accounting is used for purchases and sales of financial assets and financial liabilities. Realized gains and losses on sales are recognized on a weighted average cost basis.

The Corporation assesses at each Consolidated Balance Sheet date whether there is objective evidence that a financial asset is impaired. Impairment occurs if it is determined that significant or prolonged losses have been experienced. Factors reviewed to determine whether impairment exists include significant or prolonged declines in fair value, financial reorganization, corporate restructuring, bankruptcies and other indications of liquidity problems, or the disappearance of an active market for the asset because of financial difficulties. For financial assets classified as HTM or Loans and Receivables that are identified as impaired, their carrying amounts are reduced to their estimated realizable amounts and the credit impairment is recorded in Net Realized Gains (Losses) from Financial Instruments. If an AFS financial asset is determined to be impaired, the cumulative unrealized loss previously recorded in AOCI is removed from equity and recognized in income for the period through Net Realized Gains (Losses) from Financial Instruments. If the fair value of an impaired debt instrument classified as AFS subsequently increases, the impairment loss reversal is limited to the impairment previously recognized in Net Income. Subsequent increases in the fair value of an impaired equity instrument classified as AFS are recorded in OCI.

For the majority of Loans, losses are mitigated by CMHC's assurance of full collection of principal and accrued interest through provisions in the Social Housing Agreements, provisions in the *National Housing Act*, Ministerial Loan Guarantees or the loans are underwritten through CMHC's Mortgage Loan Insurance Activity in which case provisions for claims are established. Loans that have not been underwritten or covered by a third party guarantee are assessed on a regular basis to determine if a provision for loss is necessary.

### **Cash and Cash Equivalents**

Cash and Cash Equivalents are comprised of cash and short-term highly liquid investments with an original term to maturity of 98 days or less that are readily convertible to known amounts of cash. Cash Equivalents funded by Securities Sold Under Repurchase Agreements are classified as HTM. Cash Equivalents in the Lending Activity are Designated at Fair Value. Cash Equivalents in the Mortgage Loan Insurance and Securitization Activities are classified as AFS. Cash Equivalents must have a minimum credit rating of R-1 (Low) or equivalent as determined by S&P, Moody's or DBRS at the time they are purchased. Interest income on these investments is recorded in Income from Investment Securities.

### **Investment Securities**

Investment Securities in the Lending Activity are comprised of fixed income securities and are Designated at Fair Value through Profit or Loss. Investment Securities in the Mortgage Loan Insurance and Securitization Activities are comprised of fixed income and equity securities and are classified as AFS, HFT or Designated at Fair Value through Profit or Loss. Interest income on fixed income investments is recorded in Income from Investment Securities using the effective interest method. Dividend income on equity investments is recorded in Income from Investment Securities when the right to the dividend is established.

### **Securities Purchased Under Resale Agreements and Sold Under Repurchase Agreements**

Securities Purchased Under Resale Agreements (Reverse Repurchase Agreements) consist of the purchase of securities, typically Government treasury bills or bonds, with the commitment to resell the securities to the original seller at a specified price and future date in the near term. They are treated as collateralized lending transactions and are classified as HTM.

Securities Sold Under Repurchase Agreements (Repurchase Agreements) consist of the sale of securities with the commitment to repurchase the securities from the original buyer at a specified price and future date in the near term.

Securities Sold Under Repurchase Agreements are classified as Other Financial Liabilities. Proceeds received from Securities Sold Under Repurchase Agreements are generally invested in Securities Purchased Under Resale Agreements or Cash Equivalents for the purpose of generating additional income. Such transactions are entered into simultaneously with matching terms to maturity.

The associated interest earned and interest expenses are recorded in Income from Investment Securities and Interest Expense respectively.

### **Investment in NHA Mortgage-Backed Securities – Loans and Receivables**

Investment in NHA Mortgage-Backed Securities - Loans and Receivables represent the transfer of NHA MBS securities issued by Canadian financial institutions (Issuers) to CMHC, under the Insured Mortgage Purchase Program (IMPP), or CHT, under the CMB program, where substantially all of the risks and rewards of the transferred NHA MBS are retained by the issuers through swap agreements with CMHC or CHT. Although these securities legally represent an undivided interest in a pool of residential mortgages insured under the NHA and are backed by a timely payment guarantee by CMHC, the transfer is accounted for as a financing transaction by the Corporation.

As a result, the Corporation accounts for the transfers as secured financing, Investment in NHA Mortgage-Backed Securities – Loans and Receivables, collateralized by the NHA MBS and associated high quality reinvestment securities. The NHA MBS, reinvestment assets and swaps are not recognized on the Corporation's Consolidated Balance Sheet. The collateral is, however, held in the name of CMHC or CHT and represents the sole source of principal repayments for the Investments in NHA Mortgage-Backed Securities – Loans and Receivables. The amounts due from the swap counterparties represent the interest earned on Investment in NHA Mortgage-Backed Securities – Loans and Receivables.

### **Loans**

**Designated at Fair Value through Profit or Loss:** Loans that are part of portfolios which are economically hedged are Designated at Fair Value through Profit or Loss.

**Other:** Loans are classified as Loans and Receivables. Where loans contain forgiveness clauses, they are recorded net of the forgiveness that is reimbursed through Parliamentary appropriations when the loans are advanced.

Interest income is recognized using the effective interest method in Interest Earned on Loans and Investments in Housing Programs.

CMHC is reimbursed through Parliamentary appropriations for interest rate losses resulting from certain loans for housing programs containing interest rate clauses that are lower than the associated interest cost on the related borrowings. These loans were issued from 1946 to 1984 through provisions of the *National Housing Act*. Parliamentary appropriations are voted on an annual basis by Parliament and CMHC has over a 30 year history of past collection of interest losses through appropriations. CMHC measures these loans at amortized cost which assumes the continued receipt of appropriations going forward. If the appropriations are not received in a future year the valuation of these loans would change.

### **Investments in Housing Programs:**

The following categories are included in Investments in Housing Programs.

**Loans:** Loans under Investments in Housing Programs represent loans made under various pre-1996 housing programs that were transferred to the Provinces/Territories under the Social Housing Agreements (SHAs). For some housing programs, the Provinces/Territories are gradually acquiring CMHC's interest in the housing portfolio by making payments to CMHC. Loans under Investments in Housing Programs are classified as Loans and Receivables. Interest income on these loans is recorded in Interest Earned on Loans and Investments in Housing Programs on an accrual basis using the effective interest method.

Investments: Investments under Investments in Housing Programs represent CMHC's ownership interest in various housing projects, mostly made under Federal-Provincial Agreements, which are treated as Property, Plant and Equipment and carried at net book value. Amortization is calculated on a declining balance method over the life of the investment which best represents the agreed term over which these projects will be used to render the program services. CMHC's portion of amortization, net operating losses and disposal losses are reimbursed through Parliamentary appropriations.

### **Derivatives**

The Corporation enters into derivatives such as interest rate swaps, cross currency interest rate swaps, interest rate futures and equity index futures in order to manage its exposures to market risks. Swaps are only contracted with creditworthy counterparties that maintain a minimum rating of A- or equivalent as determined by S&P, Moody's or DBRS and are not used for speculative purposes.

Derivatives are classified as HFT as they have not been designated as eligible hedges for accounting purposes and are carried at fair value on the Quarterly Consolidated Balance Sheet. Derivatives with a positive fair value are reported as assets, while derivatives with a negative fair value are reported as liabilities.

Derivatives may be embedded in other financial instruments and are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not HFT or Designated at Fair Value through Profit and Loss.

The net of interest income and expenses is recorded in Interest Expense as earned and incurred.

### **Mortgage Loan Insurance**

**Product Classification:** CMHC classifies its mortgage loan insurance as an insurance contract where the lender faces uncertainty with regard to potential borrower default on a mortgage and therefore pays a premium to transfer the risk to CMHC. If the borrower defaults, the claim is significantly larger than the actual premium. Such contracts remain insurance contracts until the underlying insured mortgages are fully repaid and are measured in accordance with IFRS 4 *Insurance Contracts*.

**Premium Revenue:** Mortgage loan insurance premiums are due at the inception of the mortgage being insured at which time they are deferred and recognized as income over the period covered by the insurance contract using factors determined by the Appointed Actuary. These factors reflect the long-term pattern for default risk of the underlying mortgages.

**Unearned Premiums:** Unearned Premiums represent the unexpired portion of the policy premiums at the Quarterly Consolidated Balance Sheet date and therefore relate to claims that may occur from the Quarterly Consolidated Balance Sheet date to the termination of the insurance policies. Annually, the Appointed Actuary compares the unearned premiums to an estimate of total future claims on a discounted basis to ensure the amount is sufficient. Should such amount not be sufficient, a provision for premium deficiency is recorded.

**Provision for Claims:** The Provision for Claims represents an estimate for expected claims and the related settlement expenses, net of the related expected property sale proceeds, for defaults from the mortgage insurance business that have occurred on or before the Quarterly Consolidated Balance Sheet date. The provision takes into consideration the estimate of the expected ultimate cost of claims reported but not paid and claims Incurred But Not Reported (IBNR) at the Quarterly Consolidated Balance Sheet date, the time value of money and in accordance with accepted actuarial practice includes an explicit provision for adverse deviation. The estimate of IBNR is generally subject to a greater degree of uncertainty than that for reported claims.



**Insurance Policy Liability Adequacy:** Liability adequacy tests are performed annually as part of the Actuarial Valuation to ensure the adequacy of insurance policy liabilities net of Deferred Acquisition Costs (DAC) assets with respect to the Provision for Claims and Unearned Premiums. Current best estimates of future contractual cash flows, claims handling and administration costs, and investment returns from the assets backing the liabilities are taken into account in the tests. Where a deficiency is highlighted by the test, DAC assets are written off first, and insurance liabilities increased when these are written off in full. Any premium deficiency is immediately recognized in Net Income. The liability adequacy test for the Corporation has identified that no provision for premium deficiency is required.

The process of determining the provision necessarily involves risks that the actual results will deviate, perhaps significantly, from the estimates made.

The loss on actual mortgage defaults and the change in the estimated Provision for Claims are recorded in Net Claims in the year in which they occur.

The provision for Social Housing Mortgages and Index Linked Mortgages (ILM) is based on the assumptions that the cumulative premiums received and related investment income will be sufficient to meet future claim payouts. Due to the uniqueness of these programs, their provision is established as the fund balance plus a margin for adverse deviation.

**Fees:** Application fees that are designed to recover part or all acquisition costs associated with issuing mortgage loan insurance policies are deferred and amortized on the same basis as the related premiums.

**Deferred Acquisition Costs:** A portion of acquisition costs relating to the Unearned Premiums is deferred and amortized over the estimated lives of the relevant contracts.

### **Non-Current Assets Held for Sale**

Real estate acquired by the Mortgage Loan Insurance Activity through loan default is classified as Non-Current Assets Held for Sale when its carrying amount will be recovered principally through a sale transaction rather than through continuing use. The criteria for Held for Sale classification includes Management's commitment to a plan to sell the selected assets and the expectation that such a sale will be completed within a 12 month period. Events or circumstances beyond the entity's control may extend the period to complete the sale beyond one year. Such assets continue to be classified as Held for Sale as Management remains committed to its plan to sell the asset. Non-Current Assets Held for Sale are measured at the lower of their carrying amount and their fair value less cost to sell. Impairment losses and any subsequent reversals are recognized in Net Income in the period in which they occur. Non-Current Assets Held for Sale are not depreciated.

### **Timely Payment Guarantees**

**Classification:** Financial guarantee contracts are defined as those that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due. CMHC classifies its timely payment guarantee for NHA MBS and CMB as a financial guarantee contract. Such contracts remain financial guarantee contracts until all rights and obligations are extinguished or expire and are measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

**Recognition and Measurement:** Timely payment guarantee fees are initially recognized in Unearned Premiums and Fees at fair value (the premium received) plus transaction costs. Subsequently, they are measured at the amount initially recognized less the amortization of guarantee fee revenue. Should the estimated amount required to settle the timely payment guarantee obligations exceed this amount, a provision is recognized.

Application and Compensatory fees are recognized as revenues in the period where the related services are rendered. Direct costs associated with issuing timely payment guarantees are recognized in Operating Expenses as incurred.

## Income Taxes

CMHC is a prescribed federal Crown Corporation under Reg. 7100 of the *Income Tax Act* (ITA) and is subject to federal income tax as a prescribed Corporation for purposes of subsection 27(2) of the ITA. It is not subject to provincial income tax. CHT is subject to federal and provincial income taxes on the amount of taxable income for the period and is permitted a deduction for all amounts paid or payable to CHT's beneficiaries in determining income for tax purposes. As all taxable income was distributed to the beneficiaries, no provision for income taxes has been reflected for CHT in these unaudited Quarterly Consolidated Financial Statements. Nordea is a mutual fund trust pursuant to subsection 132(6) of the ITA. Nordea is subject to income tax on Net Income and net realized capital gains that are not paid or payable to unitholders at the end of the taxation year. Nordea is required to distribute all net taxable income and sufficient realized capital gains to unitholders so that it is not subject to income tax. Accordingly, no provision for income taxes is included in the unaudited Quarterly Consolidated Financial Statements in respect of Nordea.

The Corporation uses the liability method of accounting for income taxes. Under this method, Deferred Income Tax Assets and Liabilities are recognized based on the estimated tax effect of temporary differences between the carrying value of assets and liabilities on the financial statements and their respective tax bases. The Corporation uses substantively enacted income tax rates at the Quarterly Consolidated Balance Sheet date that are expected to be in effect when the asset is realized or the liability is settled. A valuation allowance is established, if necessary, to reduce the Deferred Income Tax Assets to an amount that is probable to be realized.

## Canada Mortgage Bonds

CMB, which are issued by CHT and guaranteed by CMHC, are interest-bearing bullet bonds. Coupon interest payments are made semi-annually for fixed rate CMB and quarterly for floating rate CMB. Principal repayments on the bonds are made at the end of the term. CMB are classified as Other Financial Liabilities. The Approved MBS Sellers reimburse CHT for the cost of arranging financing, including the fees paid to CMHC as Guarantor and Financial Services Advisor, underwriters and others for the distribution of CMB. These reimbursements are recorded in Other Income.

CMHC may purchase and resell CMB in the market for investment purposes. These purchases are treated as retirements of debt, with the difference between the purchase price and the carrying value of the CMB being recognized as a gain or loss in income. Gains and losses on subsequent sales are treated as a re-issuance of the debt and amortized over the remaining life of the CMB sold.

## Capital Market Borrowings

Borrowings from the Capital Markets represent borrowings incurred between 1993 and April 2008. These borrowings are Designated at Fair Value through Profit or Loss.

## Borrowings from the Government of Canada

**Borrowings Designated at Fair Value through Profit or Loss:** Since April 2008, the Lending Activity has been borrowing under terms of the Crown Borrowing Agreement. These borrowings, excluding those relating to the Municipal Infrastructure Lending Program (MILP), are Designated at Fair Value through Profit or Loss. Expenses related to these borrowings are recognized in Interest Expense in the year incurred.

**Other Government of Canada Borrowings:** Other Government of Canada Borrowings represent borrowings incurred prior to 1993 in the Lending Activity as well as those under the terms of the Crown Borrowing Agreement relating to the MILP and the IMPP which are included in the Lending Activity and Securitization Activity, respectively. They are classified as Other Financial Liabilities.

### **Housing Programs**

Parliamentary appropriations for Housing Programs, and the related expenses, are recorded on an accrual basis. They are recognized in the year in which the related expenses are incurred. Appropriations and related expenses are presented in the Quarterly Consolidated Statement of Income and Comprehensive Income as Housing Programs revenues and expenses, respectively. Those expenses incurred but not yet reimbursed are recorded in the Quarterly Consolidated Balance Sheet as Due from the Government of Canada.

### **Post-employment Benefits**

CMHC provides a defined benefit pension plan that is registered under federal legislation, supplemental pension plans, and other post-employment benefits consisting mainly of severance pay, life insurance and medical insurance.

Pension benefits are based on length of service and average earnings of the best five-year period as classified under defined benefit pension arrangements. The pension benefits are adjusted annually by a percentage equivalent to the total average change in the Consumer Price Index during the previous year.

The defined benefit plan asset or liability recognized is the present value of the obligations under the plans, less unamortized past service costs, and plan assets. Defined benefit plan assets are limited to the total of unamortized past service costs and the present value of any economic benefits available in the form of reductions in future contributions to the plan.

Net benefit plan costs are the current service cost, interest cost on the defined benefit obligation, the amortization of deferred past service costs, and the expected investment return on plan assets. These costs are recognized in Operating Expenses. Actuarial gains and losses are recognized in Other Comprehensive Income as incurred, and flow into Retained Earnings on the Quarterly Consolidated Balance Sheet.

Past service costs are deferred and amortized on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested following the introduction of, or changes to, a defined benefit plan, the past service costs are recognized immediately.

### **Investment Property**

Investment properties, which are included in Accounts Receivable and Other Assets are properties held to earn rental income or for capital appreciation, or both. Investment properties are initially recognized at cost plus transactions costs. Subsequent to initial recognition, it is measured at fair value. Fair value is determined based on valuations performed by independent and internal property appraisers who hold recognized and relevant professional qualifications. Gains or losses arising from changes in fair value are recognized in Net Income in the period in which they arise. Investment property rental income and expenses are recorded in Other Income. For certain investment properties, expenses are recoverable from the Minister and these are recorded in Housing Programs appropriations.

### **Related Party Transactions**

Related party transactions are recorded according to the relevant IFRS standard applicable to the transaction.

### **Foreign Currency Translations**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the Quarterly Consolidated Balance Sheet date. Exchange gains and losses resulting from the translation of foreign denominated balances are included in Net Unrealized Gains (Losses). Purchases and sales of foreign securities and the related income are translated into Canadian dollars at the exchange rates prevailing on the respective dates of the transactions.

### Contingent Liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognized but are disclosed in Note 19.

### Lease Transactions

Leases are classified as either operating or finance, based on the substance of the transaction at inception of the lease. Classification is re-assessed if the terms of the lease are changed.

**CMHC as Lessor:** Leases whereby a significant portion of the risks and rewards of ownership are retained by CMHC are classified as operating leases. The leased assets are included within Property, Plant and Equipment or Investment Property (included in Accounts Receivable and Other Assets on the Quarterly Consolidated Balance Sheet) and depreciation is provided on the depreciable amount of these assets on a systematic basis over their estimated useful lives. Lease income is recognized on a straight-line basis over the period of the lease unless another systematic basis is more appropriate.

**CMHC as Lessee:** Leases whereby substantially all the risks and rewards of ownership are transferred to CMHC are classified as finance leases. Assets meeting finance lease criteria are capitalized at the lower of the present value of the related lease payments or the fair value of the leased asset at the inception of the lease. Minimum lease payments are apportioned between the finance charge and the liability.

Leases which do not transfer substantially all the risks and rewards of ownership to CMHC are classified as operating leases. Payments under an operating lease are recognized in Net Income on a straight-line basis over the lease term.

## 3. FUTURE ACCOUNTING CHANGES

CMHC has identified the new standards and amendments to existing standards that have been issued by the IASB but are not yet effective on the date of issuance of these unaudited Quarterly Consolidated Financial Statements. The following pronouncements have been determined to potentially have an impact on the Corporation's results and Consolidated Financial Statements in the future. No additional standards have been issued that impact CMHC except for those disclosed in its unaudited Quarterly Consolidated Financial Statements for the period ended 30 June 2012.

### Effective Date of 1 January 2013

- On 16 December 2011, the IASB issued amendments to IFRS 7 *Financial Instruments: Disclosures* that provide new disclosure requirements in netting arrangements to enable users of the financial statements to better compare financial statements prepared in accordance with IFRS and US GAAP. The Corporation has not yet determined the impact of these amendments on its Consolidated Financial Statements.
- On 13 May 2011, the IASB issued IFRS 10 *Consolidated Financial Statements* (IFRS 10) to replace IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 provides a single consolidation model that identifies control as the basis for consolidation. As the Corporation's current accounting and consolidation practices are compliant under IFRS 10 consolidation guidelines, it does not expect that this new standard will have a material impact on its Consolidated Financial Statements.
- On 13 May 2011, the IASB issued IFRS 11 *Joint Arrangements* (IFRS 11) to replace IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities-Non-Monetary Contributions by Venturers*. IFRS 11 establishes principles for the financial reporting of joint arrangements. The Corporation does not expect that this new standard will have a material impact on its Consolidated Financial Statements.

- On 13 May 2011, the IASB issued IFRS 12 *Disclosure of Interests in Other Entities* which combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Corporation has determined that this new standard will require adjustments to its Notes to the Consolidated Financial Statements in order to meet the new requirements under IFRS 12 for unconsolidated structured entities.
- On 13 May 2011, the IASB issued IFRS 13 *Fair Value Measurement* (IFRS 13). IFRS 13 defines fair value, sets out a single framework for measuring fair value and requires disclosures about fair value measurements. While IFRS 13 does not introduce any new requirements, it reduces complexity and improves consistency by clarifying the definition of fair value and requiring its application to all fair value measurements. CMHC currently follows the IFRS 13 principles for determining fair value on most of its financial instruments, except for certain rent-producing real estate properties under the Lending Activity. These properties are fair valued based on the present value of expected future cash flows using a discount rate reflective of the characteristics of the property. Upon adoption of this new standard, all of CMHC's real estate properties will be required to be valued at their highest and best use values resulting in a potential increase in fair value of the properties as well as an increase to CMHC's Net Income. CMHC also anticipates enhanced disclosure requirements relating to fair value measurement information.
- On 16 June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements*. The amendments require the components of Other Comprehensive Income be presented in two categories: items being reclassified to Net Income in subsequent periods and items that will not be reclassified to Net Income. The new requirements are to be applied retrospectively. The Corporation does not expect that these amendments will have a material impact on its Consolidated Financial Statements.
- On 16 June 2011, the IASB issued amendments to IAS 19 *Employee Benefits* (IAS 19). Amendments to IAS 19 eliminate the "corridor method" and improve the recognition, presentation and disclosure requirements for the defined benefit plans. As the Corporation has adopted the change from the corridor method upon implementation of IFRS, this component of the amendment will not affect the Corporation's unaudited Quarterly Consolidated Financial Statements. The Corporation's analysis of the other changes indicates that the amendments will result in an overall change in pension expenses reflected in Net Income with a corresponding offset in actuarial gains and losses recognized in Other Comprehensive Income. This change is due to the discount rate being applied to the plan assets to calculate the estimated return by the plan rather than the expected rate of return that was previously allowed. These amendments also include enhanced disclosure requirements.

#### **Effective Date of 1 January 2014**

- On 16 December 2011, the IASB issued amendments to IAS 32 *Financial Instruments: Presentation* to clarify the application of the offsetting requirements. Earlier application is permitted. The Corporation has not yet determined the impact of these amendments on its Consolidated Financial Statements.

#### **Effective Date of 1 January 2015**

- On 12 November 2009, the IASB issued IFRS 9 *Financial instruments* (IFRS 9) with further revisions on 28 October 2010 to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial instrument is measured at amortized cost or fair value, based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial instrument. In December 2011, the IASB decided to delay the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015. The Corporation has not yet determined the impact of this new standard on its Consolidated Financial Statements.

## 4. CRITICAL JUDGMENTS IN APPLYING ACCOUNTING POLICIES AND MAKING ESTIMATES

### *Judgments in Applying Accounting Policies*

In the process of applying the Corporation's accounting policies, Management is required to make various judgments, apart from those involving estimations, that can significantly affect the amounts it recognizes in the unaudited Quarterly Consolidated Financial Statements. The judgments having the most significant effect on the amounts recognized in the unaudited Quarterly Consolidated Financial Statements are:

- Consolidation – significant judgments are applied in the assessment of whether the substance of the relationship between CMHC and Canada Housing Trust (a special purpose entity) indicates that, as per SIC-12, CMHC controls that special purpose entity. CMHC guarantees the timely payment of principal and interest on the Canada Mortgage Bonds, which exposes it to the majority of risks of Canada Housing Trust and as a result, CMHC consolidates the Canada Housing Trust. Significant judgments are also applied in the assessment of whether the substance of the relationship between CMHC and Nordea indicates that CMHC controls it. As CMHC is the principal investor in the fund, Nordea is reliant on CMHC's continued investment. As a result, CMHC consolidates Nordea International Equity fund;
- Derecognition – in assessing whether transfers of NHA MBS from Issuers to the Corporation under the CMB program (CHT) and IMPP (CMHC) qualify for derecognition, significant judgment is applied in determining whether substantially all the risks and rewards of ownership of the NHA MBS have been transferred; and
- Impairment of Available for Sale Financial Instruments – significant judgments are applied in assessing if losses that have been experienced are significant and/or prolonged and the asset is not expected to recover to its cost.

### *Use of Estimates and Assumptions*

The preparation of these unaudited Quarterly Consolidated Financial Statements requires Management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, comprehensive income and related disclosures. Key areas where Management has made estimates and assumptions include those related to Provision for Claims, Unearned Premiums, Fair Value of Financial Instruments, and Post-employment Benefits. Where actual results differ from these estimates and assumptions, the impact will be recorded in future periods.

### *Provision for Claims*

The Provision for Claims represents an estimate for expected claims and the related settlement expenses, net of the related expected property sale proceeds, for defaults from the mortgage insurance business that have occurred on or before the Quarterly Consolidated Balance Sheet date. In calculating the estimated liability, an estimate of losses on defaults that have been incurred but not reported is made using historical experience and the time value of money, which considers prevailing legal, economic, social and regulatory trends. See Note 10 for further details.

### *Unearned Premiums*

Mortgage loan insurance premiums are deferred and recognized as revenue over the period covered by the insurance contracts using actuarially determined factors that are reviewed annually as part of the Actuarial Valuation. The premium earning factors are derived from claim occurrence patterns based on the principle that premiums will be earned at the same rate as claims are incurred. See Note 10 for further details.

## Financial Instruments

Financial instruments carried at fair value are measured based on quoted market prices observable in the market or amounts derived from cash flow models or other valuation methodologies. The fair value measurement hierarchy described in Note 12 reflects the significance of the inputs used in making these measurements.

## Post-employment Benefits

The annual cost of pension and other post-employment benefits earned by employees is actuarially determined using the projected unit credit method prorated on service and Management's best estimate of expected long-term pension plan investment performance, compensation increases, retirement ages of employees, mortality of members and expected health care costs. These assumptions are of a long-term nature, which is consistent with the nature of post-employment benefits. Actual results could differ from these estimates. See Note 16 for further details.

## 5. SECURITIES

The following table shows the unrealized gains (losses) on Investment Securities recorded at fair value.

(in millions)	30 June 2012			31 December 2011		
	Amortized Cost <sup>1</sup>	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost <sup>1</sup>	Fair Value
Investment Securities:						
Fixed Income						
Designated at Fair Value through Profit or Loss	856	48	-	904	861	903
Available for Sale	14,113	1,064	(5)	15,172	13,061	14,165
Equities						
Held for Trading	478	-	(67)	411	486	397
Available for Sale	3,078	327	(62)	3,343	3,232	3,384

<sup>1</sup>Amortized cost for Equities is cost.

The cumulative loss from Available for Sale fixed income and equity investments of \$67 million (31 December 2011 – \$156 million) included in Accumulated Other Comprehensive Income, has not been recognized as an impairment loss in Net Income.

During the three and six months ended 30 June 2012, \$70 million of impairment losses (three and six months ended 30 June 2011 – nil) were recognized in Net Realized Gains (Losses) from Financial Instruments and no reversals of previously realized fixed income investment security impairments occurred during the year.

## 6. INVESTMENT IN NHA MORTGAGE-BACKED SECURITIES - LOANS AND RECEIVABLES

For the three month and six month period ending 30 June 2012, there were disbursements of Investment in NHA Mortgage-Backed Securities – Loans and Receivables in the amount of \$9,594 million and \$20,098 million and repayments of \$19,462 million and \$20,057 million, respectively (three and six months ended 30 June 2011 – disbursements of \$10,818 million and \$22,065 million, and repayments of \$1,064 million and \$14,490 million, respectively).

## 7. HOUSING PROGRAMS

CMHC receives Parliamentary appropriations to fund the following program expenditures, including operating expenses, in support of Housing Programs.

(in millions)	Three months ended 30 June		Six months ended 30 June	
	2012	2011	2012	2011
Assisted Housing Programs	358	339	780	768
Housing Repair and Improvement Programs	15	12	29	176
On-Reserve Housing Programs	32	30	65	104
Affordable Housing Initiative	53	-	229	95
Policy, Research and Information Transfer	1	1	2	3
Total Housing Programs Expenses	459	382	1,105	1,146
Operating Expenses	30	27	67	58
<b>Total Appropriations</b>	<b>489</b>	<b>409</b>	<b>1,172</b>	<b>1,204</b>

The following table presents the changes in the Due from (to) the Government of Canada account. The outstanding balance as of 30 June 2012 is mainly composed of housing programs expenses incurred but not yet reimbursed.

(in millions)	As at	
	30 June 2012	31 December 2011
<b>Due from (to) the Government of Canada</b>		
Balance at Beginning of Period	403	531
Total Appropriations	1,172	2,163
Total Appropriations Received	(1,180)	(2,300)
Reimbursements	(3)	9
<b>Balance at End of Period</b>	<b>392</b>	<b>403</b>

## 8. SECURITIZATION

### Guarantees-in-force

Under Section 15 of the NHA, the aggregate outstanding amount of principal guarantees may not exceed \$600 billion (31 December 2011 – \$600 billion).

The following table presents the total guarantees-in-force by program.

(in billions)	As at	
	30 June 2012	31 December 2011
NHA MBS <sup>1</sup>	175	161
CMB <sup>2</sup>	202	201
<b>Total Guarantees-in-Force</b>	<b>377</b>	<b>362</b>

<sup>1</sup>Includes \$46 billion (31 December 2011 - \$49 billion) in NHA MBS of which CMHC is entitled to payments for the timely payment guarantee

<sup>2</sup>Includes \$2 billion (31 December 2011 - \$2 billion) in investments held by CMHC in CMB issued by CHT



## 9. BORROWINGS

### Canada Mortgage Bonds

The interest expense related to Canada Mortgage Bonds for the three and six months ended 30 June 2012 is \$1,521 million and \$3,027 million, respectively (three and six months ended 30 June 2011 – \$1,602 million and \$3,222 million, respectively).

For the three and six months ended 30 June 2012, CHT issued Canada Mortgage Bonds in the amount of \$9,594 million and \$20,098 million, respectively (three and six months ended 30 June 2011 – \$10,818 million and \$22,065 million, respectively). There were \$18,700 million in maturities for the three and six months ended 30 June 2012 (three and six months ended 30 June 2011 – nil and \$12,450 million, respectively).

### Capital Market Borrowings

The interest expense related to Capital Market Borrowings for the three and six months ended 30 June 2012 is \$22 million and \$45 million, respectively (three and six months ended 30 June 2011 – \$33 million and \$67 million, respectively).

For the three and six months ended 30 June 2012, CMHC made \$300 million in repayments relating to its Capital Market Borrowings (three and six months ended 30 June 2011 – \$100 million).

### Borrowings from the Government of Canada

The interest expense related to Borrowings from the Government of Canada - Designated at Fair Value through Profit or Loss and Other for the three and six months ended 30 June 2012 is \$556 million and \$1,121 million, respectively (three and six months ended 30 June 2011 – \$579 million and \$1,159 million, respectively).

For the three and six months ended 30 June 2012, CMHC had new borrowings in the amount of \$737 million and \$1,179 million, respectively (three and six months ended 30 June 2011 – \$581 million and \$2,399 million, respectively), and repayments in the amount of \$1,444 million and \$2,649 million, respectively (three and six months ended 30 June 2011 – \$1,406 million and \$3,581 million, respectively), relating to its Borrowings from the Government of Canada.

## 10. MORTGAGE LOAN INSURANCE

### Unearned Premiums and Fees

The following table presents the changes in the Unearned Premiums and Fees balance:

(in millions)	As at	
	30 June 2012	31 December 2011
Balance at Beginning of Period	6,731	6,874
Premium Deferred on Contracts Written in the Period	776	1,622
Premiums Earned	(859)	(1,766)
Application Fees Deferred on Contracts Written in the Period	7	14
Application Fees Earned	(7)	(13)
<b>Balance at End of Period</b>	<b>6,648</b>	<b>6,731</b>

### Provision for Claims

The Provision for Claims includes amounts set aside for Incurred But Not Reported (IBNR) claims, claims reported but not paid and for Social Housing Mortgage and Index Linked Mortgage claims. The following table presents the changes in the Provision for Claims balance:

(in millions)	As at	
	30 June 2012	31 December 2011
Balance at Beginning of Period	1,041	1,096
Losses on Claims during the Period	(322)	(617)
Provision for Claims incurred during the Period	261	562
<b>Balance at End of Period</b>	<b>980</b>	<b>1,041</b>

### Mortgage Loan Insurance Risk Management

CMHC assumes the risk of loss from borrower default through mortgage insurance contracts entered into with lenders, exposing CMHC to the uncertainty surrounding the timing, frequency and severity of claims. CMHC manages its exposure to this risk of loss through prudent product design, underwriting and default management practices, and the establishment of adequate capital reserves.

A concentration of risk may arise from insurance contracts issued in a particular geographical area where local economic conditions are significantly different from average. The relative impact of the outcome is mitigated as a result of CMHC's distribution of business across different geographic areas.

### Insurance-in-force

Under Section 11 of the NHA, the total of outstanding insured amounts of all insured loans may not exceed \$600 billion (31 December 2011 – \$600 billion).

At 30 June 2012, insurance-in-force, which represents the risk exposure of the CMHC Mortgage Loan Insurance Activity, totalled \$576 billion (31 December 2011 – \$567 billion).

## 11. INCOME TAXES

The following table presents the total income taxes.

(in millions)	Three months ended 30 June		Six months ended 30 June	
	2012	2011	2012	2011
Other Comprehensive Income:				
Net Unrealized Gains (Losses) from Available for Sale Financial Instruments	41	23	57	14
Reclassification of Prior Years' Net Unrealized (Gains) Losses Realized in the Period	(5)	7	(29)	(16)
Net Actuarial Gains (Losses) on Employee Benefit Plans	(11)	(11)	(13)	(5)
Income Tax Expense (Benefit) on Other Comprehensive Income	25	19	15	(7)
Income Tax Expense on Quarterly Consolidated Statement of Equity of Canada	-	-	-	-
Income Tax Expense on Quarterly Consolidated Net Income	105	138	253	273
<b>Total</b>	<b>130</b>	<b>157</b>	<b>268</b>	<b>266</b>

## 12. FINANCIAL INSTRUMENTS

### *Determination of Fair Value*

All financial instruments are recognized initially at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Accrued interest is separately disclosed for all financial instruments.

Fair values are estimated using the following fair value methods. The fair value measurement hierarchy reflects the observability of the most significant inputs used in making these measurements.

### *Fair Value Hierarchy*

**Level 1:** Financial assets quoted in active markets are measured based on the bid price of an identical asset. Financial liabilities quoted in active markets are measured based on the ask price of an identical liability.

**Level 2:** Financial assets and liabilities not quoted in active markets that are measured based on discounted cash flow or other valuation methodologies making maximum use of directly or indirectly observable market data.

**Level 3:** Financial assets and liabilities not quoted in active markets that are measured based on discounted cash flow analysis techniques or other valuation methodologies where significant inputs are not based on observable market data. Examples of these inputs are discount rates which include assumptions related to credit and liquidity risk premiums which are unobservable in the market.

The following table represents the fair value hierarchy in which fair value measurements are categorized for assets and liabilities recorded on the Quarterly Consolidated Balance Sheet. During the three and six months ended 30 June 2012, there were no significant transfers between Level 1 and Level 2.

(in millions)	As at 30 June 2012			Total
	Level 1	Level 2	Level 3	
<b>ASSETS</b>				
Cash and Cash Equivalents	336	591	-	927
Investment Securities:				
Designated at Fair Value through Profit or Loss	577	198	129	904
Held for Trading	411	-	-	411
Available for Sale	18,412	94	9	18,515
Loans:				
Designated at Fair Value through Profit or Loss	-	6,866	-	6,866
Derivatives	-	150	-	150
Assets not recorded at Fair Value	-	-	-	264,841
<b>Total Assets</b>	<b>19,736</b>	<b>7,899</b>	<b>138</b>	<b>292,614</b>
<b>LIABILITIES</b>				
Borrowings:				
Capital Market Borrowings	1,873	-	-	1,873
Borrowings from the Government of Canada:				
Designated at Fair Value through Profit or Loss	-	6,659	-	6,659
Derivatives	-	59	-	59
Liabilities and Equity not recorded at Fair Value	-	-	-	284,023
<b>Total Liabilities and Equity</b>	<b>1,873</b>	<b>6,718</b>	<b>-</b>	<b>292,614</b>

(in millions)	As at 31 December 2011			Total
	Level 1	Level 2	Level 3	
<b>ASSETS</b>				
Cash and Cash Equivalents	617	512	-	1,129
Investment Securities:				
Designated at Fair Value through Profit or Loss	584	200	119	903
Held for Trading	397	-	-	397
Available for Sale	17,353	188	8	17,549
Loans:				
Designated at Fair Value through Profit or Loss	-	7,132	-	7,132
Derivatives	-	169	-	169
Assets not recorded at Fair Value	-	-	-	264,611
<b>Total Assets</b>	<b>18,951</b>	<b>8,201</b>	<b>127</b>	<b>291,890</b>
<b>LIABILITIES</b>				
Borrowings:				
Capital Market Borrowings	2,203	-	-	2,203
Borrowings from the Government of Canada:				
Designated at Fair Value through Profit or Loss	-	6,584	-	6,584
Derivatives	-	72	-	72
Liabilities and Equity not recorded at Fair Value	-	-	-	283,031
<b>Total Liabilities and Equity</b>	<b>2,203</b>	<b>6,656</b>	<b>-</b>	<b>291,890</b>

### Financial Instruments Carried at Amortized Cost

Using the valuation methods described in Note 17 of the 2011 Consolidated Financial Statements, the following table presents the fair values of financial instruments carried at amortized cost, except where amortized cost is a reasonable approximation of fair value.

(in millions)	As at			
	30 June 2012		31 December 2011	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
Investment in NHA Mortgage-Backed Securities – Loans and Receivables <sup>2</sup>	265,110	256,699	266,477	256,655
Securities Purchased Under Resale Agreements <sup>2</sup>	54	54	-	-
Loans – Other <sup>2</sup>	5,813	4,556	6,005	4,726
Loans – Investments in Housing Programs <sup>2</sup>	1,430	778	1,477	808
Canada Mortgage Bonds <sup>1</sup>	207,625	200,892	206,974	199,373
Borrowings from the Government of Canada – Other <sup>2</sup>	63,154	59,394	65,317	60,963

<sup>1</sup> Fair value determined based on Level 1 Criteria.

<sup>2</sup> Fair value determined based on Level 2 Criteria.

### Gains and Losses from Financial Instruments

The unrealized gains and losses arising from changes in fair value related to financial instruments classified as HFT and those Designated at Fair Value through Profit or Loss are presented in the following table.

(in millions)	Three months ended 30 June		Six months ended 30 June	
	2012	2011	2012	2011
<b>Held for Trading</b>				
Equities	(28)	-	22	-
Derivatives	17	-	(10)	(48)
<b>Total Held for Trading</b>	<b>(11)</b>	<b>-</b>	<b>12</b>	<b>(48)</b>
<b>Designated at Fair Value through Profit or Loss</b>				
Investment Securities – Designated at Fair Value	8	11	3	12
Loans – Designated at Fair Value through Profit or Loss	22	46	(51)	(9)
Capital Market Borrowings	-	(7)	31	46
Borrowings from the Government of Canada – Designated at Fair Value through Profit or Loss	(44)	(60)	26	(23)
<b>Total Designated at Fair Value through Profit or Loss</b>	<b>(14)</b>	<b>(10)</b>	<b>9</b>	<b>26</b>
Gains (Losses) from Related Party Transactions	(1)	(1)	(1)	14
<b>Total Net Unrealized Gains (Losses) from Financial Instruments</b>	<b>(26)</b>	<b>(11)</b>	<b>20</b>	<b>(8)</b>

All items Designated at Fair Value through Profit and Loss, with the exception of certain Investment Securities held within the Mortgage Loan Insurance and Securitization Activities, relate to the Lending Activity. For certain portfolios of loans and associated borrowings, the Lending Activity uses Derivatives to manage refinancing, reinvestment and currency risks, as well as mismatches between the timing of receipts from assets and payments of liabilities. Classifying the Loans, and associated Capital Market Borrowings and Borrowings from the Government of Canada, as Designated at Fair Value through Profit or Loss significantly reduces the measurement inconsistency that would otherwise arise from measuring them at amortized cost and measuring the Derivatives at fair value.

Certain Investment Securities within the Mortgage Loan Insurance and Securitization Activities are also classified as Designated at Fair Value as they are managed and reported to Management on a fair value basis.

The realized gains and losses related to financial instruments are presented in the table below.

(in millions)	Three months ended 30 June		Six months ended 30 June	
	2012	2011	2012	2011
Held for Trading	1	(1)	(3)	(1)
Designated at Fair Value through Profit or Loss	-	-	-	-
Available for Sale	(16)	43	66	120
Retirement of Debt	(6)	-	(19)	-
<b>Total Net Realized Gains (Losses) from Financial Instruments</b>	<b>(21)</b>	<b>42</b>	<b>44</b>	<b>119</b>

### 13. MARKET RISK

Market risk is the risk of adverse financial impact arising from changes in underlying market factors, including interest rates, foreign exchange rates, and equity prices.

#### Sensitivity Analysis

**Value at Risk:** Market risk for investment securities in the Mortgage Loan Insurance and Securitization portfolios is evaluated through the use of a Value at Risk (VaR) model. VaR is a statistical estimation that measures the maximum potential market loss of a portfolio over a specified holding period with a given level of confidence. The calculation of VaR is based on the Delta-normal method which may underestimate the occurrence of large losses because of its reliance on a normal distribution. The following table shows the VaR for the Mortgage Loan Insurance and Securitization investment portfolios with a 95% confidence level over a two-week holding period. The analysis is based on one-year historical data of prices, volatilities and correlations of the various bond and equity markets.

**Interest Rate Sensitivity:** The financial instruments Designated at Fair Value through Profit or Loss and classified as HFT in the Lending Activity portfolio are exposed to interest rate movements. For Loans – Designated at Fair Value through Profit or Loss, the impacts of interest rate shifts on the portfolio are not symmetrical. A -200 bps interest rate shift would result in an increase in value of \$369 million (31 December 2011 – \$403 million) whereas a +200 bps interest rate shift would result in a decrease in value of \$341 million (31 December 2011 – \$380 million). For all remaining loans, a -200 bps interest rate shift would result in an increase in value of \$1,181 million (31 December 2011 – \$1,203 million) whereas a +200 bps interest rate shift would result in a decrease in value of \$799 million (31 December 2011 - \$858 million). The following table shows the maximum exposure of the Lending Activity portfolio's net interest margin to interest rate movements with a 95% confidence over the period. The maximum exposure is limited by CMHC policy to \$1.5 million.

(in millions)	Comprehensive Income	
	As at 30 June 2012	As at 31 December 2011
Value at Risk	196	174
Maximum Exposure	0.5	1

### ***Investment in NHA Mortgage-Backed Securities – Loans and Receivables***

IMPP and CHT are exposed to both interest rate risk and prepayment/reinvestment risk. Prepayment/reinvestment risk is the risk that NHA MBS may experience varying degrees of prepayment throughout the term and these prepayments must be reinvested immediately.

To mitigate these risks, CMHC and CHT enter into swap agreements with approved financial institutions. Under these agreements, both interest rate and prepayment/reinvestment risks are transferred to swap counterparties. These swap counterparties manage reinvestment assets in accordance with pre-established investment guidelines. CMHC and CHT pay all interest received from the underlying assets to the swap counterparties and the swap counterparties pay CMHC and CHT an amount equal to the coupon payments on the Borrowings from the Government of Canada and Canada Mortgage Bonds, respectively. As a result of these swap agreements, changes in interest rates or prepayments/reinvestments have no impact on the Statement of Income and Comprehensive Income.

## **14. CREDIT RISK**

Credit risk is the risk of loss arising from a counterparty's inability to fulfill its contractual obligations. The Corporation is exposed to credit risk from various sources, including from its investment, lending, derivative, advances to mortgage-insured social housing projects in difficulty and mortgage receivable transactions.

Credit risk associated with the Corporation's fixed income investments and derivatives is managed through the implementation of policies which include minimum counterparty credit ratings and investment portfolio diversification limits by issuer, credit rating and by industry sector, and through the use of appropriate legal agreements.

CMHC is exposed to credit-related risk in the event of default of swap counterparties. This risk is mitigated by dealing with swap counterparties whose credit ratings are in accordance with its Funding, Investment and Risk Management Policies; through the use of International Swaps Derivatives Associated (ISDA) master netting agreements for derivatives which have been entered into with all counterparties; and, where appropriate, through the use of ratings-based collateral thresholds in the Credit Support Annexes. The fair value of the collateral related to derivatives held by CMHC (including those related to Investments in NHA Mortgage-Backed Securities - Loans and Receivables – IMPP) as at 30 June 2012 is \$524 million (31 December 2011 – \$739 million).

CHT is also exposed to credit-related risk in the event of default of swap counterparties. This risk is mitigated by transacting with highly rated swap counterparties and collateralization requirements based on credit ratings. The fair value of swap collateral held by CHT as at 30 June 2012 is \$489 million (31 December 2011 - \$363 million).

## **15. LIQUIDITY RISK**

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with financial liabilities. The Corporation has a liquidity risk policy which includes appropriate limits to ensure sufficient resources to meet current and projected cash requirements.

## 16. POST-EMPLOYMENT BENEFITS

CMHC's net benefit plan costs recognized in Operating Expenses are as follows:

(in millions)	Three months ended 30 June			
	Pension Plans		Other Post-employment Benefits	
	2012	2011	2012	2011
Current Service Cost, Net of Employees' Contributions	8	7	1	1
Interest Cost	17	18	2	2
Expected Return on Plan Assets (Gain) Loss	(18)	(19)	-	-
<b>Defined Benefit Plan Expense</b>	<b>7</b>	<b>6</b>	<b>3</b>	<b>3</b>

(in millions)	Six months ended 30 June			
	Pension Plans		Other Post-employment Benefits	
	2012	2011	2012	2011
Current Service Cost, Net of Employees' Contributions	15	12	3	2
Interest Cost	36	36	4	5
Expected Return on Plan Assets (Gain) Loss	(36)	(38)	-	-
<b>Defined Benefit Plan Expense</b>	<b>15</b>	<b>10</b>	<b>7</b>	<b>7</b>

The following assumptions were used to calculate these costs.

Measures	As at	
	30 June 2012	31 December 2011
<b>Defined Benefit Obligation:</b>		
Discount Rate	4.20%	4.50%
Rate of Compensation Increase	3.00%	3.00%
<b>Benefit Costs:</b>		
Discount Rate	4.50%	5.10%
Rate of Compensation Increase	3.00%	3.00%
Expected Rate of Return on Plan Assets	6.10%	6.10%

The actuarial valuation of CMHC's registered Pension Plan as at 31 December 2010, completed in the fourth quarter of 2011, reported that the Plan was fully funded on a going concern basis, but was in a solvency deficit. The 31 December 2011 valuation reports a deficit position on both a going concern basis and a solvency basis.

As is permitted under the *Pension Benefits Standards Act, 1985* (PBSA) and its related Regulations, the Corporation obtained approval from the Minister responsible for CMHC on 3 June 2012 and the Minister of Finance on 26 July 2012 to reduce the solvency special payments determined by the valuations. The reductions are from \$72.0 million to nil with respect to the solvency special payment as a result of the 2010 valuation and from \$126.7 million to \$22.1 million in 2012 with respect to the annual solvency special payments in 2012 through 2016 as a result of the 2011 valuation. As the approval from the Minister of Finance was outstanding as at 30 June 2012, the Corporation had set aside the full amount of the reductions as Restricted Cash (described below) pending Ministerial approval.

At 30 June 2012 the Corporation was seeking Ministerial approval to reduce solvency special payments with respect to the registered Pension Plan. As a result, Cash and Cash Equivalents include Restricted Cash of \$125 million, representing funds set aside for solvency special payments until such time as Ministerial approval for the reductions is obtained. Subsequent to the end of the quarter, CMHC obtained Ministerial approval for the solvency special payment reductions.



## 17. SEGMENTED INFORMATION

As described in Note 1, the unaudited Quarterly Consolidated Financial Statements include the accounts of CMHC's four activities (Mortgage Loan Insurance, Securitization, Housing Programs and Lending Activity), each of which provides different programs in support of CMHC's objectives, and the Canada Housing Trust. The financial results of each activity are determined using the accounting policies described in Note 2. The Lending Activity includes certain corporate items that are not allocated to each activity. The Housing Programs Activity includes reimbursements to the Lending Activity as described in Note 2. These reimbursements are not eliminated in the following table. Revenues are attributed to and assets are located in, Canada.

Three months ended 30 June (in millions)	Mortgage Loan Insurance		Securitization		Housing Programs		Lending		Canada Housing Trust		Eliminations <sup>1</sup>		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
<b>REVENUES</b>														
Interest Income from NHA MBS - Loans and Receivables	-	-	418	435	-	-	-	-	1,551	1,620	-	-	1,969	2,055
Premiums and Fees	448	437	63	48	-	-	-	-	-	-	-	-	511	485
Interest Earned on Loans and Investments in Housing Programs	-	-	-	-	-	-	147	162	-	-	-	-	147	162
Income from Investment Securities	134	149	8	11	-	-	9	9	-	-	(11)	(16)	140	153
Net Realized Gains (Losses) from Financial Instruments	(31)	36	11	6	-	-	-	-	-	-	(1)	-	(21)	42
Net Unrealized Gains (Losses) from Financial Instruments	(24)	2	(2)	-	-	-	-	(9)	-	-	-	(4)	(26)	(11)
Parliamentary Appropriations and Other Income	-	1	3	4	489	409	10	3	40	45	(24)	(28)	518	434
	527	625	501	504	489	409	166	165	1,591	1,665	(36)	(48)	3,238	3,320
<b>EXPENSES</b>														
Interest Expense	1	-	418	435	-	-	151	165	1,549	1,618	(26)	(16)	2,093	2,202
Operating Expenses	48	49	3	2	30	27	5	4	42	47	(24)	(28)	104	101
Housing Programs and Net Claims	142	114	-	-	459	382	-	-	-	-	-	-	601	496
	191	163	421	437	489	409	156	169	1,591	1,665	(50)	(44)	2,798	2,799
Income Taxes	81	121	20	18	-	-	1	(1)	-	-	3	-	105	138
<b>NET INCOME (LOSS)</b>	255	341	60	49	-	-	9	(3)	-	-	11	(4)	335	383
Total Revenues	527	625	501	504	489	409	166	165	1,591	1,665	(36)	(48)	3,238	3,320
Inter-segment/entity Revenues <sup>1</sup>	(9)	(17)	-	-	-	-	(3)	(3)	(24)	(28)	36	48	-	-
External Revenues	518	608	501	504	489	409	163	162	1,567	1,637	-	-	3,238	3,320

<sup>1</sup> Inter-segment/entity Revenues relate to the following:

- the Mortgage Loan Insurance Activity earns Income From Investment Securities and Holdings of CMB and Capital Market Borrowings. The Lending Activity earns Income from Investment Securities on holdings of CMB; and
- the Securitization Activity receives CMB guarantee fees and advisory fees from CHT, and earns Income from Investment Securities on holdings of Capital Market Borrowings.

Six months ended 30 June (in millions)	Mortgage Loan Insurance		Securitization		Housing Programs		Lending		Canada Housing Trust		Eliminations <sup>1</sup>		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
<b>REVENUES</b>														
Interest Income from NHA MBS - Loans and Receivables	-	-	844	879	-	-	-	-	3,087	3,259	-	-	3,931	4,138
Premiums and Fees	873	855	121	98	-	-	-	-	-	-	-	-	994	953
Interest Earned on Loans and Investments in Housing Programs	-	-	-	-	-	-	296	323	-	-	-	-	296	323
Income from Investment Securities	280	297	17	21	-	-	18	17	-	-	(23)	(32)	292	303
Net Realized Gains (Losses) from Financial Instruments	30	108	46	11	-	-	-	-	-	-	(32)	-	44	119
Net Unrealized Gains (Losses) from Financial Instruments	27	4	1	-	-	-	(6)	(9)	-	-	(2)	(3)	20	(8)
Parliamentary Appropriations and Other Income	1	1	6	7	1,172	1,204	16	6	85	93	(51)	(56)	1,229	1,255
	1,211	1,265	1,035	1,016	1,172	1,204	324	337	3,172	3,352	(108)	(91)	6,806	7,083
<b>EXPENSES</b>														
Interest Expense	2	1	844	879	-	-	304	327	3,082	3,254	(53)	(32)	4,179	4,429
Operating Expenses	104	97	6	5	67	58	10	9	90	98	(51)	(56)	226	211
Housing Programs and Net Claims	261	262	-	-	1,105	1,146	-	-	-	-	-	-	1,366	1,408
	367	360	850	884	1,172	1,204	314	336	3,172	3,352	(104)	(88)	5,771	6,048
Income Taxes	207	238	47	35	-	-	-	-	-	-	(1)	-	253	273
<b>NET INCOME (LOSS)</b>	637	667	138	97	-	-	10	1	-	-	(3)	(3)	782	762
Total Revenues	1,211	1,265	1,035	1,016	1,172	1,204	324	337	3,172	3,352	(108)	(91)	6,806	7,083
Inter-segment/entity Revenues <sup>1</sup>	(49)	(30)	-	-	-	-	(8)	(5)	(51)	(56)	108	91	-	-
External Revenues	1,162	1,235	1,035	1,016	1,172	1,204	316	332	3,121	3,296	-	-	6,806	7,083

<sup>1</sup> Inter-segment/entity Revenues relate to the following:

- the Mortgage Loan Insurance Activity earns Income From Investment Securities and Holdings of CMB and Capital Market Borrowings. The Lending Activity earns Income from Investment Securities on holdings of CMB; and
- the Securitization Activity receives CMB guarantee fees and advisory fees from CHT, and earns Income from Investment Securities on holdings of Capital Market Borrowings.

As at 30 June 2012 and 31 December 2011 (in millions)	Mortgage Loan Insurance		Securitization		Housing Programs		Lending		Canada Housing Trust		Eliminations <sup>1</sup>		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
<b>ASSETS</b>														
Investment Securities:														
Designated at Fair Value through Profit or Loss	71	66	1	1	-	-	1,317	1,325	-	-	(485)	(489)	904	903
Held for Trading	387	375	24	22	-	-	-	-	-	-	-	-	411	397
Available for Sale	18,397	17,629	1,570	1,502	-	-	-	-	-	-	(1,452)	(1,582)	18,515	17,549
Investment in NHA Mortgage-Backed Securities:														
Loans and Receivables	-	-	54,044	55,401	-	-	-	-	202,655	201,254	-	-	256,699	256,655
Loans:														
Designated at Fair Value through Profit or Loss	-	-	-	-	-	-	6,866	7,132	-	-	-	-	6,866	7,132
Other	-	-	-	-	-	-	4,556	4,726	-	-	-	-	4,556	4,726
Investments in Housing Programs	-	-	-	-	-	-	778	808	-	-	-	-	778	808
Other Assets	1,648	1,557	178	122	-	-	1,477	1,459	546	541	36	41	3,885	3,720
	20,503	19,627	55,817	57,048	-	-	14,994	15,450	203,201	201,795	(1,901)	(2,030)	292,614	291,890
<b>LIABILITIES</b>														
Borrowings:														
Canada Mortgage Bonds	-	-	-	-	-	-	-	-	202,655	201,254	(1,763)	(1,881)	200,892	199,373
Capital Market Borrowings	-	-	-	-	-	-	1,888	2,218	-	-	(15)	(15)	1,873	2,203
Borrowings from the Government of Canada	-	-	54,044	55,401	-	-	12,009	12,146	-	-	-	-	66,053	67,547
Unearned Premiums and Fees	6,648	6,731	547	528	-	-	-	-	-	-	-	-	7,195	7,259
Other Liabilities	2,016	1,713	100	111	-	-	1,083	1,057	546	541	(6)	(5)	3,739	3,417
	8,664	8,444	54,691	56,040	-	-	14,980	15,421	203,201	201,795	(1,784)	(1,901)	279,752	279,799
<b>EQUITY OF CANADA</b>														
Contributed Capital	-	-	-	-	-	-	25	25	-	-	-	-	25	25
Accumulated Other Comprehensive Income (Loss)	937	884	39	57	-	-	-	-	-	-	(24)	(39)	952	902
Retained Earnings	10,902	10,299	1,087	951	-	-	(11)	4	-	-	(93)	(90)	11,885	11,164
	11,839	11,183	1,126	1,008	-	-	14	29	-	-	(117)	(129)	12,862	12,091
	20,503	19,627	55,817	57,048	-	-	14,994	15,450	203,201	201,795	(1,901)	(2,030)	292,614	291,890

<sup>1</sup> The Balance Sheet Eliminations remove inter-entity holdings of CMB and Capital Market Borrowings, as well as inter-segment accounts arising from the allocation of operating cost, without mark-up.

## **18. RELATED PARTY TRANSACTIONS**

CMHC pays the Government of Canada fees in recognition of the Government's financial backing of the Mortgage Loan Insurance and Securitization Activities. The fees, which are recorded as a reduction of Other Income, for the three and six months ended 30 June 2012 amount to \$3 million and \$6 million, respectively (three and six months ended 30 June 2011 – \$2 million and \$5 million, respectively), for the Securitization Activity and nil (three and six months ended 30 June 2011 – nil) for the Mortgage Loan Insurance Activity. The fee for the Mortgage Loan Insurance Activity is nil as CMHC's Earnings Set Aside for Capitalization equals 100% of its target capital level calculated in accordance with guidelines set out by OSFI.

All other material related party transactions and outstanding balances are disclosed in relevant notes.

## **19. CONTINGENT LIABILITIES**

There are legal claims of \$26 million (31 December 2011 – \$20 million) against CMHC. Due to the uncertainty of the outcome of these claims, no provision for loss has been recorded. CMHC does not expect the ultimate resolution of any of the proceedings to which CMHC is party to have a significant adverse effect on its financial position.

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