NEW CENTURY FINANCIAL CORP
Form 10-K/A
April 13, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2003

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _________ to _________

Commission File Number 000-22633

NEW CENTURY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**33-0683629**
(State or other jurisdiction	**(I. R. S. Employer**

incorporation or organization)	**Identification Number)**
18400 Von Karman, Suite 1000, Irvine, California	**92612**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (949) 440-7030

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.01 par value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No ¨

The aggregate market value of common stock held by non-affiliates of the Registrant on June 30, 2003 was approximately $1.0 billion based on the closing sales price for the common stock on such date of $28.96 as reported on the Nasdaq National Market.

As of February 29, 2004, the Registrant had 33,644,944 shares of common stock outstanding.

We are filing this Amendment No. 1 on Form 10-K/A to amend our Annual Report on Form 10-K for the year ended December 31, 2003 (the Form 10-K) in order to (i) provide the information required in Part III of the Form 10-K and (ii) correct a few minor errors in Item 1 Business, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and certain of the footnotes to the financial statements in the Form 10-K filed by us on March 15, 2004. In addition, in connection with the filing of this Amendment No. 1, we are including as exhibits currently dated certifications and an updated consent letter from our independent public accountants.

While this Amendment No. 1 also sets forth the complete text of each other item of the Form 10-K, it does not change any information contained in these other items as originally filed on March 15, 2004. This Amendment No. 1 also does not reflect events that have occurred after the original filing of the Form 10-K or, except as expressly indicated, modify or update the original Form 10-K.

PART I

Item 1. *Business*

General

We are one of the nation s largest mortgage finance companies, providing first and second mortgage products to borrowers nationwide through our operating subsidiaries. We offer mortgage products designed for borrowers who generally do not satisfy the credit, documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers, such as Fannie Mae and Freddie Mac. We originate and purchase loans on the basis of the borrower s ability to repay the mortgage loan, the borrower s historical pattern of debt repayment and the amount of equity in the borrower s property (as measured by the borrower s loan-to-value ratio, or LTV). We have been originating and purchasing these types of loans since 1996 and believe we have developed a comprehensive and sophisticated process of credit evaluation and risk-based pricing that allows us to effectively manage the potentially higher risks associated with this segment of the mortgage industry.

Our borrowers generally have considerable equity in the properties securing their loans, but have impaired or limited credit profiles or higher debt-to-income ratios than traditional mortgage lenders allow. Our borrowers also include individuals who, due to self-employment or other circumstances, have difficulty verifying their income through conventional methods, and who prefer the prompt and personalized service we provide.

We originate and purchase loans through our wholesale network of 21,600 independent mortgage brokers and through our retail network of 72 branch offices located in 26 states, as well as our central retail telemarketing unit. We process and close loans through our 20 regional processing centers located in 14 states. Although a significant percentage of our loans are originated in California, we are authorized to do business in all 50 states and regularly originate and purchase loans throughout the country.

In 2003, we originated 91.8% of our loans through our wholesale channel and 8.2% through our retail channel. Of the loans that we originated, 75.1% were refinances of existing mortgages and 24.9% were for the purchase of residential property. Of the refinance transactions, 85.6% were cash-out refinances in which the borrower receives additional proceeds to pay off other debt or meet other financial needs.

In 2003, we adopted a secondary marketing strategy where we sell approximately 80% of our loans for cash in the whole loan market and hold the remaining 20% of our production for investment through on-balance sheet securitizations. We refer to this as our 80-20 secondary marketing strategy. In 2003, we sold 80.8% of our loans through whole loan sale transactions for cash and securitized 19.2% in five transactions totaling $4.9 billion, using the on-balance sheet structure.

Recent Operating Highlights

We achieved several significant operational milestones during 2003, including the following:

Significantly Higher Loan Production Volume. We increased our loan origination volume to $27.4 billion in mortgage loans in 2003, a 92.8% increase over 2002 volume of $14.2 billion.

Increased Market Share. According to *Inside B&C Lending*, our share of the non-prime mortgage market increased from 6.7% in 2002 to 8.3% in 2003, a 24.0% increase.

Improved Cash Position. Cash and cash equivalents, including restricted cash, of $386.4 million at December 31, 2003 represented a 111% increase over 2002 year-end cash and cash equivalents of $182.9 million.

Geographic Diversification. We expanded our production on the East Coast significantly during 2003. Loan production for 2003 in the 13 targeted eastern seaboard states increased from 21% to 27% of total production, a 29% increase over 2002.

Balance Sheet Growth. During 2003, we completed five securitizations structured as financings (on-balance sheet securitizations) totaling $4.9 billion in mortgage loans.

Increased Web-based Originations. Our FastQual® Web site provides mortgage brokers an automated system designed to improve service through quick, consistent loan answers. Our Wholesale Division s fourth quarter 2003 FastQual® originations of $5.4 billion represented a 209% increase over the same period in 2002. Likewise, our Retail Division s Web-based originations of $290.1 million in the fourth quarter of 2003 represented a 494% increase over the same period in 2002. Retail Web-based originations come from a direct mail program using our Web site to provide the information to prospective borrowers and to allow them to complete an application online.

Credit Mix. During 2003, we originated a larger percentage of our production in our top two credit grades. 81.1% of our 2003 production consisted of loans in our top two credit grades, compared to 58.6% for 2002. During the same period, production in our bottom two credit grades decreased from 4.8% of total production in 2002 to 3.3% in 2003. The weighted average Fair, Isaac & Company score of our loans originated increased to 612 in 2003 from 597 during 2002.

Servicing. In October 2002, we re-established our mortgage servicing operations. Our total mortgage loan servicing portfolio as of December 31, 2003 consisted of $11.6 billion in mortgage loans, including $3.4 billion in mortgage loans held for sale, $5.1 billion in mortgage loans sold with servicing retained (including our mortgage loans held for investment), and $3.1 billion in loans that we are servicing temporarily on behalf of the purchasers thereof.

Discounted Loan Sales. Our discounted loan sales for 2003 were 1.2% of total sales, which represented a 47% decrease from 2002.

Recent Financing Highlights

Expanded Credit Facilities. During 2003, we expanded our warehouse and aggregation credit facilities from $3.5 billion to $7.4 billion, including an asset-backed commercial paper facility totaling $2.0 billion that we established during the third quarter of 2003.

Convertible Debt Transaction. In July 2003, we closed a private offering of $210 million of Convertible Senior Notes due in July 2008. The notes bear interest at a rate of 3.50% per year and are convertible into our common stock at a conversion price of $34.80 per share upon the occurrence of certain events. The proceeds from the transaction were used to finance securitizations, to continue our stock repurchase program, and for other general corporate purposes.

Growth and Operating Strategies

In 2004, we plan to grow the business while at the same time positioning New Century to provide more stable, predictable earnings even when the origination environment becomes less favorable. We plan to do this through several key strategies: (i) strengthening our production franchise, (ii) building our balance sheet, (iii) exploring diversification strategies and (iv) evaluating stockholder return initiatives.

The key tactics for pursuing these strategies include:

Strengthening our Production Franchise. We intend to continue to expand our total loan production, market share, and volume on the East Coast and in other metropolitan areas outside of California. We also plan to use technology such as a new loan origination system and our FastQual® Web site to maintain low loan origination costs while providing high levels of service.

Building our Balance Sheet. We intend to increase our portfolio of on-balance sheet securitizations during 2004 by securitizing approximately 20% of 2004 production. At the same time we plan to strengthen our cash and liquidity position to protect our franchise and provide the ability to respond to disruptions in the market or other adverse conditions. Strong liquidity allows us to hold loans longer in the event that the secondary market for our loans weakens or becomes unstable due to a temporary disruption. One source of cash and liquidity that supports our business is the sale of 80% of our loans for cash through whole loan sales.

Exploring Diversification Strategies. We intend to further diversify our earnings sources by:

Expanding our Loan Servicing Program. We plan to increase the size of our servicing portfolio and to pursue the rating of our servicing platform by one or more of the major credit rating agencies during 2004.

Increasing Commercial Lending. We began to originate small balance commercial loans (loan amounts of up to $3,000,000) in 2003. We plan to increase our commercial loan production volume during 2004.

Pursuing Business Development Opportunities. We plan to evaluate and execute strategic acquisitions and new business opportunities as available.

Evaluating Stockholder Return Initiatives. We plan to declare a cash dividend of at least $0.16 per share each quarter. Depending on market conditions, our share price, our cash position and other factors, we may also continue our stock repurchase program. We have also announced that we are evaluating the advantages and disadvantages of converting into a Real Estate Investment Trust. We expect to conclude our analysis in early April 2004.

Strengths and Competitive Advantages

We believe that we have several strengths and competitive advantages that allow us to compete effectively in our business, including:

High Quality Customer Service. We strive to make the origination process easy for our borrowers and brokers by providing prompt responses, consistent and clear procedures and an emphasis on ease of use through technology.

Strong Secondary Market Relationships. We have developed strong relationships with a variety of large institutional loan buyers, including Morgan Stanley, Credit Suisse First Boston, UBS Warburg, Residential Funding, Bear Stearns, Deutsche Bank, and Goldman Sachs, who consistently bid on and buy large loan pools from us.

Performance-Based Compensation Structure. We have implemented a performance-based compensation structure, which allows us to attract, retain and motivate qualified personnel.

FastQual® Loan Underwriting Engine. Our Wholesale Division has developed a proprietary Web-based loan underwriting engine, FastQual®, generally providing our brokers and their customers with a response in less than 12 seconds.

CloseMore University. CloseMore University, our Wholesale Division s sales training program for brokers, enables us to establish relationships with new brokers and expand our relationship with existing brokers.

Advanced Technology for Credit Evaluation. The implementation of our proprietary credit grading and pricing engine has allowed us to produce a more consistent and predictable portfolio of loans.

State-of-the-Art Loan Performance Technology. The asset-backed security performance section of our Web site, www.ncen.com, employs new technology to enhance user access to our loan securitization and portfolio information. The site provides data distilled from monthly statements to certificate holders, pre-packaged reports, user-definable data views, deal documents and dynamic data analysis tools that enable users to examine the performance of the loans supporting each of our securitized transactions.

Quality Control/Quality Assurance. We have developed a variety of automated and manual pre-funding controls (Quality Control) and post-funding reviews (Quality Assurance) in order to increase the likelihood that we originate loans that comply with applicable laws, as well as with our own internal underwriting guidelines and secondary market requirements.

Management Experience and Depth. The members of our senior management team have, on average, over 20 years of experience in the consumer finance sector.

Product Types

We offer both fixed-rate loans and adjustable-rate loans, or ARMs. We also offer loans with an interest rate that is initially fixed for a period of time and subsequently converts to an adjustable rate. At each interest rate adjustment date, we adjust the rate subject to certain limitations on the amount of any single adjustment and a cap on the aggregate of all adjustments.

In addition, our products are available at different interest rates and with different origination and application points and fees, depending on the particular borrower s risk classification. See Business Underwriting Standards. Borrowers may choose to increase or decrease their interest rate through the payment of different levels of origination fees. Our maximum loan amount is generally $500,000 with a loan-to-value ratio of up to 90%. We do, however, offer larger loans with lower loan-to-value ratios through a special jumbo program. We also offer products that permit a loan-to-value ratio of up to 95% for selected borrowers with an internal risk classification of A+ or of up to 90% for selected borrowers with an internal risk classification of A- . We also offer our AA product designed to appeal to borrowers of higher credit quality.

Loans originated or purchased by us during 2003 had an average loan amount of approximately $167,000 and an average loan-to-value ratio of 82.1%. If permitted by applicable law and agreed to by the borrower, a loan originated by us may also include a prepayment charge that is triggered by the loan s full or substantial prepayment early in the loan term. Approximately 80% of the loans we originated or purchased during 2003 included some form of prepayment charge.

Loan Originations and Purchases

Our *Wholesale Division* originates and purchases loans through a network of independent mortgage brokers and correspondent lenders solicited by our account executives. Our account executives provide on-site customer service to the broker to facilitate the loan s funding. In addition, the Wholesale Division originates mortgage loans through its FastQual® Web site at www.newcentury.com, where a broker can upload a loan request and receive a response generally within 12 seconds.

Our *Retail Division* originates loans directly to the consumer through 72 retail branch offices located in 26 states and a central retail telemarketing unit that originates loans nationwide through one central office. Leads are generated through radio, direct mail, telemarketing and the Internet.

Our Wholesale Division

During 2003, our wholesale originations and purchases totaled $25.1 billion, or 91.8% of our total loan production. As of December 31, 2003, our Wholesale Division operated through 20 regional operating centers located in 14 states and employed 486 account executives.

As of December 31, 2003, we had approved over 21,600 mortgage brokers to submit loans to us. Of the total approved mortgage brokers, we originated loans through approximately 15,400 brokers during 2003. During this period, our ten largest producing brokers originated 7.0% of our wholesale production.

We have designed and implemented a detailed procedure for qualifying, approving and monitoring our network of approved mortgage brokers. We require all brokers to complete an application which requests general business information and copies of all licenses. Upon receipt of the application and supporting documentation, our Broker Services Department scrutinizes the materials for completeness and accuracy. Our Broker Services Department then independently verifies the information contained in the application through (i) a public records Web site to verify the validity and status of licenses and (ii) the Mortgage Asset Research Institute, or MARI, which provides background information from both the public and private sectors.

To be approved, a broker must enter into our standard broker agreement with New Century Mortgage Corporation pursuant to which the broker agrees to abide by the provisions of our Policy on Fair Lending and our Brokers Code of Conduct. Each broker also agrees to comply with applicable state and federal lending laws and agrees to submit true and accurate disclosures with regard to loan applications and loans. In addition, we employ a risk management team that regularly reviews and monitors the loans submitted by our brokers.

In wholesale loan originations the broker s role is to identify the applicant, assist in completing the loan application form, gather necessary information and documents and serve as our liaison with the borrower through our lending process. We review and underwrite the application submitted by the broker, approve or deny the application, set the interest rate and other terms of the loan and, upon acceptance by the borrower and satisfaction of all conditions imposed by us, fund the loan. Because brokers conduct their own marketing and employ their own personnel to complete loan applications and maintain contact with borrowers, originating loans through our Wholesale Division allows us to increase loan volume without incurring the higher marketing, labor and other overhead costs associated with increased retail originations.

Mortgage brokers can submit loan applications in two ways: (i) through an account executive in one of our sales offices or (ii) through FastQual®, our Web-based loan underwriting engine, at www.newcentury.com.

In either case, the mortgage broker will forward the original loan package to the closest regional operating center where the loan is logged in for regulatory compliance purposes, underwritten and, in most cases, approved or denied within 24 hours of receipt. If approved, we issue a conditional approval to the broker with a list of specific conditions that have to be met (for example, credit verifications and independent third-party appraisals) and additional documents to be supplied prior to the funding of the loan. An account manager and the account executive work directly with the submitting mortgage broker who originated the loan to collect the requested information and to meet the underwriting conditions and other requirements. In most cases, we fund loans within 30 days from the date of approval of an application.

FastQual® generally provides the broker with a response in less than 12 seconds. Loan information from the brokers own loan operating systems can be automatically uploaded to FastQual®. The system provides all loan products for which the borrower qualifies and thus enables brokers to offer their customers many options. Our FastQual® Web site enables mortgage brokers to evaluate loan scenarios for borrowers, submit loan applications, order credit reports, automatically credit grade the loan, obtain pricing and track the progress of the loan through funding.

Our Wholesale Division also purchases closed loans on an individual or flow basis from independent mortgage bankers and financial institutions known as correspondent lenders. We review an application for approval from each lender that seeks to sell us a closed loan. We analyze the mortgage banker s underwriting guidelines to ensure conformance with our guidelines. We also review their financial condition and licenses. We require each mortgage banker to enter into a purchase and sale agreement with customary representations and warranties regarding the loans the mortgage banker will sell to us. These representations and warranties are comparable to those given by us to the purchasers of our loans. Once the correspondent is approved, we underwrite each loan submitted by them.

The following table sets forth selected information relating to loan originations and purchases through our Wholesale Division during the periods shown:

	For the Quarters Ended			
	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
Principal balance (in millions)	$ 4,236.6	5,319.0	7,991.1	7,581.9
Average loan amount (in thousands)	163	166	182	172
Combined weighted average initial loan-to-value ratio	80.9%	82.3%	81.8%	83.9%
Percent of first mortgage loans	98.8%	98.4%	98.8%	98.3%
Property securing loans:				
Owner occupied	94.4%	94.6%	95.1%	94.5%
Nonowner occupied	5.6%	5.4%	4.9%	5.5%
Weighted average interest rate:				
Fixed-rate	7.83%	7.86%	6.78%	7.46%
ARMs initial rate	7.58%	7.42%	7.15%	7.18%
ARMs margin over index	6.05%	5.52%	5.65%	5.70%

Our Retail Division

During 2003, our Retail Division originated $2.3 billion in loans, or 8.2% of our total loan production. As of December 31, 2003, our Retail Division, including the central retail telemarketing unit, employed 678 retail loan officers. These employees were located in three regional processing centers and 72 sales offices in 28 states.

By creating a direct relationship with the borrower, retail lending provides a more sustainable loan origination franchise and greater control over the lending process. Loan origination fees contribute to profitability and cash flow and offset the higher costs of retail lending.

The following table sets forth selected information relating to loan originations through our Retail Division during the periods shown:

	For the Quarters Ended			
	March 31,	June 30,	September 30,	December 31,

	2003	2003	2003	2003
Principal balance (in millions)	$ 452.8	484.0	648.7	669.7
Average loan amount (in thousands)	123	118	124	126
Combined weighted average initial loan-to-value ratio	78.0%	78.8%	80.4%	79.8%
Percent of first mortgage loans	99.3%	99.0%	97.0%	99.4%
Property securing loans:				
Owner occupied	96.5%	96.6%	95.6%	93.3%
Nonowner occupied	3.5%	3.4%	4.4%	6.7%
Weighted average interest rate:				
Fixed-rate	8.33%	8.15%	7.66%	7.55%
ARMs initial rate	8.11%	7.92%	7.81%	7.72%
ARMs margin over index	6.61%	6.45%	6.22%	6.23%

In January 2004, we merged the loan processing functions of both our Wholesale and Retail Divisions into 20 regional processing centers located in 14 states. The combination of our processing centers is expected to improve consistency and reduce costs.

Marketing

Wholesale Marketing

Our Wholesale Division s marketing strategy focuses on the sales efforts of its account executives and on providing prompt, consistent service to mortgage brokers and other customers. Our Wholesale Division supplements its strategy with direct mail and fax programs to brokers, advertisements in trade publications, in-house production of collateral sales material, seminar sponsorships, tradeshow attendance, periodic sales contests and its e-commerce Web site, www.newcentury.com.

Another marketing strategy created by our Wholesale Division is CloseMore University (CMU), an exclusive, one-day interactive workshop. CMU travels to major cities in the United States and invites mortgage brokers in those cities to participate in the workshop. The workshop includes industry specific speakers presenting on topics ranging from how to market to your customer to how to process loans more efficiently. Brokers that attend the seminar are also introduced to our Wholesale Division s FastQual® system and are provided training on the Web site. This additional marketing strategy has fueled the growth of FastQual® during 2003. The CMU Web site address is at www.closemoreu.com.

Retail Marketing

Our Retail Division s branch operations unit relies primarily on targeted direct mail and outbound telemarketing to attract borrowers. Our direct mail programs are managed by a centralized staff who create a targeted mailing list for each branch market and oversee the completion of mailings by a third party mailing vendor. All calls or written inquiries from potential borrowers that result from the mailings are tracked centrally and then forwarded to a branch location and handled by branch loan officers.

The direct mail program uses the Retail Division s Web site, www.newcenturymortgage.com, to provide information to prospective borrowers and to allow them to complete an application online. Under the Central Telemarketing Program, the telemarketing staff solicits prospective borrowers, makes a preliminary evaluation of the applicant s credit and the value of the collateral property and refers qualified leads to loan officers in the retail branch closest to the customer.

Our Retail Division s central retail telemarketing unit solicits prospective borrowers through a variety of direct response advertising methods, such as purchased leads from aggregators, radio advertising, direct mail, search engine placement, banner ads, e-mail campaigns and links to related Web sites. The central retail telemarketing unit also markets to our current customer base through direct mail and outbound telemarketing, although such solicitations are not made within the first 12 months after loan origination. In addition, this unit maintains a comprehensive database on all customers with whom it has had contact and markets to these potential customers as well.

Financing Loan Originations and Loans Held for Sale

We require access to credit facilities in order to originate and purchase mortgage loans and to hold them pending their sale or securitization.

We use our credit facilities totaling $5.4 billion provided by Bank of America, UBS Warburg, CDC Mortgage Capital, Bear Stearns, Morgan Stanley, Greenwich Capital, and Citigroup Global Markets Realty to finance the actual funding of our loan originations and purchases. We also fund loans through our $2.0 billion asset-backed commercial paper note facility established in September 2003. We then sell the loans through whole loan sales or securitizations within two to three months and pay down the financing facilities with the proceeds. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Underwriting Standards

The loans we originate or purchase generally do not satisfy conventional underwriting standards, such as those of Fannie Mae or Freddie Mac. Therefore, our loans are likely to have higher delinquency and foreclosure rates than portfolios of mortgage loans underwritten to conventional Fannie Mae and Freddie Mac standards.

Our underwriting guidelines take into account the applicant s credit history and capacity to repay the proposed loan as well as the secured property s value and adequacy as collateral for the loan. Each applicant completes an application that includes personal information on the applicant s liabilities, income, credit history and employment history. Based on review of the loan application and other data from the applicant against our underwriting guidelines, we determine the loan terms, including the interest rate and maximum loan-to-value ratio.

Credit History

Our underwriting guidelines require a credit report on each applicant from a credit reporting company. In evaluating an applicant s credit history, we utilize credit bureau risk scores, generally known as a FICO score, which is a statistical ranking of likely future credit performance developed by Fair, Isaac & Company and the three national credit data repositories Equifax, TransUnion and Experian.

Collateral Review

A qualified independent appraiser inspects and appraises each mortgage property and verifies that it is in acceptable condition. Following each appraisal, the appraiser prepares a report that includes a market value analysis based on recent sales of comparable homes in the area and, when appropriate, replacement cost analysis based on the current cost of constructing a similar home. All appraisals must conform to the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Foundation s Appraisal Standards Board and are generally on forms acceptable to Fannie Mae and Freddie Mac. Our underwriting guidelines require a review of the appraisal by one of our qualified employees or by a qualified review appraiser that we have retained. Our underwriting guidelines then require our underwriters to be satisfied that the value of the property being financed, as indicated by the appraisal, currently supports the outstanding loan balance.

Income Documentation

Our underwriting guidelines include three levels of income documentation requirements, referred to as the full documentation, limited documentation and stated income documentation programs. Under the full documentation program, we generally require applicants to submit two written forms of verification of stable income for at least 12 months. Under the limited documentation program, we generally require applicants to submit 12 consecutive monthly bank statements on their individual bank accounts. Under the stated income documentation program, an applicant may be qualified based upon monthly income as stated on the mortgage loan application if the applicant meets certain criteria. All of these documentation programs require that, with respect to salaried employees, the applicant s employment be verified by telephone. In the case of a purchase money loan, we require verification of the source of funds, if any, to be deposited by the applicant into escrow. Under each of these programs, we review the applicant s source of income, calculate the amount of income from sources indicated on the loan application or similar documentation, review the applicant s credit history, and calculate the debt service-to-income ratio to determine the applicant s ability to repay the loan. We also review the type, use and condition of the property being financed. Our underwriters use a qualifying rate that is equal to the initial interest rate on the loan to determine the applicant s ability to repay an adjustable-rate loan. We use a qualifying rate that is 3% higher than the start rate for determining the repayment ability of applicants for our interest-only product.

Underwriting Requirements

In general, the maximum loan amount for our mortgage loans is $500,000. Our underwriting guidelines permit loans on owner-occupied, one-to-four-family residential properties to have:

a loan-to-value ratio at origination of up to 95% with respect to non-conforming first liens; and

a combined loan-to-value ratio at origination of up to 100% with respect to conforming and non-conforming second liens.

The applicability of these ratios depends on the purpose of the mortgage loan, the borrower s credit history, the borrower s repayment ability and debt service-to-income ratio, and the type and use of the property. The loan-to-value ratio of a mortgage loan that is secured by mortgaged property acquired by a borrower under a lease option purchase is determined in one of two ways. If the lease option price was set less than 12 months prior to origination, the loan-to-value ratio of the related mortgage loan is based on the lower of the appraised value at the time of origination of the mortgage loan and the sale price of the related mortgaged property. If the lease option price was set at least 12 months or more prior to origination, the loan-to-value ratio of the related mortgage loan is based on the appraised value of the related mortgaged property at the time of origination.

Our underwriting guidelines for first lien mortgage loans have the following categories and criteria for grading the potential likelihood that an applicant will satisfy the repayment obligations of a mortgage loan:

Summary of Principal Underwriting Guidelines(1)

	AA Risk	**A+Risk**	**A-Risk**	**B Risk**	**C Risk**	**C-Risk**
Existing and prior mortgage history	No 30-day late payments w/in last 12 months; must have an LTV of 95% or less; no evidence of default in 3 years.	Maximum one 30-day late payment and no 60-day late payments w/in last 12 months; must have an LTV of 95% or less; no evidence of default in 3 years.	Maximum three 30-day late payments and no 60-day late payments w/in last 12 months; must have an LTV of 90% or less; no evidence of default in 3 years.	Maximum one 60-day late payment within last 12 months; must have an LTV of 85% or less; no evidence of default in 2 years.	Maximum one 90-day late payment within last 12 months; must have an LTV of 80% or less; no evidence of default in 1 year.	Maximum of two 90-day late payments and one 120-day late payment w/in last 12 months; must have an LTV of 70% or less; no current default.
Consumer credit	Minimum credit score of 500; LTVs over 80% have higher credit score minimums.	Minimum credit score of 500; LTVs over 80% have higher credit score minimums.	Minimum credit score of 500; LTVs over 80% have higher credit score minimums.	Minimum credit score of 500; LTVs over 80% have higher credit score minimums.	Minimum credit score of 500; LTVs over 75% have higher credit score minimums.	Minimum credit score of 500.
Bankruptcy filings	Generally, no Chapter 7 or 13 Bankruptcy discharged in last 2 years.	Generally, no Chapter 7 or 13 Bankruptcy discharged in last 2 years.	Generally, no Chapter 7 Bankruptcy discharged in the last 2 years or any	Generally, no Chapter 7 Bankruptcy discharged in last 18 months or Chapter	Generally, no Chapter 7 Bankruptcy discharged in the last year or any	Chapter 7 discharged and Chapter 13 discharged or discharged at

			Chapter 13 Bankruptcy filed in the last 2 years.	13 Bankruptcy filed in the last 18 months.	Chapter 13 Bankruptcy filed in the last year.	funding.
Total debt service-to-income ratio	50% to 55%	50% to 55%	50% to 55%	50% to 55%	55%	55%
Maximum loan-to-value ratio (LTV)(2):						
Owner occupied:	95%	95%	90%	85%	80%	70%
Single family; detached PUD, or 2-unit:						
Owner occupied:	90%	90%	85%	80%	75%	65%
Condo/three-to-four unit:						
Nonowner occupied:	85%	85%	80%	75%	70%	60%

(1) The letter grades applied to each risk classification reflect our internal standards and do not necessarily correspond to the classifications used by other mortgage lenders.

(2) The maximum LTV set forth in the table is for borrowers providing full documentation. The LTV is reduced 5% for stated income applications, if applicable.

Interest Only ARM Program

For our Interest Only ARM Program, which attracts a higher credit quality borrower, we assess the borrower s mortgage repayment history, any incidents of bankruptcy, mortgage default or major derogatory credit, and we require a minimum credit score of 660, which is substantially higher than our traditional product requirements. This program is restricted to owner-occupied properties and second homes, single units, two units, condominiums or detached planned unit developments (PUDs), with no rural or unique properties allowed. We have limitations on loan amount, loan-to-value ratio, income documentation type, and the amount of cash out allowed on refinances. We assign a unique 4-level grade classification based on the credit score range for the primary borrower. The debt ratio is calculated at 3% higher than the start rate and the program requires verified liquid reserves. The loan term is 25 years with an option for interest only payments the first 10 years, converting to a 15-year fully amortized ARM in years 11 through 25.

Niche or Special Programs

We have several programs that we have designated as niche or special programs. These programs are the Special Jumbo Product, the 80/20 Combo Product and the 100% High LTV Product. In general, all of these programs require the borrower to have an excellent mortgage history over the last 12 months. In addition to credit score minimums, these programs require a more in-depth analysis of consumer credit, and both the Special Jumbo Product and the 100% High LTV have requirements for verification of liquid reserves. Overall the minimum credit score for these products is 600, although the 80/20 Combo Product allows a minimum credit score of 580 with other restrictions and limitations. Maximum loan amounts or combined loan amounts on these products range from $600,000 to $1,000,000. Higher loan amounts have higher credit score minimums and are subject to other restrictions and limitations.

Home Saver Program

We had established a sub-category of our C- credit grade, which was eliminated from our program offerings in mid-2003, for borrowers faced with at least one of the following credit scenarios: (i) the borrower had an existing mortgage that was currently in foreclosure; (ii) the borrower was subject to a notice of default filing or (iii) the borrower had a serious mortgage delinquency for more than one 120-day period in the prior 12 months or was more than 90 days late at the time of funding. This sub-category was known as our Home Saver Program. The Home Saver Program was available only to Full Documentation borrowers and permitted a maximum LTV ratio of 65% and a maximum debt service-to-income ratio of 55%. The maximum loan amount was $300,000 and all derogatory credit report items must have been brought current or paid with the loan proceeds. A maximum of 3% of the loan proceeds was allowed to the borrower in cash. If the borrower was in an open Chapter 13 bankruptcy, the bankruptcy must have been discharged with the proceeds of the loan. For the year ended December 31, 2003, Home Saver loans accounted for less than 1% of total loan originations and purchases. We no longer originate loans under this program.

Exceptions

The categories and criteria described in our underwriting guideline table above are guidelines only. On a case-by-case basis, we may determine that an applicant warrants a LTV ratio exception, a debt service-to-income ratio exception, or another exception. We may allow such an exception if the application reflects certain compensating factors such as low LTV, a maximum of one 30-day late payment on all mortgage loans during the last 12 months, and stable employment or ownership of the current residence. We may also allow an exception if the applicant places in escrow a down payment of at least 20% of the purchase price of the mortgage property or if the new loan reduces the applicant s monthly aggregate mortgage payment. Our automated credit grading system aids in identifying and managing underwriting exceptions. Certain of our loan programs and risk grade classifications limit the approval of exceptions to higher loan approval authority levels. For 2003, our overall underwriting exception rate was 14.9% on total production of $27.4 billion. For 2002, our overall underwriting exception rate was 18.5% on total production of $14.2 billion.

We evaluate our underwriting guidelines on an ongoing basis and periodically modify them to reflect our current assessment of various underwriting issues. We also maintain separate underwriting guidelines appropriate to our non-conforming second lien mortgage loans and adopt new underwriting guidelines appropriate to new loan products we may offer.

Loan Production by Borrower Risk Classification

The following table sets forth information concerning the characteristics of our fixed-rate and adjustable-rate loan production by borrower risk classification for the periods shown:

	For the Quarters Ended			
	March 31, 2003	**June 30, 2003**	**September 30, 2003**	**December 31, 2003**
AA Risk Grade:				
Percent of total purchases and originations (1)	27.1%	63.2%	73.8%	70.3%
Combined weighted average initial loan-to-value ratio	83.8	84.5		