IMPAC MORTGAGE HOLDINGS INC
Form 10-Q
May 11, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2009

or

o 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: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	**33-0675505** (I.R.S. Employer Identification No.)

19500 Jamboree Road, Irvine, California 92612

(Address of principal executive offices)

(949) 475-3600

(Registrant s telephone number, including area code)

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) Yes o No x

There were 7,618,146 shares of common stock outstanding as of May 8, 2009.

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IMPAC MORTGAGE HOLDINGS, INC.

FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	March 31, 2009 (Unaudited)	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 38,313	$ 46,215
Restricted cash	1,247	1,243
Short-term investments	5,041	
Trust assets		
Investment securities available-for-sale	1,322	2,068
Securitized mortgage collateral	5,505,729	5,894,424
Derivative assets	37	37
Real estate owned (REO)	440,916	599,084
Total trust assets	5,948,004	6,495,613
Assets of discontinued operations	137,947	141,053
Other assets	29,114	31,393
Total assets	$ 6,159,666	$ 6,715,517
LIABILITIES		
Trust liabilities		
Securitized mortgage borrowings	$ 5,691,028	$ 6,193,984
Derivative liabilities	232,357	273,584
Total trust liabilities	5,923,385	6,467,568
Trust preferred securities	11,090	15,403
Liabilities of discontinued operations	209,865	217,241
Other liabilities	6,321	6,053
Total liabilities	6,150,661	6,706,265
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Series-A junior participating preferred stock, $0.01 par value; 2,500,000 shares authorized; none issued and outstanding		
Series-B 9.375% cumulative redeemable preferred stock, $0.01 par value; liquidation value $50,000; 2,000,000 shares authorized, issued and outstanding	20	20
Series-C 9.125% cumulative redeemable preferred stock, $0.01 par value; liquidation value $111,765; 5,500,000 shares authorized; 4,470,600 shares issued and outstanding as of March 31, 2009 and December 31, 2008.	45	45

Common stock, $0.01 par value; 200,000,000 shares authorized; 7,618,146 shares issued and outstanding as of March 31, 2009 and December 31, 2008		76		76
Additional paid-in capital		1,178,569		1,177,697
Net accumulated deficit:				
Cumulative dividends declared		(815,077)		(815,077)
Retained deficit		(354,628)		(353,509)
Net accumulated deficit		(1,169,705)		(1,168,586)
Total stockholders equity		9,005		9,252
Total liabilities and stockholders equity	$	6,159,666	$	6,715,517

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(Unaudited)

	For the Three Months Ended March 31, 2009	For the Three Months Ended March 31, 2008
INTEREST INCOME	$ 712,649	$ 271,955
INTEREST EXPENSE	709,007	264,606
Net interest income	3,642	7,349
NON-INTEREST INCOME:		
Change in fair value of net trust assets, excluding REO	132,930	3,528
Losses from real estate owned	(128,201)	(4,256)
Non-interest income- net trust assets	4,729	(728)
Change in fair value of trust preferred securities	12	(4,023)
Real estate advisory fees		3,845
Other	5,508	1,898
Total non-interest income	10,249	992
NON-INTEREST EXPENSE:		
General and administrative	4,339	3,988
Personnel expense	6,278	2,330
Total non-interest expense	10,617	6,318
Net earnings from continuing operations before income taxes	3,274	2,023
Income tax expense from continuing operations	1,998	6,526
Net earnings (loss) from continuing operations	1,276	(4,503)
Net (loss) earnings from discontinued operations, net of tax	(2,395)	688
Net loss	(1,119)	(3,815)
Cash dividends on cumulative redeemable preferred stock		(3,722)
Net loss attributable to common stockholders	$ (1,119)	$ (7,537)
Net loss per common share - basic and diluted:		
Earnings (loss) from continuing operations	$ 0.17	$ (1.08)
(Loss) earnings from discontinued operations	(0.32)	0.09
Net loss per share	$ (0.15)	$ (0.99)

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Three Months Ended March 31, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings (loss) from continuing operations	$ 1,276	$ (4,503)
Losses from real estate owned	128,201	4,256
Amortization and impairment of deferred charge	1,998	6,526
Amortization and impairment of mortgage servicing rights		647
Change in fair value of net trust assets, excluding REO	(190,793)	(29,430)
Change in fair value of trust preferred securities	(12)	4,023
Accretion of interest income and expense	197,003	101,224
Stock-based compensation	779	197
Net cash (used in) provided by operating activities of discontinued operations	(2,773)	88,984
Net change in other assets and liabilities	(12,716)	(24,034)
Net cash provided by operating activities	**122,963**	**147,890**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in securitized mortgage collateral	197,532	612,291
Net change in mortgages held-for-investment	390	15
Purchase of premises and equipment	(194)	
Purchase of short-term investments	(5,041)	
Net principal change on investment securities available-for-sale	1,746	538
Proceeds from the sale of real estate owned	161,332	74,961
Net cash provided by investing activities of discontinued operations	2,657	7,040
Net cash provided by investing activities	**358,422**	**694,845**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Settlement of trust preferred securities	(3,750)	
Repayment of securitized mortgage borrowings	(479,081)	(739,536)
Preferred stock dividends paid		(3,722)
Net cash used in financing activities of discontinued operations	(6,209)	(92,942)
Net cash used in financing activities	**(489,040)**	**(836,200)**
Net change in cash and cash equivalents	(7,655)	6,535
Cash and cash equivalents at beginning of period	46,228	26,462
Cash and cash equivalents at end of period - Continuing Operations	38,313	32,901
Cash and cash equivalents at end of period - Discontinued Operations	260	96
Cash and cash equivalents at end of period	$ 38,573	$ 32,997
NON-CASH TRANSACTIONS (Continuing and Discontinued Operations):		
Transfer of loans held-for-sale and held-for-investment to real estate owned	$ 3,821	$
Transfer of securitized mortgage collateral to real estate owned	118,851	209,801

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data or as otherwise indicated)

Note A Summary of Business and Significant Accounting Policies

1. Business Summary and Financial Statement Presentation

Business Summary

Impac Mortgage Holdings, Inc. (the Company or IMH) is a Maryland corporation incorporated in August 1995 and has the following subsidiaries: IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG), and Impac Funding Corporation (IFC), together with its wholly-owned subsidiaries Impac Secured Assets Corp. (ISAC) and Impac Commercial Capital Corporation (ICCC).

In the first quarter of 2009, the Company created a new subsidiary, Integrated Real Estate Service Corporation (IRES), which will include mortgage and real estate related fee-based businesses.

The Company s operations include its continuing and discontinued operations. The continuing operations primarily include the long-term mortgage portfolio (residual interests in securitizations reflected as net trust assets and liabilities in the consolidated balance sheets), and to a lesser extent includes the mortgage and real estate related fee-based businesses. The discontinued operations include the former non-conforming mortgage and retail operations conducted by IFC, commercial operations conducted by ICCC, and warehouse lending operations conducted by IWLG.

During the first quarter of 2009, the Company revoked its election to be taxed as a REIT, effective January 1, 2009. As a result of revoking this election, the Company will be subject to income taxes as a regular corporation. As of December 31, 2008, the Company had federal and California net operating loss carryforwards of $406.8 million and $532.2 million, respectively.

The information contained throughout this document is presented on a continuing basis, unless otherwise stated.

Financial Statement Presentation

The accompanying unaudited consolidated financial statements of IMH and its subsidiaries (as defined above) have been prepared in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three-month period ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. These interim period condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the United States Securities and Exchange Commission (SEC).

All significant inter-company balances and transactions have been eliminated in consolidation. In addition, certain amounts in the prior periods consolidated financial statements have been reclassified to conform to the current year presentation.

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with GAAP. The items affected by management s estimates and assumptions include the valuation of trust assets and liabilities, the valuation of repurchase liabilities related to sold loans, the valuation of trust preferred securities, and the valuation of loans held-for-sale. Actual results could differ from those estimates.

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Market Conditions and Status of Operations

During the first quarter of 2009, the Company continues to be significantly and negatively affected by the deteriorating real estate market and the weak economic environment. These factors have led to continued deterioration in the quality of the Company s long-term mortgage portfolio, as evidenced by the continued increases in delinquencies, foreclosures and credit losses. Existing conditions are unprecedented and inherently involve significant risks and uncertainty to the Company. The current market conditions have led to fewer sources of liquidity available to the Company to operate its business. These conditions continue to adversely affect the performance of the Company s long-term mortgage portfolio, including significant losses on real estate owned.

During the quarter, the Company has initiated various mortgage and real estate related fee-based businesses, including loan modifications, real estate disposition, monitoring and surveillance services, real estate brokerage and lending services and escrow services, and has begun to generate revenues from these businesses. However, since these businesses are newly formed, there remains uncertainty about their future success.

In January 2009, the Company fully satisfied $25.0 million in outstanding trust preferred securities of Impac Capital Trust #2 for $3.75 million.

In May 2009, the Company exchanged an aggregate of $51.3 million in trust preferred securities of Impac Capital Trusts #1 and #3 for junior subordinated notes with an aggregate principal balance of $62.0 million, with a maturity date in March 2034. Under the terms of the exchange, the interest rates for each note are reduced from 8.01 percent to 2.00 percent through 2013 and increase 1.00 percent per year through 2017. Starting in 2018, the interest rates become variable at 3-month LIBOR plus 375 basis points. In connection with the exchange, the Company paid a fee of $0.5 million.

In March 2009, the Company announced that it will continue to defer interest payments on its remaining $12.0 million in trust preferred securities of Impac Capital Trust #4. At March 31, 2009, interest that has been deferred and unpaid related to these trust preferred securities was $0.4 million. The Company has the right to defer payments of interest for a period of up to 20 consecutive quarterly interest payment periods for Impac Capital Trust #4. During the deferral period, interest on the trust preferred securities will bear additional interest at a rate equal to the coupon rate on the respective security. Unless the Company again elects to defer interest payments, the Company is required to pay all accrued interest together with the additional interest at the next payment date.

In March 2009, the Company announced that it will not be paying dividends for the quarter ended March 31, 2009 on the Company s 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock. The Company has no present intentions to pay dividends on the Series B and Series C Preferred Stock, however, unpaid dividends on the preferred stock will accumulate. Until such time as all cumulative dividends on the preferred stock are paid, the Company may not pay dividends on, nor redeem, repurchase or make any distribution on, shares of its common stock. At March 31, 2009 cumulative unpaid dividends on preferred stock totaled $7.4 million. If the Company does not pay dividends on its preferred stock for six or more quarterly periods (whether or not consecutive), preferred stockholders will be entitled to elect two additional directors to the Company s Board of Directors to serve until the Company is current on all dividends.

2. Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Effective January 1, 2009, the Company adopted EITF No. 08-5, Issuer s Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement (EITF 08-5). EITF 08-5 addresses whether issuer s of liabilities should consider the effect of the third-party credit enhancement when measuring the liability at fair value under FASB Statement No. 157 Fair Value Measurements (SFAS 157). EITF 08-5 requires that the issuer of a liability with a third-party credit enhancement that is inseparable from the liability shall not include the effect of the credit enhancement in the fair value measurement of the liability. The guidance in EITF 08-5 is effective in the first reporting period beginning on or after December 15, 2008, with the effect of initially applying its guidance being included in the change in fair value in the period of adoption. The adoption of EITF 08-5 did not have a significant impact on the Company s consolidated financial statements.

Effective, January 1, 2009, application of SFAS 157 to nonfinancial assets and liabilities is required. As a result of the adoption of SFAS 157 for nonfinancial assets and liabilities, the Company has included additional disclosures as of and for the three months ended March 31, 2009 for nonrecurring fair value measurements related to its nonfinancial assets and liabilities.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued three statements of position (FSP) related to fair value measurements:

• FSP No. FAS 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4)

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- FSP No. FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1)

- FAS No. FAS 115-2 and FAS 124-2 Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2)

FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of market activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP emphasizes that even if there has been a significant decrease in the volume and level of market activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. The Company is in the process of determining the impact adopting FSP 157-4 will have on its consolidated financial statements.

FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments , to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting , to require those disclosures in summarized financial information at interim reporting periods. FSP FAS 107-1 and APB 28-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a significant effect on its consolidated financial statements.

FSP FAS 115-2 and FAS 124-2 amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. For debt securities, the statement requires that an entity assess whether it (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the Company would be required to recognize other-than-temporary impairment. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a significant effect on its consolidated financial statements.

In April 2008, the FASB voted to eliminate QSPEs from the guidance in FASB Statement No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS 140). While the revised standard has not been finalized and the FASB s proposals will be subject to a public comment period, this change may have a significant impact on the Company s consolidated financial statements as it may lose sales treatment for assets previously sold to QSPEs, as well as for future sales. An effective date for any proposed revisions has not been determined by the FASB. As of March 31, 2009, the current principal balance of QSPEs to which the Company, acting as principal, has transferred assets and received sales treatment were $643.2 million. The Company s investment in these QSPE s consists of residual interests accounted for as investment securities available-for-sale in its consolidated balance sheets. The Company is still evaluating the impact of this potential change.

In connection with the aforementioned proposed changes to SFAS 140, the FASB also is proposing three key changes to the consolidation model in FASB Interpretation No 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46R). First, the FASB has proposed to include former QSPEs in the scope of FIN 46R. In addition, the FASB supports amending FIN 46R to change the method of analyzing which party to a VIE should consolidate the VIE to a primarily qualitative determination of control instead of today s risks and rewards model. Finally, the proposed amendment is expected to require all VIEs and their primary beneficiaries to be reevaluated quarterly. The previous rules required reconsideration only when specified reconsideration events occurred. As of March 31, 2009, the only significant unconsolidated VIEs are the QSPE s described in the preceding paragraph.

3. Legal Proceedings

The Company is party to litigation and claims which are normal in the course of our operations.

In the matter of Sheldon Pittleman v. Impac Mortgage Holdings, Inc. et al filed in the United States district Court, Central district California against IMH and several of its senior officers a Third Amended Complaint was filed. A motion to dismiss was filed by the defendants on December 15, 2008. On March 10, 2009, the court sustained the defendants motion to dismiss without leave to amend. The Plaintiffs have filed a Notice of Appeal of the Order Granting the Motion to Dismiss With Prejudice and the Judgment thereon on April 7, 2009.

Please refer to IMH s report on Form 10-K for the year ended December 31, 2008 for a description of other litigation and claims.

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We believe that we have meritorious defenses to the above claims and intend to defend these claims vigorously and as such the Company believes the final outcome of such matters will not have a material adverse effect on our financial condition or results of operations. Nevertheless, litigation is uncertain and we may not prevail in the lawsuits and can express no opinion as to their ultimate resolution. An adverse judgment in any of these matters could have a material adverse effect on us.

4. Income Taxes and Deferred Charge

During the first quarter of 2009, the Company revoked its election to be taxed as a REIT, effective January 1, 2009. As a result of revoking this election, the Company will be subject to income taxes as a regular corporation.

Prior to January 1, 2009, the Company operated as a REIT under the requirements of the Internal Revenue Code. Requirements for qualification as a REIT included various restrictions on ownership of IMH s stock, requirements concerning distribution of taxable income and certain restrictions on the nature of assets and sources of income.

As of December 31, 2008, the Company had federal and California net operating loss carryforwards of $406.8 million and $532.2 million, respectively. As of December 31, 2008, the Company s taxable REIT subsidiary had an estimated federal net operating loss tax carryforward of $295.1 million. The federal net operating loss carryforward of the Company s taxable REIT subsidiary, utilization of which may be limited to the Company s taxable REIT subsidiary, begins to expire in the year 2027. As of December 31, 2008, the Company and the Company s taxable REIT subsidiary had net deferred tax assets of approximately $547.9 million and $100.0 million, respectively. The Company recorded a full valuation allowance against the net deferred tax assets as it believes it is more likely than not that the net deferred tax assets will not be recoverable.

In accordance with Accounting Research Bulletin No. 51, Consolidated Financial Statements, the Company records a deferred charge representing the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is included in other assets in the accompanying consolidated balance sheets and is amortized as a component of income tax expense in the accompanying consolidated statements of operations over the estimated life of the mortgages retained in the securitized mortgage collateral. The Company recorded a tax expense of $2.0 million and $6.5 million for the three months ended March 31, 2009 and 2008, respectively. The tax expense is the result of the amount of the deferred charge amortized and/or impaired resulting from credit losses, which does not result in any tax liability required to be paid.

Note B Fair Value of Financial Instruments

The use of fair value to measure the Company s financial instruments is fundamental to its consolidated financial statements and is a critical accounting estimate because a substantial portion of its assets and liabilities are recorded at estimated fair value.

The application of fair value estimates may be on a recurring or non-recurring basis depending on the accounting principles applicable to the specific asset or liability or whether management has elected to carry the item at its estimated fair value.

The following tables present, the Company s assets and liabilities that are measured at fair value on a recurring basis, including financial instruments for which the Company has elected the fair value option at March 31, 2009 and December 31, 2008, based on the fair value hierarchy of SFAS 157:

	Recurring Fair Value Measurements As of March 31, 2009		
	Level 1	**Level 2**	**Level 3**
Assets			
Investment securities available-for-sale	$	$	$ 1,322
Securitized mortgage collateral			5,505,729
Total assets at fair value	$	$	$ 5,507,051
Liabilities			
Securitized mortgage borrowings	$	$	$ 5,691,028
Derivative liabilities, net (1)			232,320
Trust preferred securities			11,090
Total liabilities at fair value	$	$	$ 5,934,438

(1) Derivative liabilities, net includes $37 thousand in derivative assets and $232.4 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

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	Recurring Fair Value Measurements As of December 31, 2008		
	Level 1	Level 2	Level 3
Assets			
Investment securities available-for-sale	$	$	$ 2,068
Securitized mortgage collateral			5,894,424
Total assets at fair value	$	$	$ 5,896,492
Liabilities			
Securitized mortgage borrowings	$	$	$ 6,193,984
Derivative liabilities, net (1)			273,547
Trust preferred securities			15,403
Total liabilities at fair value	$	$	$ 6,482,934

(1) Derivative liabilities, net includes $37 thousand in derivative assets and $273.6 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

Level 3 assets and liabilities were 100 percent of total assets at fair value and total liabilities at fair value at March 31, 2009 and December 31, 2008, respectively.

The following tables present a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2009 and 2008:

	Level 3 Recurring Fair Value Measurements For the quarter ended March 31, 2009				
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Derivative liabilities, net	Trust preferred securities
Fair value, December 31, 2008	$ 2,068	$ 5,894,424	$ (6,193,984)	$ (273,547)	$ (15,403)
Total gains (losses) included in earnings:					
Interest income	95	476,709			
Interest expense			(673,807)		
Change in fair value of net trust assets, excluding REO	905	(549,021)	697,203	(16,157)	
Change in fair value of trust preferred securities					12
Total gains (losses) included in earnings	1,000	(72,312)	23,396	(16,157)	12
Transfers in and/or out of Level 3					
Purchases, issuances and settlements	(1,746)	(316,383)	479,560	57,384	4,301
Fair value, March 31, 2009	$ 1,322	$ 5,505,729	$ (5,691,028)	$ (232,320)	$ (11,090)
Unrealized (losses) gains still held (1)	$ (897)	$ (8,100,780)	$ 9,256,884	$ (235,173)	$ 54,380

(1) Represents the amount of unrealized (losses) gains relating to assets and liabilities classified as Level 3 that are still held at March 31, 2009.

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	Level 3 Recurring Fair Value Measurements For the quarter ended March 31, 2008			
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Trust preferred securities
Fair value, January 1, 2008	$ 15,248	$ 782,574	$ (767,704)	$ (40,952)
Total gains (losses) included in earnings:				
Interest income	200	(88)		
Interest expense			(8,901)	(154)
Change in fair value of net trust assets, excluding REO	(4,290)	(248,982)	287,104	
Change in fair value of trust preferred securities				(4,023)
Total gains (losses) included in earnings	(4,090)	(249,070)	278,203	(4,177)
Transfers in and/or out of Level 3 (1)		526,469	(562,467)	
Purchases, issuances and settlements	(537)	(93,015)	53,573	
Fair value, March 31, 2008	$ 10,621	$ 966,958	$ (998,395)	$ (45,129)
Unrealized (losses) gains still held (2)	$ (2,461)	$ (386,800)	$ 419,861	$ 54,115

(1) Transfers in and/or out of Level 3 are reflected using values as of the beginning of the period.

(2) Represents the amount of unrealized (losses) gains relating to assets and liabilities classified as Level 3 that are still held at March 31, 2008.

Based on the lack of observable market data resulting from inactive markets, recurring fair value measurements designated as Level 3 have increased significantly at March 31, 2009 compared to March 31, 2008, resulting from transfers from Level 2 to Level 3 during 2008.

FASB Statement No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) permits fair value accounting to be elected for certain assets and liabilities on an individual contract basis at the time of acquisition or under certain other circumstances referred to as remeasurement event dates. For those items for which fair value accounting is elected, changes in fair value will be recognized in earnings, and fees and costs associated with the origination or acquisition of such items will be recognized as incurred rather than deferred. In addition, SFAS 159 allows application of the Statement s provisions to eligible items existing at the effective date, and management has elected to apply SFAS 159 to certain of those items as discussed below.

The following is a description of the measurement techniques for items recorded at fair value on a recurring basis and a non-recurring basis.

Recurring basis

Investment securities available-for-sale The Company elected to carry all of its investment securities available-for-sale at fair value. The investment securities consist primarily of non-investment grade mortgage-backed securities. The fair value of the investment securities are measured based upon the Company s expectation of inputs that other market participants would use. Such assumptions include judgments about the underlying collateral, prepayment speeds, credit losses, forward interest rates and certain other factors. Given the market disruption and lack of observable market data as of March 31, 2009 and December 31, 2008, the fair value of the investment securities available-for-sale were measured using significant internal expectations of market participants assumptions.

Securitized mortgage collateral The Company elected to carry all of its securitized mortgage collateral at fair value. These assets consist primarily of non-conforming mortgage loans securitized between 2002 and 2007. Fair value measurements are based on the Company s estimated cash flow models, non-binding quoted prices for the underlying bonds and yield analysis. The Company s assumptions include its expectations of inputs that other market participants would use in pricing these assets. These assumptions include judgments about the underlying collateral, prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors. As of March 31, 2009, securitized mortgage collateral had an unpaid principal balance of $13.6 billion, compared to an estimated fair value of $5.5 billion. The aggregate unpaid principal balance exceeds the fair value by $8.1 billion at March 31, 2009. As of March 31, 2009, the unpaid principal balance of loans 90 days or more past due was $3.0 billion compared to an estimated fair value of $1.0 billion. The aggregate unpaid principal balances of loans 90 days or more past due exceed the fair value by $2.0 billion at March 31, 2009.

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Securitized mortgage borrowings The Company elected to carry all of its securitized mortgage borrowings at fair value. These borrowings consist of individual tranches of bonds issued by securitization trusts and are primarily backed by non-conforming mortgage loans. Fair value measurements include the Company s judgments about the underlying collateral assumptions such as prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors and are based upon non-binding quoted prices for the individual tranches of bonds, if available. As of March 31, 2009, securitized mortgage borrowings had an outstanding principal balance of $15.0 billion compared to an estimated fair value of $5.7 billion. The aggregate outstanding principal balance exceeds the fair value by $9.3 billion at March 31, 2009.

Trust preferred securities The Company elected to carry all of its trust preferred securities at fair value. These securities were measured based upon an analysis prepared by the Company, which considered the Company s own credit risk, including consideration of recent settlements with trust preferred debt holders, comparison to the terms and market prices of the Company s preferred stock and negotiations of revised terms of restructured trust preferred securities. As of March 31, 2009, trust preferred securities had an unpaid principal balance of $65.5 million compared to an estimated fair value of $11.1 million. The aggregate unpaid principal balance exceeds the fair value by $54.4 million at March 31, 2009.

Derivative assets and liabilities For non-exchange traded contracts, fair value is based on the amounts that would be required to settle the positions with the related counterparties as of the valuation date. Valuations of derivative assets and liabilities are based on observable market inputs, if available. To the extent observable market inputs are not available, fair values measurements include the Company s judgments about the future cash flows, forward interest rates and certain other factors, including counterparty risk. Additionally, these values also take into account the Company s own credit standing, to the extent applicable, thus included in the valuation of the derivative instrument is the value of the net credit differential between the counterparties to the derivative contract.

The following tables present changes in fair value of recurring fair value measurements for the three months ended March 31, 2009 and 2008, respectively:

Recurring Fair Value Measurements
Changes in Fair Value Included in Net Loss
For the three months ended March 31, 2009

			Change in Fair Value of		
	Interest Income (1)	**Interest Expense (1)**	**Net Trust Assets**	**Trust Preferred Securities**	**Total**
Investment securities available-for-sale	$ 95	$	$ 905	$	$ 1,000
Securitized mortgage collateral	476,709		(549,021)		(72,312)
Securitized mortgage borrowings		(673,807)	697,203		23,396
Derivative instruments			(16,157)(2)		(16,157)

Trust preferred securities								12		12
Total	**$**	**476,804**	**$**	**(673,807)**	**$**	**132,930**(3)	**$**	**12**	**$**	**(64,061)**

(1) Amounts represent interest income and interest expense accretion included in interest income and interest expense, respectively in the consolidated statement of operations.

(2) Included in this amount is $41.7 million in changes in the fair value of derivative instruments, offset by $57.9 million in cash payments from the securitization trusts for the three months ended March 31, 2009.

(3) For the three months ended March 31, 2009, change in the fair value of trust assets, excluding REO was $132.9 million. Excluded from the ($190.8) million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is $57.9 million in cash payments from the securitization trusts related to the Company s net derivative liabilities.

Recurring Fair Value Measurements
Changes in Fair Value Included in Net Loss
For the three months ended March 31, 2008

					Change in Fair Value of					
		Interest Income (1)		**Interest Expense (1)**		**Net Trust Assets**		**Trust Preferred Securities**		**Total**
Investment securities available-for-sale	$	200	$		$	(4,290)	$		$	(4,090)
Securitized mortgage collateral		(25,595)				(3,229,500)				(3,255,095)
Securitized mortgage borrowings				(75,675)		3,419,134				3,343,459
Derivative instruments						(181,816)(2)				(181,816)
Trust preferred securities				(154)				(4,023)		(4,177)
Total	$	(25,395)	$	(75,829)	$	3,528(3)	$	(4,023)	$	(101,719)

(1) Amounts represent interest income and interest expense accretion included in interest income and interest expense, respectively in the consolidated statement of operations.

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(2) Included in this amount is ($155.9) million in changes in the fair value of derivative instruments and $25.9 million in cash payments from the securitization trusts for the three months ended March 31, 2008.

(3) For the three months ended March 31, 2008, change in the fair value of trust assets, excluding REO was $3.5 million. Excluded from the $29.4 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is $25.9 million in cash payments from the securitization trusts related to the Company s net derivative liabilities.

In connection with the fair value accounting for investment securities available-for-sale and securitized mortgage collateral and borrowings, interest income and interest expense is recognized using effective yields, which are based, in part, on estimated fair values for these instruments. As the market s expectation of future credit losses has increased between periods, market participants have demanded higher yields, which have resulted in significant reductions in the fair values of these instruments. These reductions in fair value have significantly increased the effective yields used for purposes of recognizing interest income and interest expense on these instruments.

The change in fair value of the asset and liabilities above, excluding derivative instruments, are primarily due to the changes in credit risk. The change in fair value for derivative instruments is primarily due to the change in the forward LIBOR curve for the quarter.

Non-recurring basis

The Company is required to measure certain assets and liabilities at fair value from time-to-time. These fair value measurements typically result from the application of specific accounting pronouncements under GAAP. The fair value measurements are considered non-recurring fair value measurements under SFAS 157.

Loans held-for-sale - Loans held-for-sale for which the fair value option was not elected are carried at lower of cost or market (LOCOM). When available, such measurements are based upon what secondary markets offer for portfolios with similar characteristics, and are considered Level 2 measurements. If market pricing is not available, such measurements are significantly impacted by the Company s expectations of other market participants assumptions, and are considered Level 3 measurements. The Company utilizes internal pricing processes to estimate the fair value of loans held-for-sale, which is based on recent loan sales and estimates of the fair value of the underlying collateral. Loans held-for-sale, which are primarily included in assets of discontinued operations, are considered Level 3 fair value measurements at March 31, 2009 and December 31, 2008 based on the lack of observable market inputs.

Real estate owned - REO, which consists of residential real estate acquired in satisfaction of loans, is carried at net realizable value. Upon foreclosure, REO is adjusted to the estimated fair value of the residential real estate less estimated selling and holding costs, offset by expected mortgage insurance proceeds to be received, if any. Subsequently, REO is recorded at the lower of carrying value or estimated fair value less costs to sell. Fair values of REO are generally based on appraisals or market prices, and considered Level 2 measurements at March 31, 2009 and

December 31, 2008.

Lease liability In connection with the discontinuation of our non-conforming mortgage, retail mortgage, warehouse lending and commercial operations, a significant amount of office space that was previously occupied is no longer being used by the Company. The Company has subleased a significant amount of this office space. The Company has recorded a liability, included within discontinued operations, representing the fair value of the minimum lease payments over the remaining life of the lease, offset by the expected proceeds from sublet revenue related to this office space. This liability is based on the present value techniques that incorporate the Company s judgments about estimated sublet revenue and discount rates. Therefore, this liability is considered a Level 3 measurement at March 31, 2009 and December 31, 2008.

The following tables present the fair values of those financial assets measured at fair value on a non-recurring basis at March 31, 2009 and December 31, 2008:

	Non-recurring Fair Value Measurements As of March 31, 2009			Total Gains (Losses) For the Quarter Ended
	Level 1	**Level 2**	**Level 3**	**March 31, 2009**
Loans held-for-sale (1)			$ 101,830	$ (72)
REO (2)		342,789		(85,658)
Lease liability (3)			(6,800)	58

(1) Includes $0.4 million and $101.4 million of loans held-for-sale within continuing and discontinued operations, respectively at March 31, 2009.

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(2) Includes $336.8 million and $6.0 million in REO within continuing and discontinued operations, respectively at March 31, 2009. For the quarter ended March 31, 2009, losses of $85.7 million related to additional impairment write-downs, included $84.3 million and $1.4 million within continuing and discontinued operations, respectively.

(3) Amounts are included in discontinued operations.

	Non-recurring Fair Value Measurements As of December 31, 2008 Level 1	Level 2	Level 3	Total Losses For the Year Ended December 31, 2008
Loans held-for-sale (1)			$ 108,223	$ 45,960

(1) Includes $0.4 million and $107.8 million of loans held-for-sale within continuing and discontinued operations, respectively at December 31, 2008.

Note C Stock Options

The fair value of options granted, which is amortized to expense over the option vesting period, is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Three Months Ended March 31, 2009	2008
Risk-free interest rate		1.88% to 2.13%
Expected lives (in years)		3.25
Expected volatility (1)		87.3% - 89.9%
Expected dividend yield (2)		0.00%
Grant date fair value of share options		$7.14 - 7.76

(1) Expected volatilities are based on the historical volatility of the Company s stock over the expected option life.

(2) Expected dividend yield is zero because a dividend on the common stock was not probable over the expected life of the options granted during the quarters ended March 31, 2009 and 2008.

There were no stock options granted during the three months ended March 31, 2009.

The following table summarizes activity, pricing and other information for the Company s stock options for the three months ended March 31, 2009:

	Number of Shares	Weighted-Average Exercise Price ($)
Options outstanding at January 1, 2009	1,140,186	$ 37.18
Options granted		
Options exercised		
Options forfeited / cancelled	(500)	12.00
Options outstanding at March 31, 2009	1,139,686	$ 37.19
Options exercisable at March 31, 2009	295,760	$ 86.96

As of March 31, 2009, there was approximately $3.0 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plan. That cost is expected to be recognized over a weighted average period of 0.9 years.

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Note D Reconciliation of Earnings Per Share

The following table presents the computation of basic and diluted net earnings per share including the dilutive effect of stock options and cumulative redeemable preferred stock outstanding for the periods indicated:

	For the Three Months Ended March 31, 2009	2008
Numerator for basic earnings per share:		
Net earnings (loss) from continuing operations	$ 1,276	$ (4,503)
Net (loss) earnings from discontinued operations	(2,395)	688
Less: Cash dividends on cumulative redeemable preferred stock		(3,722)
Net loss attributable to common stockholders	$ (1,119)	$ (7,537)
Denominator for basic earnings per share:		
Basic weighted average number of common shares outstanding during the period	7,618	7,610
Denominator for diluted earnings per share:		
Diluted weighted average number of common shares outstanding during the period	7,618	7,610
Net effect of dilutive stock options		
Diluted weighted average common shares	7,618	7,610
Net loss per common share - basic and diluted:		
Earnings (loss) from continuing operations	$ 0.17	$ (1.08)
(Loss) earnings from discontinued operations	(0.32)	0.09
Net loss per share	$ (0.15)	$ (0.99)

For the three months ended March 31, 2009 and 2008, stock options to purchase 1.1 million and 1.3 million shares, respectively, were outstanding but not included in the above weighted average calculations because they were anti-dilutive.

Note E Segment Reporting

The Company has two reporting segments, the continuing operations and discontinued operations. The following tables present the selected financial data and operating results by reporting segments for the periods indicated:

	Continuing Operations	Discontinued Operations	Consolidated
Balance Sheet Items as of March 31, 2009:			
Securitized mortgage collateral	$ 5,505,729	$	$ 5,505,729
Loans held-for-sale	361	101,469	101,830
Total assets	6,021,719	137,947	6,159,666
Total liabilities	5,940,796	209,865	6,150,661
Total stockholders equity (deficit)	80,923	(71,918)	9,005

Balance Sheet Items as of December 31, 2008:						
Securitized mortgage collateral	$	5,894,424	$		$	5,894,424
Loans held-for-sale		454		107,769		108,223
Total assets		6,574,464		141,053		6,715,517
Total liabilities		6,489,024		217,241		6,706,265
Total stockholders equity (deficit)		85,440		(76,188)		9,252

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	Continuing Operations	Discontinued Operations	Consolidated