BULLDOG TECHNOLOGIES INC
Form 8-K
May 09, 2006

UNITED STATES SECURITIES AND

EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 OR 15(d) of The Securities Exchange Act of 1934

Date of Report (Date of earliest event reported) **May 4, 2006**

BULLDOG TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of incorporation)

000-50321

(Commission File Number)

980377543

(IRS Employer Identification No.)

301 11120 Horseshoe Way, Richmond, British Columbia, Canada V7A 5H7

(Address of principal executive offices and Zip Code)

(604) 271-8656

Registrant's telephone number, including area code

Not Applicable

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 5.02. Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers.

The Registrant announces that Scott Smith has resigned as a director of the Registrant, effective May 4, 2006.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

BULLDOG TECHNOLOGIES INC.

/s/ John Cockburn

By: John Cockburn

President, Chief Executive Officer, Secretary, and Director

Date: May 9, 2006

l Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The principal differences between conforming loans and non-conforming loans include applicable loan-to-value ratios, credit and income histories of the mortgagors, documentation required for approval of the mortgagors, type of properties securing the mortgage loans, loan sizes, and the mortgagors' occupancy status with respect to the mortgaged properties. Second mortgage loans are mortgage loans secured by a second lien on the property and made to borrowers owning single-family homes for the purpose of debt consolidation, home improvements, education and a variety of other purposes. Income is earned primarily from net interest income received by IMH on mortgage loans and mortgage-backed and other collateralized securities acquired and held in its portfolio. Mortgage loans and mortgage-backed and other collateralized securities are financed with capital, borrowings provided from CMOs, warehouse facilities, which are referred to as reverse repurchase agreements, and borrowings secured by mortgage-backed securities. IFC supports the investment objectives of the Long-Term Investment Operations by supplying the Long-Term Investment Operations mortgage loans and mortgage-backed securities at prices that are comparable to those available through investment bankers and other third parties. 3 Mortgage Loans Held in the Portfolio The Company originates loans through its network of conduit sellers and brokers, and invests a substantial portion of its portfolio in non-conforming mortgage loans and, to a lesser extent, second mortgage loans. The Company also purchases such loans from third parties for long-term investment and for resale. Management believes that non-conforming mortgage loans provide an attractive net earnings profile and produce higher yields without commensurately higher credit risks when compared with conforming mortgage loans. The Company primarily originates or purchases "A" or "A-" grade mortgage loans (collectively, "A Loans", as defined by the Company) and to a lesser extent "B" and "C" grade mortgage loans (collectively, "B/C Loans", as defined by the company). "A" grade loans generally have a Fair Isaac Credit Score ("FICO") of 620 or better and "A-" grade loans generally have a FICO score of 550 or better. The FICO was developed by Fair Isaac Co., Inc. of San Rafael, California. It is an electronic evaluation of past and present credit accounts on the borrower's credit bureau report. This includes all reported accounts as well as public records and inquiries. The following table summarizes the percentage of mortgage loans by credit grade in the long term investment portfolio for the periods shown. At At December 31, December 31, 2000 1999 ------------ ------------ "A" Loans............................ 90.3% 89.1% "B/C" Loans.......................... 9.7 10.9 ---------- 100.0% 100.0% ===== ===== The Company believes that a structural change in the mortgage banking industry has occurred which has increased demand for higher yielding non-conforming mortgage loans. This change has been caused by a number of factors, including: (1) investors' demand for higher-yielding assets due to historically low interest rates over the past few years, (2) increased securitization of high-yielding non-conforming mortgage loans by the investment banking industry, (3) quantification and development of standardized credit mortgage loans, and (4) increased competition in the securitization industry, which has reduced borrower interest rates and fees, thereby making non-conforming mortgage loans more affordable. Investments in Mortgage-Backed Securities Subsequent to 1997, the Company's investment strategy has been to only acquire or invest in mortgage-backed securities that are secured by mortgage loans underwritten and purchased by the Mortgage Operations. Prior to 1998, the Company acquired other collateralized securities secured by loans generated by third parties. In connection with the issuance of mortgage-backed securities by IFC in the form of real estate mortgage investment conduits ("REMICs"), IMH has and may retain senior or subordinated securities as regular interests on a short-term or long-term basis. Such securities or investments may subject the Company to credit, interest rate and/or prepayment risks. In general, subordinated classes of a particular series of securities bear all losses prior to the related senior classes. Losses in excess of expected losses at the time such securities are purchased would adversely affect the Company's yield on such securities and could result in the failure of the Company to recoup its initial investment. The Company may also acquire REMIC or CMO residual interests created through its own securitizations or those of third parties. See "--Mortgage Operations--Securitization and Sale Process," and "--Risk Factors--Value of Our Portfolio of Mortgage-Backed Securities May be Adversely Affected." Financing The Long-Term Investment Operations are primarily financed through the issuance of CMOs, short-term borrowings under reverse repurchase agreements, borrowings secured by mortgage-backed securities, and proceeds from the sale of capital stock. Refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for more information regarding the Company's financing arrangements. Collateralized Mortgage Obligations. As the Long-Term Investment Operations accumulates mortgage loans in its long-term investment portfolio, the Company may issue CMOs secured by such loans as a means of financing its Long-Term Investment Operations. The decision to issue CMOs is based on the Company's current and future investment needs, market conditions and other factors. For accounting and tax purposes, the mortgage loans financed through the issuance of CMOs are treated as assets of the Company, and the CMOs are treated as debt of the Company, when for accounting purposes the CMO qualifies as a financing arrangement. Each issue of CMOs is fully 4 payable from the principal and interest payments on the underlying mortgage loans collateralizing such debt, any cash or other collateral required to be pledged as a condition to receiving the desired rating on the debt, and any investment income on such collateral. The Long-Term Investment Operations earns the net interest spread between the interest income on the mortgage loans securing the CMOs and the interest and other expenses associated with the CMO financing. The net interest spread may be directly impacted by the levels of prepayment of the underlying mortgage loans and, to the extent each CMO class has variable rates of interest, may be affected by changes in short-term interest rates. When the Company issues CMOs for financing purposes, it seeks an investment grade rating for such CMOs by a nationally recognized rating agency. To secure such a rating, it is often necessary to pledge collateral in excess of the principal amount of the CMOs to be issued, or to obtain other forms of credit enhancements such as additional mortgage loan insurance. The need for additional collateral or other credit enhancements depends upon factors such as the type of collateral provided, the interest rates paid, the geographic concentration of the mortgaged property securing the collateral, and other criteria established by the rating agencies. The pledge of additional collateral reduces the capacity of the Company to raise additional funds through short-term secured borrowings or additional CMOs, and diminishes the potential expansion of its investment portfolio. As a result, the Company's objective is to pledge additional collateral for CMOs only in the amount required to obtain an investment grade rating for the CMOs by a nationally recognized rating agency. Total loss exposure to the Company is limited to the equity invested in the CMOs at any point in time. The Company believes that under prevailing market conditions an issuance of CMOs receiving other than an investment grade rating would require payment of an excessive yield to attract investors. The Company's CMOs typically are structured as one-month London interbank offered rate ("LIBOR") "floaters" and fixed rate securities with interest payable monthly. Interest rates on adjustable rate CMOs range from 0.18% to 3.60% over one-month LIBOR and from 6.65% to 7.25% on fixed rate CMOs depending on the class of the CMOs issued. The CMOs are guaranteed for the holders by a mortgage loan insurer, giving the CMOs the highest rating established by a nationally recognized rating agency. Reverse Repurchase Agreements. The Company has reverse repurchase agreements at interest rates that are consistent with the Company's financing objectives. A reverse repurchase agreement, although structured as a sale and repurchase obligation, acts as a financing vehicle under which the Company effectively pledges its mortgage loans and mortgage securities as collateral to secure a short-term loan. Generally, the other party to the agreement makes the loan in an amount equal to a percentage of the market value of the pledged collateral. At the maturity of the reverse repurchase agreement, the Company is required to repay the loan and correspondingly receives back its collateral. Under reverse repurchase agreements, the Company retains the instruments of beneficial ownership, including the right to distributions on the collateral and the right to vote on matters as to which certificate holders vote. Upon a payment default under such agreements, the lending party may liquidate the collateral. The Company's borrowing agreements require the Company to pledge cash, additional mortgage loans or additional securities backed by mortgage loans in the event the market value of existing collateral declines. The Company may be required to sell assets to reduce its borrowings to the extent that cash reserves are insufficient to cover such deficiencies in collateral. To reduce its exposure to the credit risk of reverse repurchase agreement lenders, the Company enters into such agreements with several different parties and follows its own credit exposure procedures. The Company monitors the financial condition of its reverse repurchase agreement lenders on a regular basis, including the percentage of mortgage loans that are the subject of reverse repurchase agreements with a single lender. See "--Risk Factors--Inability to Generate Liquidity May Adversely Affect Our Operations." Borrowings Secured by Mortgage-Backed Securities. The Company finances a portion of its mortgage-backed securities portfolio with principal only notes. The notes represent senior or subordinated interests in trust funds primarily consisting of a pool of mortgage loans. The notes represent non-recourse obligations of the Company. Other Mortgage-Backed Securities. As an additional alternative for the financing of its Long-Term Investment Operations, the Company may issue other mortgage-backed securities. The Company may issue mortgage pass-through certificates representing an undivided interest in pools of mortgage loans. The holders of mortgage pass-through certificates receive their pro rata share of the principal payments made on a pool of mortgage loans and 5 interest at a pass-through interest rate that are fixed at the time of offering. The Company may retain up to a 100% undivided interest in a significant number of the pools of mortgage loans underlying such pass-through certificates. The retained interest, if any, may also be subordinated so that, in the event of a loss, payments to certificate holders will be made before the Company receives its payments. Unlike the issuance of CMOs, the issuance of mortgage pass-through certificates will not create an obligation of the Company to security holders in the event of borrower default. However, as in the case of CMOs, the Company may be required to obtain various forms of credit enhancements in order to obtain an investment grade rating for issues of mortgage pass-through certificates by a nationally recognized rating agency. Mortgage Operations The Mortgage Operations, conducted by IFC and Impac Lending Group ("ILG"), a division of IFC, purchases primarily non-conforming mortgage loans and, to a lesser extent, second mortgage loans from its network of third party correspondent sellers, wholesale brokers and retail customers. IFC is the Mortgage Operations and includes correspondent business along with wholesale and retail business from ILG. IFC subsequently securitizes and sells loans to permanent investors, including the Long-Term Investment Operations. All mortgage loans originated or purchased by IFC will be made available for sale to IMH at prices that are comparable to those available through third parties at the date of sale and subsequent transfer to IMH. IMH owns all of the preferred stock of, and 99% of the economic interest in, IFC, while Joseph R. Tomkinson, Chairman and Chief Executive Officer, William S. Ashmore, President, and Richard J. Johnson, Executive Vice President and Chief Financial Officer, are the holders of all of the outstanding voting stock of, and 1% of the economic interest in, IFC. As of December 31, 2000, IFC maintained relationships with 263 correspondent sellers and 983 wholesale brokers. Correspondents originate and close mortgage loans under IFC's mortgage loan programs on a flow (loan-by-loan) basis or through bulk sale commitments. Correspondents include savings and loan associations, commercial banks, mortgage bankers and mortgage brokers. ILG began operations in January 1999 and markets, underwrites, processes and funds mortgage loans for both of the Company's wholesale and retail customers. Through the wholesale division, ILG allows mortgage brokers to work directly with the Company to originate, underwrite and fund their mortgage loans. Many of the Company's wholesale customers cannot conduct business with the Mortgage Operations as correspondent sellers because they do not meet the higher net worth requirements. Through the retail division, ILG markets mortgage loans directly to the public. Both the wholesale and retail divisions offer all of the loan programs, including Progressive Series and Progressive Express, that are offered by IFC. IFC can compete effectively with other non-conforming mortgage loan conduits through its efficient loan purchasing process, flexible purchase commitment options and competitive pricing and by designing non-conforming mortgage loans to suit the needs of its correspondent loan originators and their borrowers, which are intended to provide sufficient credit quality to its investors. In addition to earnings generated from ongoing securitizations and sales to third-party investors, the Mortgage Operations supports the Long-Term Investment Operations of the Company by supplying IMH with non-conforming mortgage loans and securities backed by such loans. As a non-conforming mortgage loan conduit, IFC acts as an intermediary between the originators of mortgage loans that do not currently meet the guidelines for purchase by government-sponsored entities that guarantee mortgage-backed securities (i.e. Fannie Mae and Freddie Mac) and permanent investors in mortgage-backed securities secured by or representing an ownership interest in such mortgage loans. IFC also acts as a bulk purchaser of primarily non-conforming mortgage loans. The Company believes that non-conforming mortgage loans provide an attractive net earnings profile, producing higher yields without commensurately higher credit risks when compared to mortgage loans that qualify for purchase by Fannie Mae or Freddie Mac. In addition, based on the Company's experience in the mortgage banking industry and in the mortgage conduit business, the Company believes it provides mortgage loan sellers with an expanded and competitively priced array of non-conforming and, to a lesser extent, B/C Loan products, timely purchasing of loans, mandatory, best efforts and optional rate-lock commitments, and flexible master commitments. See "--Purchase Commitment Process and Pricing." Marketing and Production Marketing Strategy. The Company's competitive strategy is to be a low-cost national acquirer of mortgage loans to be held for long-term investment, sold in the secondary market as whole loans or securitized as mortgage-backed 6 securities. A key feature of this approach is the use of a large national network of correspondent originators and wholesale brokers. This allows IFC to shift the high fixed costs of interfacing with the homeowner to its customers. The marketing strategy for the Mortgage Operations is designed to accomplish three objectives: (1) attract a geographically diverse group of both large and small correspondent originators and brokers, (2) establish relationships with correspondents and brokers that facilitate their ability to offer a variety of loan products designed by IFC, and (3) purchase loans and securitize and sell them in the secondary market or to the Long-Term Investment Operations. In order to accomplish these objectives, IFC designs and offers loan products that are attractive to potential non-conforming borrowers and to end-investors in non-conforming mortgage loans and mortgage-backed securities. IFC has historically emphasized and continues to emphasize flexibility in its mortgage loan product mix as part of its strategy to attract and establish long-term relationships with correspondents and brokers. IFC also maintains relationships with numerous end-investors so that it may develop products that they may be interested in as market conditions change, which in turn may be offered through the correspondent network. As a consequence, IFC is less dependent on acquiring conforming mortgage loans and has acquired significant volumes of non-conforming loans. In response to the needs of its non-conforming mortgage loan correspondents, and as part of its strategy to facilitate the sale of its loans through the Mortgage Operations, IFC's marketing strategy offers efficient response time in the purchase process, direct and frequent contact with its correspondents and brokers through a trained sales force and flexible commitment programs. Finally, due to the price sensitivity of most homebuyers, IFC is competitive in pricing its products in order to attract sufficient numbers of borrowers. Impac Direct Access System for Lending ("IDASL"). IDASL is not a lead generator for mortgage brokers, but is an interactive internet system that enables our customers to access loan status, current pricing, purchase confirmations and receive consistent and reliable automated loan underwriting decisions within minutes. In addition, IDASL has an integrated credit-reporting interface that provides our customers with a very competitive tool enabling them to render a loan decision at point of sale. IDASL is intended to increase efficiencies not only for our customers but also for the Mortgage Operations by significantly decreasing the processing time for a mortgage loan, while improving employee production and maintaining superior customer service, which together leads to higher closing ratios, improved profit margins and increased profitability at all levels of its business operations. Future enhancements to IDASL, which are expected to be implemented during the second quarter of 2001, are expected to include the ability to provide automated mortgage insurance approval, fraud detection and electronic property appraisal that are intended to further streamline the entire mortgage application and approval process. Most importantly, IDASL allows IFC to move closer to its correspondents and brokers with minimal future capital investment while maintaining centralization, a key factor in the success of the Company's operating strategy. During the fourth quarter of 2000, IFC's customers increased average monthly volume of loans submitted through the IDASL system by 27% over third quarter of 2000 loan submissions. Loan submissions during the fourth quarter of 2000 averaged $555.5 million per month in loan volume as compared to $438.0 million per month during the third quarter of 2000 and $236.0 million per month during the second quarter of 2000. By December 31, 2000, substantially all of IFC's correspondents were submitting loans through IDASL and 100% of all wholesale loans delivered by brokers were directly underwritten through IDASL. The Progressive Series Loan Program. The underwriting guidelines utilized in the Progressive Series Loan Program ("Progressive Series"), as developed by IFC, are intended to assess the borrower's ability and willingness to repay the mortgage loan obligation and to assess the adequacy of the mortgaged property as collateral for the mortgage loan. Progressive Series is designed to meet the needs of borrowers with excellent credit, as well as those with credit that has been adversely affected. Progressive Series consists of six mortgage loan programs. Each program has different credit criteria, reserve requirements, qualifying ratios and loan-to-value ratio ("LTV") restrictions. Series I is designed with credit history and income requirements typical of "A" credit borrowers. In the event a borrower does not fit the series I criteria, the borrower's mortgage loan is placed into either series II, III, III+, IV, V or VI, depending on which series' mortgage loan parameters meets the borrower's unique credit profile. Series II, III, III+, IV, V or VI allow for less restrictive standards because of certain compensating or offsetting factors such as a lower LTV, verified liquid assets, job stability, pride of ownership and, in the case of refinance mortgage loans, length of time owning the mortgaged property. The philosophy of Progressive Series is that no single borrower characteristic should automatically determine whether an application for a mortgage loan should be approved or disapproved. Lending decisions are based on a risk analysis assessment after the review of the entire mortgage loan file. Each mortgage loan is individually underwritten with emphasis placed on the overall quality of the mortgage loan. All Progressive Series 7 borrowers are required to have debt service-to-income ratios within the range of 45% to 55% (calculated on the basis of monthly income), depending on the LTV of the mortgage loan. The Progressive Express Loan Program. IFC has also developed an additional program to the Progressive Series, called the Progressive Express Loan Program ("Progressive Express"). The concept of Progressive Express is to underwrite loans focusing on the borrower's FICO, the borrower's ability and willingness to repay the mortgage loan obligation, and assessment of the adequacy of the mortgage property as collateral for the loan. Progressive Express offers six levels of mortgage loan programs. Progressive Express has a minimum FICO that must be met by the borrower's primary wage earner and does not allow for exceptions to the FICO requirement. The FICO requirement is as follows: Progressive Express I - above 680, Progressive Express II - 680-620, Progressive Express III - 619-601, Progressive Express IV - 600-581, Progressive Express V - 580-551, and Progressive VI - 550-500. Each Progressive Express program has different FICO requirements, credit criteria, reserve requirements, and LTV restrictions. Progressive Express I is designed for credit history and income requirements typical of "A+" credit borrowers. In the event a borrower does not fit the Progressive Express I criteria, the borrower's mortgage loan is placed into either Progressive Express II, III, IV, V or VI, depending on which series' mortgage loan parameters meets the borrowers unique credit profile. Mortgage Loans Acquired. A majority of mortgage loans purchased by the Mortgage Operations are non-conforming mortgage loans. Currently, the maximum principal balance for a conforming loan is $275,000. Loans that exceed such maximum principal balance are referred to as "jumbo loans." Non-conforming mortgage loans generally consist of jumbo loans or other loans that are originated in accordance with underwriting or product guidelines that differ from those applied by Fannie Mae and Freddie Mac. Non-conforming loans may involve greater risk as a result of different underwriting and product guidelines. A portion of the mortgage loans purchased through the Mortgage Operations are B/C Loans, as described below, which may entail greater credit risks than other non-conforming loans. IFC generally does not acquire mortgage loans with principal balances above $750,000 for "A" quality loans, and $500,000 for B/C Loans. Non-conforming loans purchased by IFC pursuant to its underwriting programs typically differ from those purchased pursuant to the guidelines established by Fannie Mae and Freddie Mac primarily with respect to required documentation, LTV ratios, borrower income or credit history, interest rates, borrower occupancy of the mortgaged property, and/or property types. To the extent that these programs reflect underwriting standards different from those of Fannie Mae and Freddie Mac, the performance of loans made may reflect higher delinquency rates and/or credit losses. Mortgage loans acquired by IFC are generally secured by first liens and, to a lesser extent, second liens on single (one-to-four) family residential properties with either fixed or adjustable interest rates. Fixed rate mortgage loans ("FRMs") have a constant interest rate over the life of the loan, which is generally 15 or 30 years. The interest rate on adjustable rate mortgage loans ("ARMs") are typically tied to an index, such as six-month LIBOR or the one-year constant maturity Treasury index ("CMT Index") and are adjustable periodically at various intervals. ARMs are typically subject to lifetime interest rate caps and periodic interest rate and/or payment caps. The interest rates on ARMs are typically lower than the average comparable fixed rate loan initially, but may be higher than average comparable fixed rate loans over the life of the loan. Currently, IFC purchases (1) FRMs that have original terms to maturity ranging from 10 to 30 years, (2) ARMs that adjust based on LIBOR or the CMT Index, and (3) 2-year and 3-year FRMs that adjust to six-month ARMs approximately two to three years following origination at an interest rate based upon a defined index plus a spread. Substantially all mortgage loans purchased by IFC fully amortize over their remaining terms, however, IFC may purchase mortgage loans with other interest rate and maturity characteristics. The credit quality of the loans purchased by IFC varies depending upon the specific program under which such loans are purchased. For example, a principal credit risk inherent in adjustable rate mortgage loans is the potential "payment shock" experienced by the borrower as rates rise, which could result in increased delinquencies and credit losses. In the case of negative amortization mortgage loans, a portion of the interest due accrues to the underlying principal balance of the loan, thereby increasing the LTV ratio of the mortgage loans. As a general rule, mortgage loans with higher LTV ratios are vulnerable to higher delinquency rates given the borrower's lower equity investment in the underlying property. Limited documentation mortgage loans, by contrast, must meet more rigorous criteria for 8 borrower credit quality in order to compensate for the reduced level of lender review with respect to the borrower's earnings history and capacity. The following table summarizes IFC's mortgage loan acquisitions by type of loan, including net premiums, for the periods shown: Year ended Year ended December 31, 2000 December 31, 1999 ---------------- ---------------- (dollars in millions, except for average loan size) Non-conforming Loans: Volume of loans .... $ 2,108.5 $ 1,669.4 --------------- ------------- Percent of total volume .... 99.8% 99.9% Conforming Loans: Volume of loans .... $ 4.2 $ 2.3 --------------- ------------- Percent of total volume .... 0.2% 0.1% --------------- ------------- Total Mortgage Loan Acquisitions .... $ 2,112.7 $ 1,671.7 =============== ============= Fixed Rate Loans: Volume of loans .... $ 1,555.1 $ 1,037.0 --------------- ------------- Percent of total volume .... 73.6% 62.0% Adjustable Rate Loans: Volume of loans .... 557.6 634.7 --------------- ------------- Percent of total volume .... 26.4% 38.0% --------------- ------------- Total Mortgage Loan Acquisitions .... $ 2,112.7 $ 1,671.7 =============== ============= Average Loan Size .... $ 155,000 $ 156,000 =============== ============= IFC's loan purchase activities are expected to continue to focus on those regions of the country where higher volumes of non-conforming mortgage loans are originated, including California, Florida, Texas, Georgia, New Jersey, New York, Washington, Illinois, Colorado, and Nevada. The highest concentration of non-conforming mortgage loans purchased by IFC relates to properties located in California and Florida because of generally higher property values and mortgage loan balances. During the years ended December 31, 2000 and 1999, mortgage loans secured by California and Florida properties accounted for approximately 40% and 13%, respectively, and 44% and 11%, respectively, of mortgage loan acquisitions. Of the $2.1 billion in mortgage loans acquired during the year ended December 31, 2000, $1.0 billion, or 48%, were acquired from IFC's top ten sellers. During the year ended December 31, 2000, Express Lending accounted for $223.2 million, or 11%, of mortgage loans acquired by IFC. No other sellers accounted for more than 10% of the total mortgage loans acquired by IFC during the year ended December 31, 2000. A portion of the mortgage loans acquired by IFC are comprised of B/C Loans. For the year ended December 31, 2000, such loans accounted for 0.5% of IFC's total loan acquisitions as compared to 2% of IFC's total loan acquisitions during 1999. In general, B/C Loans are residential mortgage loans made to borrowers with lower credit ratings than borrowers of higher quality, A Loans, and are normally subject to higher rates of loss and delinquency than other non- conforming loans purchased by IFC. As a result, B/C Loans normally bear a higher rate of interest and are typically subject to higher fees (including greater prepayment fees and late payment penalties) than non-conforming A Loans. In general, greater emphasis is placed upon the value of the mortgaged property and, consequently, the quality of appraisals, and less upon the credit history of the borrower in underwriting B/C Loans than in underwriting A Loans. In addition, B/C Loans are generally subject to lower LTV ratios than A Loans. Under IFC's B/C Loan program, underwriting authority is delegated only to correspondents who meet strict underwriting guidelines established by IFC, see "--Purchase Guidelines, Underwriting Methods, Seller Eligibility and Quality Control." 9 High Loan-to-Value Loans. High loan-to-value loans ("125 Loans") consist of second mortgage loans to qualified borrowers who have limited access to traditional mortgage-related financing generally because of a lack of equity in their homes. The loans are typically closed-end (usually 15 years), fixed rate, fully-amortizing loans secured by a first or second lien on the borrower's primary residence, and are typically used by consumers to pay-off credit card and other unsecured indebtedness. Almost all of these loans are made in excess of the value of the underlying collateral available to secure such loans, up to a maximum of 125% of the property's LTV ratio. Purchase Commitment Process and Pricing Master Commitments. As part of its marketing strategy, IFC has established mortgage loan purchase commitments ("Master Commitments") with sellers that, subject to certain conditions, entitle the seller to sell and obligate IFC to purchase a specified dollar amount of non-conforming mortgage loans over a period generally ranging from six months to one year. The terms of each Master Commitment specify whether a seller may sell loans to IFC on a mandatory, best efforts or optional rate-lock basis. Master Commitments do not generally obligate IFC to purchase loans at a specific price, but rather provide the seller with a future outlet for the sale of its originated loans based on IFC's quoted prices at the time of purchase. Master Commitments specify the types of mortgage loans the seller is entitled to sell to IFC and generally range from $2 million to $50 million in aggregate committed principal amount. The provisions of IFC's Seller/Servicer Guide are incorporated in each of the Mortgage Operations' Master Commitments and may be modified by negotiations between the parties. In addition, there are individualized Master Commitment options available to sellers, which include alternative pricing structures or specialized loan products. In order to obtain a Master Commitment, a seller may be asked to pay a non-refundable up-front or non-delivery fee, or both, to the Company. As of December 31, 2000, IFC had outstanding Master Commitments with 135 sellers to purchase mortgage loans in the aggregate principal amount of $2.1 billion over periods ranging from six months to one year, of which $1.2 billion had been purchased or committed to be purchased pursuant to rate-locks. Sellers who have entered into Master Commitments may sell mortgage loans to the Mortgage Operations by executing individual, bulk or other rate-locks (each, a "rate-lock"). Each rate-lock, in conjunction with the related Master Commitment, specifies the terms of the related sale, including the quantity and price of the mortgage loans or the formula by which the price will be determined, the rate-lock type and the delivery requirements. Historically, the up-front fee paid by a seller to IFC to obtain a Master Commitment on a mandatory delivery basis is often refunded pro rata as the seller delivers loans pursuant to rate-locks. Any remaining fee after the Master Commitment expires is retained by the Mortgage Operations. Following the issuance of a specific rate-lock, IFC is subject to the risk of interest rate fluctuations and enters into hedging transactions to diminish such risk. Hedging transactions may include mandatory or optional forward sales of mortgage loans or mortgage-backed securities, interest rate caps, floors and swaps, mandatory forward sales, mandatory or optional sales of futures, and other financial futures transactions. The nature and quantity of hedging transactions are determined by the management of IFC based on various factors, including market conditions and the expected volume of mortgage loan purchases. Deferred hedging gains and losses are presented on IFC's balance sheet in mortgage loans held-for-sale. These deferred amounts are recognized upon the sale or securitization of the related mortgage loans. As of December 31, 2000 and 1999, IFC had $(7,000) and $792,000, respectively, of deferred hedging gains (losses) included in mortgage loans held-for-sale. Bulk and Other Rate-Locks. IFC also acquires mortgage loans from sellers that are not purchased pursuant to Master Commitments. These purchases may be made on an individual rate-lock basis. Bulk rate-locks obligate the seller to sell and IFC to purchase a specific group of loans, generally ranging from $500,000 to $125 million in aggregate committed principal amount, at set prices on specific dates. Bulk rate-locks enable IFC to acquire substantial quantities of loans on a more immediate basis. The specific pricing, delivery and program requirements of these purchases are determined by negotiation between the parties but are generally in accordance with the provisions of IFC's Seller/Servicer Guide. Due to the active presence of investment banks and other substantial investors in this area, bulk pricing is extremely competitive. Loans are also purchased from individual sellers (typically smaller originators of mortgage loans) who do not wish to sell pursuant to either a Master Commitment or bulk rate-lock. The terms of these individual purchases are based primarily on IFC's Seller/Servicer Guide and standard pricing provisions. 10 Mandatory, Best-Efforts and Optional Rate-Locks. Mandatory rate-locks require the seller to deliver a specified quantity of loans to IFC over a specified period of time regardless of whether the loans are actually originated by the seller or whether circumstances beyond the seller's control prevent delivery. IFC is required to purchase all loans covered by the rate-lock at prices established at the time of rate-lock. If the seller is unable to deliver the specified loans, it may instead deliver comparable loans approved by IFC within the specified delivery time. Failure to deliver the specified mortgage loans or acceptable substitute loans under a mandatory rate-lock obligates the seller to pay IFC a penalty, and, if IFC's mortgage loan yield requirements have declined, the present value of the difference in yield IFC would have obtained on the mortgage loans that the seller agreed to deliver and the yield available on similar mortgage loans subject to mandatory rate-lock issued at the time of such failure to deliver. In contrast, mortgage loans sold on a best-efforts basis must be delivered to IFC only if they are actually originated by the seller. The best-efforts rate-lock provides sellers with an effective way to sell loans during the origination process without any penalty for failure to deliver. Optional rate-locks give the seller the option to deliver mortgage loans to IFC at a fixed price on a future date and requires the payment of up-front fees to IFC. Any up-front fees paid in connection with optional rate-locks are retained by IFC if the loans are not delivered. Pricing. IFC sets purchase prices at least once every business day for mortgage loans it acquires for its Mortgage Operations based on prevailing market conditions. Different prices are established for the various types of loans, rate-lock periods and types of rate-locks (mandatory or best-efforts). IFC's standard pricing is based on the anticipated price it receives upon sale or securitization of the loans, the anticipated interest spread realized during the accumulation period, the targeted profit margin and the anticipated issuance, credit enhancement, and ongoing administrative costs associated with such sale or securitization. The credit enhancement cost component of IFC's pricing is established for individual mortgage loans or pools of mortgage loans based upon the characteristics of such loans or loan pools. As the characteristics of the loans or loan pools vary, this cost component is correspondingly adjusted upward or downward to reflect the variation. IFC's adjustments are reviewed periodically by management to reflect changes in the costs of credit enhancement. Adjustments to IFC's standard pricing may also be negotiated on an individual basis under Master Commitments or bulk or individual rate-locks with sellers. See "--Securitization and Sale Process." Purchase Guidelines, Underwriting Methods, Seller Eligibility and Quality Control Purchase Guidelines. IFC has developed comprehensive purchase guidelines for the acquisition of mortgage loans by the Mortgage Operations. Each loan underwritten assesses the borrower's FICO, ability and willingness to repay the mortgage loan obligation and the adequacy of the mortgaged property as collateral for the mortgage loan. Subject to certain exceptions and the type of loan product, each purchased loan must conform to the loan parameters and eligibility requirements specified in IFC's Seller/Servicer Guide with respect to, among other things, loan amount, type of property, LTV ratio, mortgage insurance, credit history, debt service-to-income ratio, appraisal and loan documentation. IFC also performs a full legal documentation review prior to the purchase of all loans. All mortgage loans originated under IFC's loan programs are underwritten either by employees of IFC or by contracted mortgage insurance companies or delegated sellers. Underwriting Methods. Under all of IFC's underwriting methods, loan documentation requirements for verifying the borrower's income and assets vary according to LTV ratios and other factors. Generally, as the standards for required documentation are lowered, the borrowers' down payment requirements are increased and the required LTV ratios are decreased. The borrower is also required to have a stronger credit history, larger cash reserves and an appraisal of the property that is validated by an enhanced desk and field review. Lending decisions are based on a risk analysis assessment after the review of the entire mortgage loan file. Each mortgage loan is individually underwritten with emphasis placed on the overall quality of the mortgage loan. Under the Progressive Series program, IFC underwrites one-to-four family mortgage loans with LTV ratios at origination of up to 97% of the property's appraised value, depending on, among other things, a borrower's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property. Second lien financing of the mortgaged properties may be provided by lender's other than IFC at origination, however, the combined LTV ratio generally may not exceed 100% of the property's appraised value. Progressive Express has a minimum FICO that must be met by the borrower's primary wage earner and does not allow for exceptions to the FICO requirement. Each Progressive Express program has different FICO requirements, credit criteria, reserve 11 requirements, and LTV ratio restrictions. Under the Progressive Express program, IFC underwrites single family dwellings with LTV ratios at origination of up to 97% of the property's appraised value. In order for the property to be eligible for the Progressive Express, it must be a single family residence (1 unit only), condominium, and/or planned unit development. Under Progressive Express, the borrower must disclose employment and assets on the application, however there is no verification of the information. IFC uses the program parameters as guidelines only. On a case-by-case basis, IFC may determine that the prospective mortgagor warrants an exception outside the standard program guidelines. An exception may be allowed if the loan application reflects certain compensating factors, including (1) the prospective mortgagor has demonstrated an ability to save and devote a greater portion of income to basic housing needs, (2) the prospective mortgagor may have a potential for increased earnings and advancement because of education or special job training, even if the prospective mortgagor has just entered the job market, (3) the prospective mortgagor has demonstrated an ability to maintain a debt free position, (4) the prospective mortgagor may have short term income that is verifiable but could not be counted as stable income because it does not meet the remaining term requirements, and (5) the prospective mortgagor's net worth is substantial enough to suggest that repayment of the loan is within the prospective mortgagor's ability. IFC does not publish an approved appraiser list for its correspondent sellers. Mortgage sellers may select any appraiser of choice, regardless of the LTV ratio of the related loan, from the seller's approved appraiser list. At the discretion of the underwriter, a full appraisal, an enhanced desk review appraisal, or a field review appraisal may be required. Seller Eligibility Requirements. Mortgage loans acquired by the Mortgage Operations are originated by various sellers, including savings and loan associations, banks and mortgage bankers. Sellers are required to meet certain regulatory, financial, insurance and performance requirements established by IFC before they are eligible to participate in its mortgage loan purchase program, and must submit to periodic reviews by IFC to ensure continued compliance with these requirements. IFC's current criteria for seller participation generally includes a minimum tangible net worth requirement of $500,000, approval as a Fannie Mae or Freddie Mac Seller/Servicer in good standing, a Housing and Urban Development ("HUD") approved mortgagee in good standing or a financial institution that is insured by the Federal Deposit Insurance Corporation ("FDIC") or comparable federal or state agency, and that the seller is examined by a federal or state authority. In addition, sellers are required to have comprehensive loan origination quality control procedures. In connection with its qualification, each seller enters into an agreement that generally provides for recourse by IFC against the seller in the event of a breach of representations or warranties made by the seller with respect to mortgage loans sold to IFC, which includes but is not limited to any fraud or misrepresentation during the mortgage loan origination process or upon early payment default on such loans. The underwriting program consists of three separate subprograms. IFC's principal delegated underwriting subprogram is a fully delegated program designed for loan sellers that meet higher financial and performance criteria than those applicable to sellers generally. Generally, qualifying sellers have tangible net worth of at least $1.5 million and are granted delegated underwriting authority to a maximum loan amount of $500,000 for all mortgage products under this subprogram. The second subprogram is a delegated program pursuant to which sellers have tangible net worth of $500,000 to $1.5 million and are granted delegated underwriting authority to a maximum loan amount of $300,000. The third program is for sellers with tangible net worth of $500,000 in which sellers are under IFC's non-delegated underwriting program. IFC has established a delegated underwriting program, which is similar in concept to the delegated underwriting programs established by Fannie Mae and Freddie Mac. Under this program, qualified sellers are required to underwrite loans in compliance with IFC's underwriting guidelines as set forth in IFC's Seller/Servicer Guide and by individual Master Commitment. In order to determine a seller's eligibility to perform under its delegated underwriting program, an internal review is undertaken by IFC's loan committee. In connection with its approval, the seller must represent and warrant to IFC that all mortgage loans sold to IFC will comply with IFC's underwriting guidelines. The current financial, historical loan quality and other criteria for seller participation in this program generally include a minimum net worth requirement and verification of the seller's good standing, including the seller's experience and demonstrated performance, with Fannie Mae or Freddie Mac or HUD. IFC periodically reviews the sellers participating in its delegated underwriting program and will retain those sellers that it believes are productive. 12 Mortgage loans acquired under IFC's non-delegated underwriting program are either fully underwritten by IFC's underwriting staff or involve the use of contract underwriters. IFC has contracted with several national mortgage insurance firms that conduct contract underwriting for mortgage loan acquisitions by IFC. Under these contracts, IFC relies on the credit review and analysis of the contract underwriter, as well as its own pre-purchase eligibility review to ensure that the loan meets program acceptance, its own follow-up quality control procedures, and the representations and warranties of the contract underwriter. Loans that are not acquired under either delegated or contract underwriter methods are fully underwritten by IFC's underwriting staff. In such cases, IFC performs a full credit review and analysis to ensure compliance with its loan eligibility requirements. This review specifically includes, among other things, an analysis of the underlying property and associated appraisal, and an examination of the credit, employment and income history of the borrower. Under all of these methods, loans are purchased only after completion of a legal documentation and eligibility criteria review. Quality Control. IFC performs a post-closing quality control review on a minimum of 25% of the mortgage loans originated or acquired under the Progressive Series and Progressive Express programs for complete re-verification of employment, income and liquid assets used to qualify for such mortgage loans. Such reviews also include procedures intended to detect evidence of fraudulent documentation and/or imprudent activity during the processing, funding, servicing or selling of the mortgage loans. Verification of occupancy and applicable information is made by regular mail. Securitization and Sale Process General. The Mortgage Operations primarily utilizes warehouse lines of credit and equity to finance the acquisition and origination of mortgage loans from its customers. When a sufficient volume of mortgage loans with similar characteristics has been accumulated, generally $100 million to $350 million, IFC will securitize them through the issuance of mortgage-backed securities in the form of REMICs or resell them as bulk whole loan sales. The period between the time IFC commits to purchase mortgage loans and the time it sells or securitizes such mortgage loans generally ranges from 10 to 90 days, depending on certain factors including the length of the purchase commitment period, the loan volume by product type and the securitization process. Any decision by IFC to issue REMICs or to sell the loans in bulk is influenced by a variety of factors. REMIC transactions are generally accounted for as sales of the mortgage loans and can eliminate or minimize any long-term residual investment in such loans. REMIC securities consist of one or more classes of "regular interests" and a single class of "residual interest." The regular interests are tailored to the needs of investors and may be issued in multiple classes with varying maturities, average lives and interest rates. These regular interests are predominantly senior securities but, in conjunction with providing credit enhancement, may be subordinated to the rights of other regular interests. The residual interest represents the remainder of the cash flows from the mortgage loans (including, in some instances, reinvestment income) over the amounts required to be distributed to the regular interests. In some cases, the regular interests may be structured so that there is no significant residual cash flow, thereby allowing IFC to sell its entire interest in the mortgage loans. As a result, in some cases, all of the capital originally invested in the mortgage loans by the Company is redeployed in the Mortgage Operations. Each series of mortgage-backed securities is typically fully payable from the mortgage assets underlying such series, and the recourse of investors is limited to such assets and any associated credit enhancement features, such as senior/subordinated structures. To the extent the Company holds subordinated securities, the Company generally bears all losses prior to the related senior security holders. Generally, any losses in excess of the credit enhancement obtained are borne by the security holders. Except in the case of a breach of the standard representations and warranties made by the Company when mortgage loans are securitized, such securities are non-recourse to the Company. Typically, the Company has recourse to the sellers of loans for any such breaches, but there are no assurances of the sellers' abilities to honor their respective obligations. Credit Enhancement. REMICs created by the Mortgage Operations are structured so that one or more of the classes of such securities are rated investment grade by at least one nationally recognized rating agency. In contrast to Agency Certificates (pass-through certificates guaranteed by Fannie Mae or Freddie Mac) in which the principal and interest payments are guaranteed by the U.S. government or one of its agencies, securities created by the Mortgage 13 Operations do not benefit from any such guarantee. The ratings for the Mortgage Operations' REMICs are based upon the perceived credit risk by the applicable rating agency of the underlying mortgage loans, the structure of the securities and the associated level of credit enhancement. Credit enhancement is designed to provide protection to the security holders in the event of borrower defaults and other losses including those associated with fraud or reductions in the principal balances or interest rates on mortgage loans as required by law or a bankruptcy court. The Mortgage Operations can utilize multiple forms of credit enhancement, including special hazard insurance, private mortgage insurance reserve funds, letters of credit, surety bonds, over-collateralization and subordination or any combination of the foregoing. In determining whether to provide credit enhancement through subordination or other credit enhancement methods, the Mortgage Operations takes into consideration the costs associated with each method. Ratings of mortgage-backed securities are based primarily upon the characteristics of the pool of underlying mortgage loans and associated credit enhancement. A decline in the credit quality of such pools (including delinquencies and/or credit losses above initial expectations), or of any third-party credit enhancer, or adverse developments in general economic trends affecting real estate values or the mortgage industry, could result in downgrades of such ratings. In connection with the securitization of B/C Loans, the levels of subordination required as credit enhancement for the more senior classes of securities issued are higher than those with respect to its non-conforming A Loans. Similarly, in connection with the securitization of Mortgage loans secured by second liens, the levels of subordination required as credit enhancement for the more senior classes of securities issued are higher than those with respect to its mortgage loans secured by first liens. Thus, to the extent that the Company retains any of the subordinated securities created in connection with such securitizations and losses with respect to such pools of B/C Loans or mortgage loans secured by second liens are higher than expected, the Company's future earnings could be adversely affected. Master Servicing and Servicing Master Servicing General. IFC generally performs the function of master servicer with respect to mortgage loans it sells and securitizes. The master servicer's function includes collecting loan payments from servicers of loans and remitting loan payments, less master servicing fees receivable and other fees, to a trustee or other purchaser for each series of mortgage-backed securities or loans master serviced. In addition, as master servicer, IFC monitors compliance with its servicing guidelines and is required to perform, or to contract with a third party to perform, all obligations not adequately performed by any servicer. A master servicer typically employs servicers to carry out servicing functions. In addition, IFC acts as the master servicer for all loans acquired by the Long-Term Investment Operations. With respect to its function as a master servicer for loans owned by IMH, IFC and IMH have entered into agreements having terms substantially similar to those described below for servicing agreements. Master servicing fees are generally 0.03% per annum on the declining principal balances of the loans serviced. As of December 31, 2000 and 1999, IFC's master servicing portfolio was $4.0 billion and $2.9 billion, respectively. IFC offers its sellers of mortgage loans the right to retain servicing. In the case of servicing retained mortgage loans, the Company will enter into servicing agreements with the sellers of mortgage loans to service the mortgage loans they sell to the Company. Each servicing agreement will require the servicer to service the Company's mortgage loans as required under the Company's servicing guide, which is generally consistent with Fannie Mae and Freddie Mac guidelines and procedures. Each servicer will collect and remit principal and interest payments, administer mortgage escrow accounts, submit and pursue insurance claims, and initiate and supervise foreclosure proceedings on the mortgage loans serviced. Each servicer will also provide accounting and reporting services required by the Company for such loans. The servicer will be required to follow such collection procedures as are customary in the industry. The servicer may, at its discretion, arrange with a defaulting borrower a schedule for the liquidation of delinquencies, provided primary mortgage insurance coverage is not adversely affected. Each servicing agreement will provide that the servicer may not assign any of its obligations with respect to the mortgage loans serviced for the Company, except with the Company's consent. The following table summarizes delinquency statistics for IFC's master servicing portfolio based on principal balance for the periods shown (dollars in millions): 14 At December 31, At December 31, 2000 1999 --------------------- --------------------- Principal % of Master Principal % of Master Balance Servicing Balance Servicing of Loans Portfolio of Loans Portfolio -------- --------- -------- --------- Loans delinquent for: 60-89 days .... $ 65.8 1.63% $ 30.8 1.07% 90 days .... 26.0 0.64 21.1 0.73 ------- ---- ------- ---- 91.8 2.27 51.9 1.80 Foreclosures pending .... 57.1 0.56 47.0 1.64 Bankruptcies pending .... 22.5 1.41 26.9 0.93 ------- ---- ------- ---- Total delinquencies, foreclosures and bankruptcies .... $ 171.4 4.24% $ 125.8 4.37% ======= ==== ======= ==== Master Servicing Fees. The Company expects to retain master servicing fees on loans sold. Master servicing fees receivable have characteristics similar to "interest-only" securities; accordingly, they have many of the same risks inherent in "interest-only" securities, including the risk that they will lose a substantial portion of their value as a result of rapid prepayments occasioned by declining interest rates. Master servicing fees receivable represent the present value of the difference between the interest rate on mortgage loans purchased by the Mortgage Operations and the interest rate received by investors who purchase the securities backed by such loans, in excess of the normal loan servicing fees charged by either (1) the Mortgage Operations on loans acquired "servicing released" or (2) correspondents who sold loans to the Mortgage Operations with "servicing retained" (the "Excess Servicing Fees). Currently, the secondary market for master servicing fees receivable is limited). IFC intends to hold the master servicing fees receivable for investment. Accordingly, if IFC had to sell these receivables, the value received may or may not be at or above the values at which IFC carried them on its balance sheet. To the extent that servicing fees on a mortgage loan exceed an adequate compensation (typically ranging from 0.25% to 0.50% per annum of the mortgage loan principal amount), the Mortgage Operations will generate Excess Servicing Fees receivable as an asset that represents an estimated present value of those excess fees assuming a certain prepayment rate on the mortgage loan. In determining present value of future cash flows, the Mortgage Operations will use a market discount rate. Prepayment assumptions will be based on recent evaluations of the actual prepayments of the Mortgage Operations' servicing portfolio or on market prepayment rates on new portfolios on which the Mortgage Operations has no experience and the interest rate environment at the time the master servicing fees receivable are created. Management of the Company believes that, depending upon the level of interest rates from time to time, investments in current coupon master servicing fees receivable may be prudent, and if interest rates rise, these investments will mitigate declines in income that may occur in the Mortgage Operations. Servicing General. IFC subcontracts or sells all of its servicing obligations under such loans to independent third parties pursuant to sub-servicing agreements or the servicing guide. IFC believes that the selection of third-party sub-servicers or the sale of servicing rights is more effective than establishing a servicing department within the Company. However, part of IFC's responsibility is to continually monitor the performance of the sub-servicers or servicers through monthly performance reviews and regular site visits. Depending on these sub-servicer reviews, the Company may in the future rely on its internal collection group to take an ever more active role to assist the sub-servicer in the servicing of these loans. Servicing includes collecting and remitting loan payments, making required advances, accounting for principal and interest, holding escrow or impound funds for payment of taxes and insurance, if applicable, making required inspections of the mortgaged property, contacting delinquent borrowers, and supervising foreclosures and property dispositions in the event of unremedied defaults in accordance with the Company's guidelines. Servicing fees range from 0.25% per annum for FRMs to 0.50% per annum for B/C Loans and ARMs on the declining principal balances of loans serviced. IFC generally acquires all of its loans on a "servicing released" basis. To the extent IFC finances the acquisition of such loans with its warehouse line with IWLG, IFC pledges such loans and the related servicing rights to IWLG as collateral. As a result, IWLG has an absolute right to control the servicing of such loans (including the right to collect 15 payments on the underlying mortgage loans) and to foreclose upon the underlying real property in the case of default. Typically, IWLG delegates its right to service the mortgage loans securing the warehouse line to IFC. The following table summarizes certain information regarding IFC's servicing portfolio of mortgage loans for the periods shown (dollars in millions, except average loan size): Year ended Year ended December 31, 2000 December 31, 1999 ---------------- ---------------- Beginning servicing portfolio .... $ 2,393.4 $ 3,714.0 Add: Loan acquisitions .... 2,078.8 1,647.7 Less: Servicing transferred .... (1,266.0) (2,270.8) Principal paydowns (1) .... (777.3) (697.5) ---------------- ---------------- Ending servicing portfolio .... $ 2,428.9 $ 2,393.4 ================= ================= Number of loans serviced .... 20,664 22,096 Average loan size .... $ 118,000 $ 108,000 Weighted average interest rate .... 9.88% 9.43% ---------- (1) Includes normal principal runoff and principal prepayments. Mortgage Servicing Rights. When the Mortgage Operations purchases loans which include the associated servicing rights, the allocated price paid for the servicing rights is reflected on its financial statements as Mortgage Servicing Rights ("MSRs"). MSRs differ from master servicing fees receivable primarily by the required amount of servicing to be performed, the loss exposure to the owner of the instrument, and the financial liquidity of the instrument. In contrast to MSRs, where the owner of the instrument acts as the servicer, master servicing fees receivable do not require the owner of the instrument to service the underlying mortgage loan. In addition, master servicing fees receivable subject their owners to greater loss exposure from delinquencies or foreclosure on the underlying mortgage loans than MSRs because a master servicer stands behind the servicer and potentially the owner of the mortgage loan in priority of payment. Both MSRs and master servicing fees receivable are purchased and sold in the secondary markets. However, MSRs are generally more liquid and can be sold at less of a discount as compared to master servicing fees receivable. During periods of declining interest rates, prepayments of mortgage loans increase as homeowners look to refinance at lower rates, resulting in a decrease in the value of the Company's MSRs. Mortgage loans with higher interest rates are more likely to result in prepayments. At December 31, 2000 and 1999, IFC had $10.9 million and $15.6 million, respectively, of MSRs. Warehouse Lending Operations The Warehouse Lending Operations, conducted by IWLG, provides warehouse and repurchase financing to affiliated companies and to approved mortgage banks, some of which are correspondents of IFC, to finance mortgage loans during the time from the closing of the loans to their sale or other settlement with pre-approved investors. Generally, the non-conforming mortgage loans funded with such warehouse lines of credit are acquired by IFC. IWLG's warehouse lines are non-recourse and IWLG looks mainly to the sale or liquidation of the mortgage loans as a source of repayment. Any claim of IWLG as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay. Borrowings under the warehouse facilities are presented on the Company's balance sheets as finance receivables. IFC's outstanding warehouse line balances on IWLG's balance sheet are structured to qualify under REIT asset tests and to generate income qualifying under the 75% gross income test. Terms of affiliated warehouse lines are based on Bank of America's prime rate with advance rates between 90% and 98% of the fair value of the mortgage loans outstanding. Outstanding warehouse line balances to non-affiliates on IWLG's balance sheet may not qualify under REIT asset tests and may not generate income qualifying under the 75% gross income test. Terms of non-affiliated warehouse lines, including the commitment amount, are determined based upon the financial strength, historical performance and other qualifications of the borrower. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for a more detailed discussion of IWLG's warehouse line to IFC. 16 Regulation The rules and regulations applicable to the Mortgage Operations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers, and fix maximum loan amounts. Mortgage loan acquisition activities are subject to, among other laws, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act and the Real Estate Settlement Procedures Act and the regulations promulgated that prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. IFC is an approved Fannie Mae and Freddie Mac seller/servicer. IFC is subject to the rules and regulations of Fannie Mae and Freddie Mac with respect to acquiring, processing, selling and servicing conforming mortgage loans. In addition, IFC is required annually to submit to Fannie Mae and Freddie Mac audited financial statements, and each regulatory entity has its own financial requirements for sellers/servicers. For any conforming mortgage loan activities, IFC's affairs are also subject to examination by Fannie Mae and Freddie Mac at any time to assure compliance with the applicable regulations, policies and procedures. Additionally, there are various state and local laws and regulations affecting the Mortgage Operations. Mortgage operations also may be subject to applicable state usury statutes. The Company is presently in material compliance with all material rules and regulations to which it is subject. Competition In purchasing non-conforming mortgage loans and issuing securities backed by such loans, the Company competes with established mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift and loan associations, finance companies, mortgage bankers, insurance companies, other lenders and other entities purchasing mortgage assets. The continued consolidation in the mortgage banking industry may also reduce the number of current sellers available to the Mortgage Operations, thus reducing the Company's potential customer base, resulting in IFC's purchasing a larger percentage of mortgage loans from a smaller number of sellers. Such changes could negatively impact the Mortgage Operations. Mortgage-backed securities issued by the Mortgage Operations and the Long-Term Investment Operations face competition from other investment opportunities available to prospective investors. The Company faces competition in its Mortgage Operations and Warehouse Lending Operations from other financial institutions, including but not limited to banks and investment banks. Many of the institutions with which the Company competes in its Mortgage Operations and Warehouse Lending Operations have significantly greater financial resources than the Company. However, IFC can compete effectively with other non-conforming mortgage loan conduits through its efficient loan purchasing process, flexible purchase commitment options and competitive pricing and by designing non-conforming mortgage loans to suit the needs of its correspondent loan originators and their borrowers, while providing sufficient credit quality to its investors. Employees As of December 31, 2000, the Company had 212 full- and part-time employees and 22 temporary and contract employees. IFC employed 199 full- and part-time employees and 20 temporary and contract employees while IWLG employed 13 and 2, respectively. Employees and operating management of the Long-Term Investment Operations and Mortgage Operations are employed by IFC while employees of the Warehouse Lending Operations are employed by IWLG. The Company believes that relations with its employees are good. The Company is not a party to any collective bargaining agreement. 17 RISK FACTORS A prolonged economic downturn or recession would adversely affect our operations and financial condition Although we have not operated during a period of prolonged general economic downturn or a recession, these events have historically resulted in a reduction in mortgage origination activity and an increase in the rate of mortgage defaults. The United States economy is currently undergoing a period of slowdown, which some observers view as a recession. This economic condition has been worsened by the September 11th terrorist attacks in New York City and Washington, D.C. A continued economic downturn or recession would have a significant adverse impact on our operations and our financial condition. For example, a reduction in new mortgages will adversely affect our ability to expand our mortgage portfolio, our principal means of increasing our earnings. In addition, a decline in new mortgage activity will likely result in reduced activity for our warehouse lending operations and our long-term investment portfolio operations. In the case of our mortgage operations, a decline in mortgage activity may result in fewer loans that meet its criteria for purchase and securitization, thus resulting in a reduction in interest income and fees and gain on sale of loans. We may also experience larger than previously reported credit losses on our portfolio due to a higher level of defaults on our mortgage loans. Inability to generate liquidity may adversely affect our operations If we cannot generate sufficient liquidity, we will be unable to continue our operations, grow our asset base, maintain our hedging policy and pay dividends. We have traditionally derived our liquidity from four sources: . financing facilities provided to us by others to acquire mortgage assets; . whole loan sales and securitizations of acquired or originated mortgage loans; . our issuance of equity and debt securities; and . earnings from operations. We cannot assure you that any of these alternatives will be available to us, or if available, that we will be able to negotiate favorable terms. Our ability to meet our long-term liquidity requirements is subject to the renewal of our credit and repurchase facilities and/or obtaining other sources of financing, including additional debt or equity from time to time. Any decision by our lenders and/or investors to make additional funds available to us in the future will depend upon a number of factors, such as our compliance with the terms of our existing credit arrangements, our financial performance, industry and market trends in our various businesses, the general availability of, and rates applicable to, financing and investments, the lenders' and/or investors' own resources and policies concerning loans and investments, and the relative attractiveness of alternative investment or lending opportunities. If we cannot raise cash by selling debt or equity securities, we may be forced to sell our assets at unfavorable prices or discontinue various business activities. Our inability to access the capital markets could have a negative impact on our earnings and ability to pay dividends. 18 Margin calls on financing facilities may adversely affect our operations Prior to the fourth quarter of 1998, we generally had no difficulty in obtaining favorable financing facilities or in selling acquired mortgage loans. However, during the fourth quarter of 1998, the mortgage industry experienced substantial turmoil as a result of a lack of liquidity in the secondary markets. At that time, investors expressed unwillingness to purchase interests in securitizations due in part to: . the lack of financing to acquire these securitization interests; . the widening of returns expected by institutional investors on securitization interests over the prevailing Treasury rate; and . market uncertainty. As a result, many mortgage loan originators, including our company, were unable to access the securitization market on favorable terms, which resulted in some companies declaring bankruptcy. Originators, like our company, were required to sell loans on a whole loan basis and liquidate holdings of mortgage-backed securities to repay short-term borrowings. However, the large amount of loans available for sale on a whole loan basis affected the pricing offered for these loans, which in turn reduced the value of the collateral underlying the financing facilities. Therefore, many providers of financing facilities initiated margin calls. Margin calls resulted when our lenders evaluated the market value of the collateral securing our financing facilities and required us to provide them with additional equity or collateral to secure our borrowings. Our financing facilities were short-term borrowings and due to the turmoil in the mortgage industry during the latter part of 1998 many traditional providers of financing facilities were unwilling to provide facilities on favorable terms, or at all. Our current financing facilities continue to be short-term borrowings and we expect this to continue. If we cannot renew or replace maturing borrowings, we may have to sell, on a whole loan basis, the loans securing these facilities which, depending upon market conditions, may result in substantial losses. Dependence on securitizations for liquidity We rely significantly upon securitizations to generate cash proceeds to repay borrowings and to create credit availability. Any reduction in our ability to complete securitizations may require us to utilize other sources of financing, which may be on unfavorable terms, if such financing is available at all. In addition, delays in closing sales of our mortgage loans increase our risk by increasing the warehousing period for the loans, further exposing our company to credit risks. Furthermore, gains on sales from our securitizations represent a significant portion of our earnings. Several factors could affect our ability to complete securitizations of our mortgages, including: . conditions in the securities and secondary markets; . credit quality of the mortgage loans acquired or originated through our mortgage operations; . volume of our mortgage loan purchases and originations; . our ability to obtain credit enhancements; and . lack of investors purchasing higher risk components of the securities. If we are unable to profitably securitize a significant number of our mortgage loans in a particular financial reporting period, then we could experience lower income or a loss for that period. As a result of turmoil in the securitization market during the latter part of 1998, many mortgage lenders, including our company, were required to sell mortgage loans on a whole loan basis under adverse market conditions in order to generate liquidity. Many of these sales were made at prices lower than our carrying value of the mortgage loans and we experienced substantial losses. We cannot assure you that we will be able to continue to profitably securitize or sell our loans on a whole loan basis, or at all. 19 The market for first loss risk securities, which are securities that take the first loss when mortgages are not paid by the borrowers, is generally limited. In connection with our REMIC securitizations, we endeavor to sell all securities subjecting us to a first loss risk. If we cannot sell these securities, we may be required to hold them for an extended period, subjecting us to a first loss risk. Our borrowings and substantial leverage may cause losses Risks of use of collateralized mortgage obligations To grow our investment portfolio, we borrow a substantial portion of the market value of substantially all of our investments in mortgage loans and our remaining mortgage-backed securities portfolio. We currently prefer to use collateralized mortgage obligations as financing vehicles to increase our leverage, since mortgage loans held for collateralized mortgage obligation collateral are retained for investment rather than sold in a secondary market transaction. Retaining mortgage loans as collateral for collateralized mortgage obligations exposes our operations to greater credit losses than does the use of other securitization techniques that are treated as sales. Although our liability under a collateralized mortgage obligation is limited to the collateral used to create the collateralized mortgage obligation, we generally are required to make a cash equity investment to fund collateral in excess of the amount of the securities issued. If we experience credit losses on the pool of loans subject to the collateralized mortgage obligation greater than we expected, the value of our equity investment will decrease and we would have to increase the allowance for loan losses on our financial statements. Cost of borrowings may exceed return on assets The cost of borrowings under our financing facilities corresponds to a referenced interest rate plus or minus a margin. The margin varies depending on factors such as the nature and liquidity of the underlying collateral and the availability of financing in the market. We will experience net interest losses if the returns on our assets financed with borrowed funds fail to cover the cost of our borrowings. Default risks under financing facilities If we default under our financing facilities, our lenders could force us to liquidate the collateral. If the value of the collateral is less than the amount borrowed, we could be required to pay the difference in cash. If we were to declare bankruptcy, some of our reverse repurchase agreements may obtain special treatment and our creditors would then be allowed to liquidate the collateral without any delay. On the other hand, if a lender with whom we have a reverse repurchase agreement declares bankruptcy, we might experience difficulty repurchasing our collateral, or enforcing our claim for damages, and it is possible that our claim could be repudiated and we could be treated as an unsecured creditor. If this occurs, our claims would be subject to significant delay and we may receive substantially less than our actual damages or nothing at all. Risk of lack of return of investment upon liquidation We have pledged a substantial portion of our assets to secure the repayment of collateralized mortgage obligations issued in securitizations, our financing facilities and our other borrowings. We will also pledge substantially all of our current and future mortgage loans to secure borrowings pending their securitization or sale. The cash flows we receive from our investments that have not yet been distributed, pledged or used to acquire mortgage loans or other investments may be the only unpledged assets available to our unsecured creditors and you if our company was liquidated. Interest rate fluctuations may adversely affect our operating results Our operations, as a portfolio manager, a mortgage loan acquirer and originator or a warehouse lender, may be adversely affected by rising and falling interest rates. Higher interest rates may discourage potential borrowers from refinancing mortgages, borrowing to purchase homes or seeking second mortgages. This may 20 decrease the amount of mortgages available to be acquired or originated by our mortgage operations and decrease the demand for warehouse financing provided by our warehouse lending operations to originators of mortgage loans. If short- term interest rates exceed long-term interest rates, there is a higher risk of increased loan prepayments, as borrowers may seek to refinance their fixed and adjustable rate mortgage loans at lower long-term fixed interest rates. Increased loan prepayments could lead to a reduction in the number of loans in our investment portfolio and reduce our net interest income. We are subject to the risk of rising mortgage interest rates between the time we commit to purchase mortgages at a fixed price and the time we sell or securitize those mortgages. An increase in interest rates will generally result in a decrease in the market value of mortgages that we have committed to purchase at a fixed price, but have not yet sold or securitized or have not been properly hedged. Risks of repricing of assets and liabilities Our principal source of revenue is net interest income or net interest spread from our investment portfolio, which is the difference between the interest we earn on our interest earning assets and the interest we pay on our interest bearing liabilities. The rates we pay on our borrowings are independent of the rates we earn on our assets and may be subject to more frequent periodic rate adjustments. Therefore, we could experience a decrease in net interest income or a net interest loss because the interest rates on our borrowings could increase faster than the interest rates on our assets. If our net interest spread becomes negative, we will be paying more interest on our borrowings than we will be earning on our assets and we will be exposed to a risk of loss. Additionally, the rates paid on our borrowings and the rates received on our assets may be based upon different indices (i.e., LIBOR, U.S. Treasuries, etc.). If the index used to determine the rate on our borrowings increases faster than the index used to determine the rate on our assets, we will experience a declining net interest spread, which will have a negative impact on our profitability and may result in losses. Risks of adjustable rate mortgages A substantial portion of the mortgage assets held by our long-term investment operations are fixed for a period of time then become adjustable rate mortgages or bear interest based upon short-term interest rate indices. We generally fund these mortgage assets with variable borrowings. To the extent that there is an increase in the interest rate index used to determine our adjustable rate borrowings that is not covered by our current hedging policy, the net interest margin will decrease or become negative. Interest rate caps Adjustable rate mortgages typically have interest rate caps, which limit interest rates charged to the borrower during any given period. Our borrowings are not subject to similar restrictions. As a result, in a period of rapidly increasing interest rates, the interest rates we pay on our borrowings could increase without limitation, while the interest rates we earn on our adjustable rate mortgage assets would be capped. If this occurs, our net earnings could be significantly reduced or we could suffer a net interest loss. Prepayments of adjustable rate mortgage loans may adversely affect our operations Mortgage prepayments generally increase on our adjustable rate mortgages when fixed mortgage interest rates fall below the then-current interest rates on outstanding adjustable rate mortgage loans. Prepayments on mortgage loans are also affected by the terms and credit grades of the loans, conditions in the housing and financial markets and general economic conditions. Most of the adjustable rate mortgages that we acquire are originated within three months of the time we purchased the mortgages and generally bear initial interest rates which are lower than their fully-indexed amount (the applicable index plus the margin). If we acquire these mortgages at a premium and they are prepaid prior to or soon after the time of adjustment to a fully-indexed rate without payment of any prepay penalty, we would not have received interest at the fully-indexed rate 21 during such period and we must expense the unamortized premium that was paid for the loan at the time of the prepayment. This means we would lose the opportunity to earn interest at that rate over the expected life of the mortgage. Also, if prepayments on our adjustable rate mortgage loans increase when interest rates are declining, our net interest income may decrease if we cannot reinvest the prepayments in mortgage assets bearing comparable rates. We generally acquire mortgages on a "servicing released" basis, meaning we acquire both the mortgages and the rights to service them. This strategy requires us to pay a higher purchase price or premium for the mortgages. If our mortgage loans that we acquire at a premium prepay faster than originally projected, generally accepted accounting principles require us to write down the remaining capitalized premium amounts at a faster speed than was originally projected, which would decrease our current net interest income. Value of our portfolio of mortgage-backed securities may be adversely affected Prior to 1998, we invested in mortgage-backed securities known as interest- only, principal-only, residual interest and subordinated securities. Investments in residual interest and subordinated securities are much riskier than investments in senior mortgage-backed securities because these subordinated securities bear all credit losses prior to the related senior securities. On a percentage basis, the risk associated with holding residual interest and subordinated securities is greater than holding the underlying mortgage loans directly due to the concentration of losses in the subordinated securities. We estimate future cash flows from these securities and value them utilizing assumptions based in part on projected discount rates, mortgage loan prepayments and credit losses. If our actual experience differs from our assumptions, we would be required to reduce the value of these securities. The market for our asset-backed securities is extremely limited and we cannot assure you that we could sell these securities at their reported value, or at any value or that we could recoup our initial investment. In addition, we may not obtain our anticipated yield or we may incur losses if the credit support available within certain mortgage-backed securities is inadequate due to unanticipated levels of losses, or due to difficulties experienced by the credit support provider. Delays or difficulties encountered in servicing mortgage-backed securities may cause greater losses and, therefore, greater resort to credit support than was originally anticipated, and may cause a rating agency to downgrade certain classes of our securities. We undertake additional risks by acquiring and investing in mortgage loans Risk of failure to obtain credit enhancements We do not obtain credit enhancements such as mortgage pool or special hazard insurance for all of our mortgage loans and investments. Generally, we require mortgage insurance on any loan with a loan-to-value ratio greater than 80%. During the time we hold mortgage loans for investment, we are subject to risks of borrower defaults and bankruptcies and special hazard losses that are not covered by standard hazard insurance. If a borrower defaults on a mortgage loan that we hold, we bear the risk of loss of principal to the extent there is any deficiency between the value of the related mortgaged property and the amount owing on the mortgage loan and any insurance proceeds available to us through the mortgage insurer. In addition, since defaulted mortgage loans, which under our financing arrangements are mortgage loans that are generally 30 to 90 days delinquent in payments, may be considered ineligible collateral under our borrowing arrangements, we could bear the risk of being required to own these loans without the use of borrowed funds until they are ultimately liquidated or sold at a loss. Greater risks from non-conforming Alt-A mortgage loans We are an acquirer and originator of non-conforming Alt-A residential mortgage loans. These are residential mortgages that do not qualify for purchase by government sponsored agencies such as the 22 Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Our operations may be negatively affected due to our investments in non-conforming Alt-A mortgage loans. Credit risks associated with non- conforming Alt-A mortgage loans are greater than conforming mortgage loans. The interest rates we charge on non-conforming Alt-A loans are often higher than those charged for conforming loans in order to compensate for the lower liquidity. However, lower levels of liquidity may cause us to hold loans or other mortgage-related assets supported by these loans that we otherwise would not hold. By doing this, we assume the potential risk of increased delinquency rates and/or credit losses as well as interest rate risk. Additionally, the combination of different underwriting criteria and higher rates of interest leads to greater risk, including higher prepayment rates and higher delinquency rates and/or credit losses. Risks related to lending to non-conforming Alt-A borrowers As a lender of non-conforming Alt-A mortgage loans, we market to borrowers who may be unable to obtain mortgage financing from conventional mortgage sources. Loans made to such non-conforming Alt-A borrowers generally entail a higher risk of delinquency and higher losses than loans made to borrowers who utilize conventional mortgage sources. Delinquency, foreclosures and losses generally increase during economic slowdowns or recessions. The actual risk of delinquencies, foreclosures and losses on loans made to non-conforming Alt-A borrowers could be higher under adverse economic conditions than those currently experienced in the mortgage lending industry in general. Further, any material decline in real estate values increase the loan-to-value ratios of loans previously made by us, thereby weakening collateral coverage and increasing the possibility of a loss in the event of a borrower default. Any sustained period of increased delinquencies, foreclosures or losses after the loans are sold could adversely affect the pricing of our future loan sales and our ability to sell our loans in the future. In the past, certain of these factors have caused revenues and net income of many participants in the mortgage industry, including us, to fluctuate from quarter to quarter. Second mortgages entail greater risks Our security interest in the property securing second mortgages is subordinated to the interest of the first mortgage holder and the second mortgages have a higher cumulative loan-to-value ratio. If the value of the property is equal to or less than the amount needed to repay the borrowers obligation to the first mortgage holder upon foreclosure, all or a portion of our second mortgage loan will not be repaid. Geographic concentration of mortgage loans has higher risks We do not set limitations on the percentage of our mortgage asset portfolio composed of properties located in any one area (whether by state, zip code or other geographic measure). Concentration in any one area increases our exposure to the economic and natural hazard risks associated with that area. We estimate that a high concentration of the loans included in securitizations in which we hold residual interests are secured by properties in California and Florida. Certain parts of California and Florida have experienced an economic downturn in past years and have suffered in the past the effects of certain natural hazards. Potential losses related to recourse obligations Mortgage-backed securities issued in connection with our securitizations have been non-recourse to us, except in the case of a breach of standard representations and warranties made by us when the loans are securitized. While we have recourse against our customers, the correspondent sellers and mortgage brokers of mortgage loans, we cannot assure you that they will honor their obligations. We also engage in bulk whole loan sales pursuant to agreements that provide for recourse by the purchaser against us. In some cases, the remedies available to a purchaser of mortgage loans from us are broader than those available to us against those who sell us these loans. If a purchaser exercises its rights against us, we may not always be able to enforce whatever remedies we may have against our customers. 23 Risks related to representations and warranties in loan sales and securitizations In connection with our securitizations, we transfer loans acquired or originated by us into a trust in exchange for cash and, in the case of a CMO, residual certificates issued by the trust. The trustee will have recourse to us with respect to the breach of the standard representations and warranties made by us at the time such loans are transferred. While we generally have recourse to our customers for any such breaches, there can be no assurance of our customers' abilities to honor their respective obligations. Also, we engage in bulk whole loan sales pursuant to agreements that generally provide for recourse by the purchaser against us in the event of a breach of one of our representations or warranties, any fraud or misrepresentation during the mortgage loan origination process, or upon early default on such mortgage loan. We generally limit the potential remedies of such purchasers to the potential remedies we receive from the people from whom we acquired or originated the mortgage loans. However, in some cases, the remedies available to a purchaser of mortgage loans from us may be broader than those available to us against the sellers of the loans and should a purchaser enforce its remedies against us, we may not always be able to enforce whatever remedies we have against our customers. In the ordinary course of our business, we are subject to claims made against us by borrowers and trustees in our securitizations arising from, among other things, losses that are claimed to have been incurred as a result of alleged breaches of fiduciary obligations, misrepresentations, errors and omissions of our employees, officers and agents (including our appraisers), incomplete documentation and our failure to comply with various laws and regulations applicable to our business. We believe that our liability with respect to any currently asserted or threatened claims or legal actions are not likely to be material to our results of operations or financial condition. However, any claims asserted against us in the future may result in legal expenses or liabilities that could have a material adverse effect on our results of operations or financial condition. We face risks related to our use of IDASL We utilize the Internet in our business principally for the implementation of our automated loan origination program, IDASL. IDASL may be interrupted if the Internet experiences periods of poor performance, if our computer systems or the systems of our third-party service providers contain defects, or if customers are reluctant to use or have inadequate connectivity to the Internet. Increased government regulation of the Internet could also adversely affect our use of the Internet in unanticipated ways and discourage our customers from using our services. If our ability to use the Internet in providing our services is impaired, our ability to originate or acquire loans on an automated basis could be delayed or reduced. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period. We are subject to risks of operational failure that are beyond our control Substantially all of our operations are located in Newport Beach, California. Our systems and operations are vulnerable to damage and interruption from fire, flood, telecommunications failure, break-ins, earthquake and similar events. Our operations may also be interrupted by power disruptions, including rolling black-outs currently implemented in California due to the state's continuing acute power shortage. We do not maintain alternative power sources. Furthermore, our security mechanisms may be inadequate to prevent security breaches to our computer systems, including from computer viruses, electronic break-ins and similar disruptions. Such security breaches or operational failures could expose us to liability, impair our operations, result in losses, and harm our reputation. We rely on third-party software for the implementation of IDASL We have a licensing agreement with a third-party vendor for the use of hardware and software for IDASL. Substantially all of our correspondents are submitting loans through IDASL and 100% of all of our wholesale loans delivered by brokers are directly underwritten through the use of IDASL. The termination or impairment of this license could result in delays and reductions in the acquisition and origination of mortgage loans until 24 equivalent hardware and software could be licensed and integrated, if at all possible, which may harm our business. In addition, we would be harmed if the provider from whom we license software ceases to deliver and support reliable products, enhance their current products or respond to emerging industry standards. If the hardware or software provided by our vendor fails for any reason, and the back-up hardware and software is not implemented in a timely manner, it may also delay and reduce those mortgage loan acquisitions and originations done through IDASL. The third-party hardware and software also may not continue to be available to us on commercially reasonable terms or at all. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period. Intense competition for mortgage loans may adversely affect our operations We compete in acquiring and originating non-conforming Alt-A mortgage loans and issuing mortgage-backed securities with: . other mortgage conduit programs; . investment banking firms; . savings and loan associations; . banks; . thrift and loan associations; . finance companies; . mortgage bankers; . insurance companies; . other lenders; and . other entities purchasing mortgage assets. Some of our competitors are larger and have greater resources than we do. Consolidation in the mortgage banking industry may adversely affect us by reducing the number of current customers of our mortgage operations and our potential customer base. As a result, we may have to purchase a larger percentage of mortgage loans from a smaller number of customers, which could cause us to have to pay higher premiums for loans. We undertake additional risks in providing warehouse financing As a warehouse lender, we lend money to mortgage bankers on a secured basis and we are subject to the risks associated with lending to mortgage banks, including the risks of fraud, borrower default and bankruptcy, any of which could result in credit losses for us. Our claims as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay. We may not pay dividends to stockholders REIT provisions of the Internal Revenue Code generally require us to distribute to our stockholders at least 90% of all of our taxable income. These provisions restrict our ability to retain earnings and renew capital for our business activities. We may decide at a future time not to be treated as a REIT, which would cause us to be taxed at the corporate level and to cease paying regular dividends. Also, to date, a portion of our taxable income consists of distributions by our mortgage operations subsidiary to our long- term investment operations entity. However, our mortgage operations was not, and is not, required under the REIT provisions to make these distributions. Since we are trying to retain earnings for future growth, we may not cause our mortgage operations subsidiary to make these distributions in the future. This would materially affect the amount of taxable income generated by us and the amount of dividends required to be paid by us to our stockholders. 25 Due to losses incurred in 2000, we did not declare any dividends from September 2000 until September 25, 2001. To the extent we do not generate any taxable income, there can be no assurance that we will continue to declare and pay dividends. Potential Alternative Minimum Tax Liability To the extent we have a net operating loss carryover for federal income tax purposes, we can offset our regular taxable income for the 2001 taxable year with the net operating loss carryover and thereby eliminate our liability for regular corporate income tax on the amount of income so offset. In computing alternative minimum tax, however, we will be allowed to use only 90% of the net operating loss deduction allowable for purposes of computing the regular income tax. Thus, to the extent we shelter our income with the net operating loss carryover deduction, we will be subject to alternative minimum tax at a rate of 20% on 10% of the income offset by the net operating loss for regular tax purposes. In other words, the effective federal income tax rate on the amount offset by the net operating loss deduction is 2%. If we fail to maintain our REIT status, we may be subject to taxation as a regular corporation We believe that we have operated and intend to continue to operate in a manner that enables us to meet the requirements for qualification as a REIT for federal income tax purposes. We have not requested, and do not plan to request, a ruling from the Internal Revenue Service that we qualify as a REIT. Moreover, no assurance can be given that legislation, new regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a REIT or the federal income tax consequences of such qualification. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational and stockholder ownership requirements on a continuing basis. If we fail to qualify as a REIT, we would not be allowed a deduction for distributions to stockholders in computing our taxable income and would be subject to federal income tax at regular corporate rates. We also may be subject to the federal alternative minimum tax. Unless we are entitled to relief under specific statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year during which we were disqualified. Therefore, if we lose our REIT status, the funds available for distribution to you would be reduced substantially for each of the years involved. Failure to qualify as a REIT could adversely affect the value of our common stock. Effect of distribution requirements As a REIT, we are subject to annual distribution requirements, which limit the amount of cash we have available for other business purposes, including amounts to fund our growth. Other tax liabilities Even if we qualify as a REIT, we may be subject to certain federal, state, and local taxes on our income, property and operations that could reduce operating cash flow. 26 Our quarterly operating results may fluctuate Our results of operations, and more specifically our earnings, may significantly fluctuate from quarter to quarter based on several factors, including: . changes in the amount of mortgage loans we originate; . differences between our cost of funds on borrowings and the average interest rates earned on our mortgage loans; . our inability to complete or decisions not to complete significant bulk whole loan sales or securitizations in a particular quarter; and . problems generally affecting the mortgage loan industry. A delay in closing a particular mortgage loan sale or securitization would also increase our exposure to interest rate fluctuations by lengthening the period during which our variable rate borrowings under our warehouse facilities are outstanding. If we were unable to sell a sufficient number of mortgage loans at a premium during a particular reporting period, our revenues for that period would decline, which could have a material adverse affect on our operations. As a result, our stock price could also fluctuate. Our share prices have been and may continue to be volatile Historically, the market price of our common stock has been volatile. During 2000, our stock reached a high of $4.38 per share and a low of $1.83 per share. For the first nine months of 2001, our common stock reached a high of $8.15 per share and a low of $2.85 per share. On October 8, 2001, the closing sale price of our common stock was $7.26 per share. The market price of our common stock is likely to continue to be highly volatile and could be significantly affected by factors including: . the amount of dividends paid; . availability of liquidity in the securitization market; . loan sale pricing; . calls by warehouse lenders or changes in warehouse lending rates; . unanticipated fluctuations in our operating results; . prepayments on mortgages; . valuations of securitization related assets; . cost of funds; and . general market conditions. In addition, significant price and volume fluctuations in the stock market have particularly affected the market prices for the common stock of mortgage REIT companies such as ours. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. If our results of operations fail to meet the expectations of securities analysts or investors in a future quarter, the market price of our common stock could also be materially adversely affected. 27 Value of our Mortgage Servicing Rights is Subject to Adjustment When we purchase loans that include the associated servicing rights, the allocated cost of the servicing rights is reflected on our financial statements as mortgage servicing rights. To determine the fair value of these servicing rights, we use assumptions to estimate future net servicing income including projected discount rates, mortgage loan prepayments and credit losses. If actual prepayments or defaults with respect to loans serviced occur more quickly than we originally assumed, we would have to reduce the carrying value of our mortgage servicing rights. We do not know if our assumptions will prove correct. Our Operating Results Will be Affected by the Results of Our Hedging Activities To offset the risks associated with our mortgage operations, we enter into transactions designed to hedge our interest rate risks. To offset the risks associated with our long-term investment operations, we attempt to match the interest rate sensitivities of our adjustable rate mortgage assets held for investment with the associated financing liabilities. Our management determines the nature and quantity of the hedging transactions based on various factors, including market conditions and the expected volume of mortgage loan purchases. We do not limit management's use of certain instruments in such hedging transactions. While the Company believes that it is properly hedging its interest rate risk, the accounting for such hedging activities do not generally qualify for hedge accounting under accounting principles generally accepted in the United States of America and FAS 133. The effect of the Company's hedging strategy may result in some volatility in its quarterly earnings as interest rates go up or down. The volatility in earning is a result of the Company marking to market its hedges but not being allowed to mark to market the underlying loans related to the hedges in place. While the Company believes it is properly hedging its interest rate risk, we cannot assure you that our hedging transactions will offset our risks of losses. 28 Reduction in Demand for Residential Mortgage Loans and Our Non-Conforming Loan Products May Adversely Affect Our Operations The availability of sufficient mortgage loans meeting our criteria is dependent in part upon the size and level of activity in the residential real estate lending market and, in particular, the demand for non-conforming mortgage loans, which is affected by: . interest rates; . national economic conditions; . residential property values; and . regulatory and tax developments. If our mortgage loan purchases decrease, we will have: . decreased economies of scale; . higher origination costs per loan; . reduced fee income; . smaller gains on the sale of non-conforming mortgage loans; and . an insufficient volume of loans to effect securitizations which requires us to accumulate loans over a longer period. Our Delinquency Ratios and Our Performance May be Adversely Affected by the Performance of Parties Who Sub-Service our Loans We contract with third-party sub-servicers for the sub-servicing of all our loans, including those in our securitizations, and our operations are subject to risks associated with inadequate or untimely servicing. Poor performance by a sub-servicer may result in greater than expected delinquencies and losses on our loans. A substantial increase in our delinquency or foreclosure rate could adversely affect our ability to access the capital and secondary markets for our financing needs. Also, with respect to loans subject to a securitization, greater delinquencies would adversely impact the value of any interest-only, principal-only and subordinated securities we hold in connection with that securitization. In a securitization, relevant agreements permit us to be terminated as servicer under specific conditions described in these agreements, such as the failure of a sub-servicer to perform certain functions within specific time periods. If, as a result of a sub-servicer's failure to perform adequately, we were terminated as servicer of a securitization, the value of any servicing rights held by us would be adversely affected. 29 Recent Developments The Tax Relief Extension Act of 1999 was enacted and it contains several tax provisions regarding REITs. It includes a provision, which reduces the annual distribution requirement for REIT taxable income from 95% to 90%. It also changes the 10% voting securities test under current law to a 10% vote or value test. Thus, subject to certain exceptions, a REIT will no longer be allowed to own more than 10% of the vote or value of the outstanding securities of any issuer, other than a qualified REIT subsidiary or another REIT. One exception to this new test, which is also an exception to the 5% asset test under current law, allows a REIT to own any or all of the securities of a taxable REIT subsidiary. A taxable REIT subsidiary can perform non-customary services as well as engage in non-real estate activities. A taxable REIT subsidiary will be taxed as a regular C corporation but will be subject to earnings stripping limitations on the deductibility of interest paid to its REIT. In addition, the REIT will be subject to a 100% excise tax to the extent any transaction between the taxable REIT subsidiary and the REIT is not conducted on an arm's length basis. Securities of a taxable REIT 30 subsidiary will constitute non-real-estate assets for purposes of determining whether at least 75% of a REIT's assets consist of real estate assets. In addition, no more that 20% of a REIT's total assets can consist of securities of taxable REIT subsidiaries. These new tax provisions became effective January 1, 2001. In addition, grandfather protection is provided with respect to the 10% value test for securities of a corporation held by a REIT on July 12, 1999, but such protection ceases to apply after the corporation engages in a substantial new line of business or acquires any substantial asset and also ceases to apply after the acquisition of additional securities of the corporation by the REIT after July 12, 1999. Because we currently own more than 10% of the value of IFC, we have made an election to have

IFC become a taxable REIT subsidiary as of January 1, 2001. Potential Characterization of Distributions or Gain on Sale as Unrelated Business Taxable Income to Tax-Exempt Investors If (1) all or a portion of our assets are subject to the rules relating to taxable mortgage pools, (2) we are a "pension-held REIT," (3) a tax-exempt stockholder has incurred debt to purchase or hold our common stock, or (4) the residual REMIC interests we buy generate "excess inclusion income," then a portion of the distributions to and, in the case of a stockholder described in (3), gains realized on the sale of common stock by, such tax-exempt stockholder may be subject to Federal income tax as unrelated business taxable income under the Internal Revenue Code. Classification as a Taxable Mortgage Pool Could Subject Us to Increased Taxation If we have borrowings with two or more maturities and, (1) those borrowings are secured by mortgage loans or mortgage-backed securities and, (2) the payments made on the borrowings are related to the payments received on the underlying assets, then the borrowings and the pool of mortgage loans or mortgage backed securities to which such borrowings relate may be classified as a taxable mortgage pool under the Internal Revenue Code. If any part of our company were to be treated as a taxable mortgage pool, then our REIT status would not be impaired, but a portion of the taxable income we recognize may, under regulations to be issued by the Treasury Department, be characterized as "excess inclusion" income and allocated among our stockholders to the extent of and generally in proportion to the distributions we make to each stockholder. Any excess inclusion income would: . not be allowed to be offset by a stockholder's net operating losses; . be subject to a tax as unrelated business income if a stockholder were a tax-exempt stockholder; . be subject to the application of federal income tax withholding at the maximum rate (without reduction for any otherwise applicable income tax treaty) with respect to amounts allocable to foreign stockholders; and . be taxable (at the highest corporate tax rate) to us, rather than to our stockholders, to the extent the excess inclusion income relates to stock held by disqualified organizations (generally, tax-exempt companies not subject to tax on unrelated business income, including governmental organizations). Based on advice of our tax counsel, we take the position that our existing financing arrangements do not create a taxable mortgage pool. However, the IRS may successfully maintain that our financing arrangements do qualify as a taxable mortgage pool. In addition, we may enter into arrangements creating excess inclusion income in the future. Our Operations May be Adversely Affected if We are Subject to the Investment Company Act We intend to conduct our business at all times so as not to become regulated as an investment company under the Investment Company Act. The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. 31 In order to qualify for this exemption we must maintain at least 55% of our assets directly in mortgage loans, qualifying pass-through certificates and certain other qualifying interests in real estate. Our ownership of certain mortgage assets may be limited by the provisions of the Investment Company Act. If the Securities and Exchange Commission adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exception, we could be required to restructure our activities or sell certain of our assets. To insure that we continue to qualify for the exemption we may be required at times to adopt less efficient methods of financing certain of our mortgage assets and we may be precluded from acquiring certain types of higher-yielding mortgage assets. The net effect of these factors will be to lower at times our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption. Future Revisions in Policies and Strategies at the Discretion of Our Board of Directors May be Affected Without Stockholder Consent Our board of directors, including a majority of our unaffiliated directors, has established our investment and operating policies and strategies. We may: . invest in the securities of other REITs for the purpose of exercising control; . issue securities in exchange for property; and . repurchase or otherwise reacquire our shares or other securities in the future. In October 1998, we adopted a repurchase plan to repurchase up to $5.0 million of our common stock in the open market. In 1999, the board of directors approved common stock repurchases up to an additional $5.0 million, or a total of $10.0 million. During 1999, we repurchased 2.0 million shares of our common stock for $9.9 million. During 2000, we adopted a repurchase plan to repurchase up to $3.0 million of our common stock in the open market. As of December 31, 2000, we had repurchased 991,000 shares for $2.3 million. We may also underwrite the securities of other issuers, although we have no present intention to do so. Any of the policies, strategies and activities may be modified or waived by our board of directors, subject in certain cases to approval by a majority of our unaffiliated directors, without stockholder consent. Effect of Future Offerings May Adversely Affect Market Price of Our Securities We may elect to increase our capital resources by making additional private or public offerings of securities in the future.

We do not know: . the actual or perceived effect of these offerings; . the timing of these offerings; . the dilution of the book value or earnings per share of our securities then outstanding; and . the effect on the market price of our securities then outstanding. Risk Relating to Common Stock The sale or the proposed sale of substantial amounts of our common stock in the public market could materially adversely affect the market price of our common stock or other outstanding securities. Maryland Business Combination Statute The Maryland General Corporation Law establishes special requirements for "business combinations" between a Maryland corporation and "interested stockholders" unless exemptions are applicable. An interested stockholder is any person who beneficially owns 10% or more of the voting power of our then- outstanding 32 voting stock. Among other things, the law prohibits for a period of five years a merger and other similar transactions between our company and an interested stockholder unless the board of directors approved the transaction prior to the party becoming an interested stockholder. The five-year period runs from the most recent date on which the interested stockholder became an interested stockholder. The law also requires a supermajority stockholder vote for such transactions after the end of the five-year period. This means that the transaction must be approved by at least: . 80% of the votes entitled to be cast by holders of outstanding voting shares, and . two-thirds of the votes entitled to be cast by holders of outstanding voting shares other than shares held by the interested stockholder or an affiliate of the interested stockholder with whom the business combination is to be effected. The business combination statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests. Maryland Control Share Acquisition Statute Maryland law provides that "control shares" of a Maryland corporation acquired in a "control share acquisition" have no voting rights except to the extent approved by a vote of the other stockholders. Two-thirds of the shares eligible to vote must vote in favor of granting the "control shares" voting rights. "Control shares" are shares of stock that, taken together with all other shares of stock the acquirer previously acquired, would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power: . one-tenth or more but less than one-third, . one-third or more but less than a majority, or . a majority or more of all voting power. Control shares do not include shares of stock the acquiring person is entitled to vote as a result of having previously obtained stockholder approval. A "control share acquisition" means the acquisition of control shares, subject to certain exceptions. If a person who has made (or proposes to make) a control share acquisition satisfies certain conditions (including agreeing to pay expenses), he may compel our board of directors to call a special meeting of stockholders to consider the voting rights of the shares. If such a person makes no request for a meeting, we have the option to present the question at any stockholders' meeting. If voting rights are not approved at a meeting of stockholders then, subject to certain conditions and limitations, we may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value. We will determine the fair value of the shares, without regard to voting rights, as of the date of either: . the last control share acquisition, or . the meeting where stockholders considered and did not approve voting rights of the control shares. If voting rights for control shares are approved at a stockholders' meeting and the acquirer becomes entitled to vote a majority of the shares of stock entitled to vote, all other stockholders may exercise appraisal rights. This means that you would be able to force us to redeem your stock for fair value. Under Maryland law, the fair value may not be less than the highest price per share paid in the control share acquisition. Furthermore, certain limitations otherwise applicable to the exercise of dissenters' rights would not apply in the context of a control share acquisition. The control share acquisition statute would not apply to shares acquired in a merger, consolidation or share exchange if we were a party to the transaction. The control share acquisition statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests. Possible Adverse Consequences of Limits on Ownership of Shares Our charter limits ownership of our capital stock by any single stockholder to 9.5% of our outstanding shares. Our charter also prohibits anyone from buying shares if the purchase would result in us losing our REIT status. This could happen if a share transaction results in fewer than 100 persons owning all of our shares or in five or fewer persons, applying certain broad attribution rules of the Internal Revenue Code, owning more than 33 50% (by value) of our shares. If you or anyone else acquires shares in excess of the ownership limit or in violation of the ownership requirements of the Internal Revenue Code for REITs, we: . will consider the transfer to be null and void; . will not reflect the transaction on our books; . may institute legal action to enjoin the transaction; . will not pay dividends or other distributions with respect to those shares; . will not recognize any voting rights for those shares; . will consider the shares held in trust for the benefit of our Company; and . will either direct the affected person to sell the shares and turn over any profit to us, or . we will redeem the shares. If we redeem the shares, it will be at a price equal to the lesser of: (a) the price paid by the transferee of the shares, or (b) the average of the last reported sales prices on the American Stock Exchange on the ten trading days immediately preceding the date fixed for redemption by our board of directors. An individual who acquires shares that violate the above rules bears the risk that (1) he may lose control over the power to dispose of his shares, (2) he may not recognize profit from the sale of his shares if the market price of the shares increases and (3) he may be required to recognize a loss from the sale of his shares if the market price decreases. Limitations on Acquisition and Change in Control Ownership Limit The 9.5% ownership limit discussed above may have the effect of precluding acquisition of control of our company by a third party without consent of our board of directors. ITEM 2. PROPERTIES The primary executive and administrative offices of the Company are located in Newport Beach, California. The Company has entered into a 10-year lease expiring May 2008 to use approximately 74,000 square feet of office space at a rate of $153,000 per month. The Company believes that these facilities will adequately provide for the Company's future growth needs. ITEM 3. LEGAL PROCEEDINGS On September 1, 2000, a complaint captioned Michael P. and Shellie Gilmor v. Preferred Credit Corporation and Impac Funding Corporation, et. al. was filed in the United States District Court for the Western District of Missouri, Case No. 4-00-00795-SOW, as a purported class action lawsuit alleging that the defendants violated Missouri's Second Loans Act and Merchandising Practices Act. In July 2001, the Missouri complaint was amended to include IMH and other IMH-related entities. The plaintiffs in the Gilmor lawsuit are also alleging a defendant class action. On July 26, 2001, a complaint captioned James and Jill Baker, et al. v. Century Financial Group, Inc., et al., was filed in the Circuit Court of Clay County, Missouri, Case No. CV100-4294CC as a purported class action. This lawsuit alleges violations of Missouri's Second Loans Act and Merchandising Practices Act. The plaintiffs in the Baker action also allege a defendant class action. On August 2, 2001, a complaint captioned Frazier, et al. v. Preferred Credit, et al., was filed in the Circuit Court of Tennessee for the Thirtieth Judicial District at Memphis, Case No. CT004762-01. This is also stated as a purported class action lawsuit alleging violations of Tennessee's usury statute and Consumer Protection Act. On August 8, 2001, a complaint captioned Mattie L. Street v. PSB Lending Corp., et al., was filed in the Circuit Court of Tennessee for the Thirtieth Judicial District at Memphis, Case No. CT004888-01. The Street action is also stated as a purported class action lawsuit alleging violations of Tennessee's usury statute and Consumer Protection Act. On October 2, 2001, a complaint captioned Deborah Searcy, Shirley Walker, et. al. vs. Impac Funding Corporation, Impac Mortgage Holdings, Inc. et. al. was filed in the Wayne County Circuit Court, State of Michigan, as a purported class action lawsuit alleging that the defendants violated Michigan's Secondary Mortgage Loan Act, Credit Reform Act and Consumer Protection Act. Except for the Searcy case in Michigan, all of the foregoing cases have been removed to federal court. All of the purported class action lawsuits are similar in nature in that they allege that the mortgage loan originators violated the respective state's statutes by charging excessive fees and costs when making second mortgage loans on residential real estate. The complaints allege that IFC was a purchaser, and is a holder, along with other IMH-related entities, of second mortgage loans originated by other lenders. The plaintiffs in the lawsuits are seeking damages that include disgorgement, restitution, rescission, actual damages, statutory damages, exemplary damages, and punitive damages. Damages are unspecified in each of the complaints. The Company believes that it has meritorious defenses to such claims and intends to defend these claims vigorously. Nevertheless, litigation is uncertain, and the Company may not prevail in the lawsuits and can express no opinion as to their ultimate outcome. The Company is a party to litigation and claims, which are normal in the course of its operations. While the results of such litigation and claims cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on the Company. 34 ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Certain information contained in the following Management's Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements within the meaning of the Securities Act of 1933 and the Exchange Act of 1934 which can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "should," "anticipate," "estimate," or "believe" or comparable terminology. The Company's actual results may differ materially from those contained in the forward-looking statements. Factors which may cause such differences to occur are discussed in "Item 1. Business--Risk Factors" as well as those factors discussed below. General Impac Mortgage Holdings, Inc. was incorporated in Maryland in August 1995 and operates as a mortgage REIT, which, together with its subsidiaries and related companies, primarily operates three businesses: (1) the Long-Term Investment Operations, (2) the Mortgage Operations, and (3) the Warehouse Lending Operations. The Long-Term Investment Operations invests primarily in non-conforming residential mortgage loans and securities backed by such loans. The Mortgage Operations purchases and sells and securitizes primarily non-conforming mortgage loans. The Warehouse Lending Operations provides warehouse and repurchase financing to originators of mortgage loans. The Company elects to be taxed as a REIT for federal income tax purposes, which generally allows the Company to pass through income to stockholders without payment of federal income tax at the corporate level. The Company is entitled to 99% of the earnings or losses of IFC, IMH's non-consolidated REIT qualified subsidiary, through its ownership of all of the non-voting preferred stock of IFC. As such, the Company records its investment in IFC using the equity method. Under this method, original investments are recorded at cost and adjusted by the Company's share of earnings or losses. Relationships with Impac Entities On May 5, 1999, Impac Commercial Holdings, Inc. ("ICH") executed a stock purchase agreement pursuant to which it issued to Fortress Partners LP ("Fortress") $12.0 million of series B convertible preferred stock of ICH. In addition, FIC Management Inc. ("FIC"), an affiliate of Fortress, entered into a definitive agreement with RAI Advisors, LLC ("RAI") for the assignment of RAI's rights and interests in the management agreement with ICH. In connection with these transactions, the submanagement agreement among RAI, IMH and IFC was terminated and a new submanagement agreement was entered into among FIC, IMH and IFC and the right of first refusal agreement among RAI, ICH, ICCC, IMH and IFC was terminated. Under the new submanagement agreement, IMH and IFC provided various services including, accounting, data processing and secondary marketing to ICH, as Fortress deems necessary. On December 31, 1999, the submanagement agreement between FIC, IMH and IFC expired and subsequently Messrs. Joseph R. Tomkinson, Chairman and Chief Executive Officer of IMH, and Frank P. Filipps, an unaffiliated director of IMH, resigned from the board of directors of ICH. Many of the officers and directors of the Company are officers, directors and owners of IFC. The Company owns all of the preferred stock of, and 99% of the economic interest in, IFC, while Joseph R. Tomkinson, Chairman and Chief Executive Officer, William S. Ashmore, President, and Richard J. Johnson, Executive Vice President and Chief Financial Officer, are the holders of all of the outstanding voting stock of, and 1% of the economic interest in, IFC. Significant Transactions Common Stock Exchange Offering In March 1999, certain stockholders of the Company exchanged 1,359,507 shares of their Common Stock, at an average price of $5.70 per share, for 11% senior subordinated debentures due to mature on February 15, 2004. The debentures are unsecured obligations of the Company subordinated to all indebtedness of the Company's subsidiaries. The debentures bear interest at 11% per annum from their date of issuance, payable quarterly, commencing May 15, 1999, until the debentures are paid in full. The debentures mature on February 15, 2004, at which the date may be extended once by the Company to a date not later than May 15, 2004, provided that the Company satisfies certain 35 conditions. Commencing on February 15, 2001, the debentures are redeemable, at the Company's option, in whole at any time or in part from time to time, at the principal amount to be redeemed plus accrued and unpaid interest thereon to the redemption date. Exchange of Series B Cumulative Convertible Preferred Stock for Series C Cumulative Convertible Preferred Stock In February 2000, all shares of Series B 10.5% Cumulative Convertible Preferred Stock ("Series B Preferred Stock") was exchanged for Series C 10.5% Cumulative Convertible Preferred Stock ("Series C Preferred Stock") and the conversion rate was adjusted to $4.72 per share from $4.95 per share convertible into 5.29661 shares of Common Stock from 5.050505 shares of Common Stock or an aggregate of 6,355,932 shares of Common Stock from 6,060,606 shares of Common Stock. Other than the foregoing, the Series C Preferred Stock has the same rights, preferences and privileges as the Series B Preferred Stock. Repurchase of Common Stock During 2000, the Company's Board of Directors authorized the Company to repurchase up to $3.0 million of the Company's Common Stock. For the year ended December 31, 2000, the Company repurchased 991,000 shares of its Common Stock for $2.3 million. The acquired shares were canceled. Collateralized Mortgage Obligations The Company issued two CMOs during the year ended December 31, 2000. The first CMO was issued in January 2000 for $452.0 million and was collateralized by $428.1 million of adjustable rate mortgages and $27.6 million of residential loans secured by first or second trust deeds. The second CMO was issued in November 2000 for $491.6 million and was collateralized by $477.8 million of adjustable rate mortgages and $19.2 million of residential loans secured by second trust deeds. The new CMOs completed during 2000 included $144.0 million of mortgage loan collateral from five previous CMOs. The mortgage loan collateral from the previous CMOs was "collapsed" into the new CMOs and resulted in substantially improved capital leverage, lower borrowing costs and reduced amortization exposure on the $144.0 million of previous CMO collateral. Additionally, approximately $32.6 million of capital that was invested in the previous CMOs was released and reinvested in the Company's Long-Term Investment Operations. The issuance of CMOs provides the Company with immediate liquidity, a locked-in net interest rate spread and eliminates the Company's exposure to margin calls on such loans. Real Estate Mortgage Investment Conduits IFC issued five REMICs during the year ended December 31, 2000. The following table presents selected information on the issuance of REMICs during 2000 (dollars in millions): Issue Issuance Principal Date Issuance Name Amount Amount --------- --- 3/27/00 Impac Secured Assets Trust 2000-1.... $ 271.7 $ 275.8 6/27/00 Impac Secured Assets Trust 2000-2.... 269.5 275.0 9/26/00 Impac Secured Assets Trust 2000-3.... 344.7 349.9 11/20/00 Impac Secured Assets Trust 2000-4.... 200.0 200.0 12/21/00 Impac Secured Assets Trust 2000-5.... 200.0 200.0 Status of Acquisition of a California Thrift and Loan In July 2000, the Company withdrew its application to acquire a California Thrift and Loan ("Bank"). The decision to withdraw its application was based upon management's assessment that a mutually acceptable approval to operate the Bank was not likely. Management does not believe that the decision to withdraw its application adversely affected the Company's operations and profitability. The $14.5 million of capital, which had been set aside to capitalize the Bank upon approval of the application, was redeployed in the Company's operating businesses and to further grow the Company's balance sheet. The Company may re-evaluate this decision in the future if there is a 36 change in the regulatory environment regarding residential mortgage lending. All capitalized expenses associated with the acquisition of the Bank, which were incurred during the approval process, were written-off during 2000. Total capitalized expenses written-off by IFC during 2000 represented an after-tax charge of $781,000 to the Company. Core Business Operations Business Strategy: During 1999, the Company initiated a plan to restructure its balance sheet in order to increase book value per common share, generate additional liquidity and improve the overall credit quality of its investment securities and mortgage loan portfolios. To that end, the Company completed the following transactions during 1999: (1) the exchange of 1.4 million shares of Common Stock for 11.0% senior subordinated debt due 2/15/2004, (2) a stock repurchase program to repurchase up to $10.0 million of outstanding Common Stock and (3) the re-securitization of a portion of its investment securities portfolio. The Company continued to restructure its balance sheet during 2000 by completing the following transactions: (1) issuing two CMOs for $943.6 million, which included $144.0 million of mortgage loan collateral from five previous CMOs, (2) repurchasing $2.3 million of Common Stock, (3) writing- off $52.6 million of non-performing investment securities available-for-sale ("investment securities") and (4) providing $14.5 million of additional loan loss provisions to write-off non-performing mortgage loans, including 125 Loans. In addition to executing the Company's plan to restructure its balance sheet during 2000, the Company renewed its focus on its core business operations, the Long-Term Investment Operations, the Mortgage Operations and the Warehouse Lending Operations, which produced positive operating earnings during the year ended December 31, 2000. During 2000, the Long-Term Investment Operations increased its loan portfolio while improving credit quality of Mortgage Assets on its balance sheet, the Mortgage Operations increased loan production while the wholesale and retail mortgage platforms operated by ILG continued to grow and the Warehouse Lending Operations increased average finance receivables and its customer base. The Long-Term Investment Operations portfolio of mortgage loans increased 8% to $1.4 billion at December 31, 2000 as compared to $1.3 billion at December 31, 1999. As the long-term loan portfolio grew, the weighted average LTV decreased to 85% at December 31, 2000 from 86% at December 31, 1999 while mortgage loans that were 90 or more days past due and real estate owned (collectively, "Non-performing Loans") decreased 24% to $46.1 million as compared to $60.7 million, respectively. The loan delinquency rate on loans 60 or more days past due decreased to 4.89% as of December 31, 2000 from 5.43% as of December 31, 1999. In addition, during 2000 the Company wrote-off substantially all investment securities secured by HLTV second trust deeds, investment securities secured by franchise loan receivables and certain sub- prime subordinated securities, all of which were acquired prior to 1998. Subsequent to 1997, the Company's investment strategy has been to only acquire or invest in investment securities that are secured by mortgage loans underwritten and purchased by the Mortgage Operations due to their superior historical performance. The Company believes that increased loan production by the Mortgage Operations was due to the Company's superior loan programs and services offered by the Mortgage Operations, and also partly due to the success of the Company's automated underwriting system, called IDASL, which stands for Impac Direct Access System for Lending. IDASL has exceeded, and continues to exceed, the Company's initial expectations as loan submissions through IDASL by the Mortgage Operations' correspondent sellers and wholesale brokers has increased each quarter since IDASL's implementation during the first quarter of 2000. Loan submissions during the fourth quarter of 2000 averaged $555.5 million per month in loan volume as compared to $438.0 million per month during the third quarter of 2000 and $236.0 million per month during the second quarter of 2000. By December 31, 2000, substantially all of IFC's correspondent sellers were submitting loans through IDASL and 100% of all wholesale loans delivered by brokers were directly underwritten through IDASL. IDASL is not a lead generator for mortgage brokers, but is an interactive internet system that enables the Company's customers to access loan status, current pricing, purchase confirmations and receive consistent and reliable automated loan underwriting decisions within minutes. In addition, IDASL has an integrated credit-reporting interface that provides the Company's customers with a very competitive tool enabling them to render a loan decision at point of sale. IDASL dramatically increases efficiencies not only for our customers but also for the Mortgage Operations by significantly decreasing the processing time for a mortgage loan, while improving employee production and maintaining superior customer service, which together leads to higher closing 37 ratios, improved profit margins and increased profitability at all levels of its business operations. Most importantly, IDASL allows the Mortgage Operations to move closer to its borrowers with minimal future capital investment while maintaining centralization, a key factor in the success of the Company's operating strategy. Loan production by the Mortgage Operations increased 24% to $2.1 billion during 2000 as compared to $1.7 billion during 1999 as total originations of 1-4 family properties as forecast by the Mortgage Bankers Association ("MBA") decreased 20% during 2000 as compared to 1999. According to the MBA, the primary reason for the forecasted decrease in total 1-4 family originations during 2000 is the decrease in refinance activity. The MBA forecasts a decrease in refinance activity to 19% of total 1-4 family originations during 2000 as compared to actual refinance activity of 34% of total 1-4 family originations during 1999. The Mortgage Operations is less affected by volatile changes in the refinance market as it continues to rely primarily on purchased money activity as compared to refinance activity. The Mortgage Operations acquired or originated mortgage refinances of 19% of total loan production during 2000 and 23% of total loan production during 1999. Wholesale and retail loan originations generated by ILG, which was established in January 1999, increased 210% to $276.3 million during 2000 as compared to $89.0 million during 1999. As of December 31, 2000, ILG had 983 approved wholesale mortgage brokers. The Company expects loan originations at ILG to remain strong during 2001 with the expected implementation of IDASL with the Mortgage Operations' strategic partner. ILG's strategic partner supplies mortgage automation software and provides an internet connection to 33,000 users nationwide with direct automated download capabilities to the Mortgage Operations' products via IDASL. Recently, ILG's strategic partner was acquired by Ellie Mae, a provider of internet solutions to the mortgage industry, which the Company believes will further enhance ILG's penetration into the wholesale lending arena. In order to mitigate interest rate and market risk, the goal of the Mortgage Operations during 2001 is to continue to securitize its mortgage loans more frequently. The Company believes this will require less capital and will provide more liquidity with less interest rate and price volatility as the accumulation and holding period of mortgage loans is reduced. The Mortgage Operations successfully completed two REMIC securitizations in November and December of 2000 for an aggregate of $400.0 million as compared to one REMIC per quarter for each of the first three quarters of 2000. Additionally, the Mortgage Operations completed a REMIC securitization in January of 2001 for $200.0 million. During the fourth quarter of 2000, the Warehouse Lending Operations focused on internal restructuring and technology initiatives, including the development and implementation of a web-based funding and delivery system, with the overall goal of increasing its customer base and outstanding balances during 2001. The Warehouse Lending Operations continued to provide a consistent contribution to net earnings during 2000. The Company did not declare a common stock dividend during the fourth quarter of 2000 and plans to utilize its tax loss carry forwards during 2001. The Company believes that it is prudent to take advantage of its tax loss carry forwards and retain capital to continue the expansion and growth of its core operating businesses. The Company believes that the retention of earnings will allow the Company to increase its assets and book value during 2001. The Company will likely need to pay common stock dividends in 2002 as the tax loss carry forwards are expected to be completely used. Diluted book value decreased to $6.67 per common share at December 31, 2000 as compared to diluted book value of $8.60 per common share at December 31, 1999. Book value declined during 2000 as the Company wrote-down investment securities of $52.6 million, increased its allowance for loan losses to absorb realized losses of $17.8 million, primarily from HLTV loans, and declared preferred and common stock dividends of $10.9 million. Long-Term Investment Operations: During the year ended December 31, 2000, the Long-Term Investment Operations, conducted by IMH and IMH Assets, acquired $454.0 million of mortgages from IFC as compared to $638.3 million acquired during 1999. Mortgages purchased by the Long-Term Investment Operations during 2000 consisted of $23.3 million of FRMs and $418.2 million of ARMs secured by first liens on residential property and $12.5 million of fixed rate second trust deeds secured by residential property. In addition, $213.9

million, or 50%, of mortgages acquired during 2000 for long-term investment had prepayment penalties as compared to $222.9 million, or 35%, of mortgages with prepayment penalties acquired during 1999. During 2000, the Long-Term Investment Operations sold $55.9 million, in unpaid principal balance, of mortgage loans to third party investors as compared to $10.8 million of loans sold to third party investors during 1999. In addition, the Long-Term Investment Operations 38 had investment securities of $36.9 million at December 31, 2000. Of the $36.9 million of investment securities, $29.2 million were subordinated securities collateralized by mortgages, $7.7 million were "interest only" securities, and none were subordinated securities collateralized by other loans. During 2000, the Long-Term Investment Operations acquired no securities created by IFC through the issuance of REMICs as compared to $22.0 million during 1999. During 2000, IMH Assets issued CMOs totaling $943.6 million, which were collateralized by $952.8 million of mortgage loans, as compared to CMOs totaling $298.1 million, which were collateralized by $316.2 million of mortgage loans, during 1999. As of December 31, 2000, the Long-Term Investment Operations' portfolio of mortgage loans consisted of $1.4 billion of mortgage loans held in trust as collateral for CMOs and $16.7 million of mortgage loans held-for- investment, of which approximately 26% were FRMs and 74% were ARMs. The weighted average coupon of the Long-Term Investment Operations portfolio of mortgage loans was 9.34% at December 31, 2000 with the weighted average margin of 4.17%. The portfolio of mortgage loans included 90% of non-conforming A Loans and 10% of B/C Loans. During 2000, constant prepayment rates ("CPR") on the Company's CMO portfolio decreased to 25% CPR as compared to 37% CPR during 1999. The loan delinquency rate of mortgages held for long-term investment which were 60 or more days past due, inclusive of foreclosures and delinquent bankruptcies, decreased to 4.89% at December 31, 2000 as compared to 5.43% at December 31, 1999. Mortgage Operations: The Mortgage Operations, conducted by IFC and ILG, supports the Long-Term Investment Operations of the Company by supplying IMH and IMH Assets with mortgages for long-term investment. As such, IFC sold $454.0 million, in unpaid principal balance, of mortgages to the Long-Term Investment Operations as compared to $638.3 million, in unpaid principal balance, of loans sold during 1999. IFC's mortgage acquisitions increased 24% to $2.1 billion during 2000 as compared to $1.7 billion of mortgages acquired during 1999. During 2000, IFC securitized $1.3 billion, in unpaid principal balance, of mortgages and sold whole loans to third party investors totaling $62.6 million, in unpaid principal balance, of mortgages. This compares to loan securitizations of $360.1 million, in unpaid principal balance, of mortgages and whole loan sales to third party investors of $824.1 million, in unpaid principal balance, of mortgages during 1999. Loan securitizations and sales during 2000 resulted in gain on sale of loans of $19.7 million as compared to gain on sale of loans of $27.1 million during 1999. IFC had deferred revenue of $5.0 million at December 31, 2000 as compared to $7.6 million at December 31, 1999. IFC's master servicing portfolio increased 38% to $4.0 billion at December 31, 2000 as compared to $2.9 billion at December 31, 1999. Of the $4.0 billion of mortgage loans master serviced by IFC at December 31, 2000, IFC is the master servicer for $2.6 billion of loans collateralizing REMIC securities and $1.3 billion of mortgage loans collateralizing CMOs. In addition, of the $4.0 billion of loans master serviced by IFC, IFC owns servicing rights on $2.4 billion in unpaid principal balance of mortgages. Mortgages collateralized by properties located in California represented 39% and 40% of IFC's master servicing portfolio at December 31, 2000 and 1999, respectively. The loan delinquency rate of mortgages in IFC's master servicing portfolio which were 60 or more days past due, inclusive of foreclosures and delinquent bankruptcies, was 4.24% and 4.37% at December 31, 2000 and 1999, respectively. Warehouse Lending Operations: The Warehouse Lending Operations, conducted by IWLG, had outstanding finance receivables of $405.4 million of which $138.4 million was outstanding to external customers. As of December 31, 2000, IWLG had approved warehouse lines available to 52 external customers totaling $391.5 million as compared to 46 customers totaling $325.0 million as of December 31, 1999. Overall, average finance receivables increased 32% to $418.8 million during 2000 as compared to $317.5 million during 1999 while average finance receivables to external customers increased 59% to $134.7 million from $84.8 million, respectively. RESULTS OF OPERATIONS-- IMPAC MORTGAGE HOLDINGS, INC. Year Ended December 31, 2000 as compared to Year Ended December 31, 1999 Results of Operations Net loss for the year ended December 31, 2000 was $(54.2) million, or $(2.70) per diluted common share, compared to net earnings of $22.3 million, or $0.76 per diluted common share, for 1999. The loss for 2000 was 39 primarily the result of non-recurring, non-cash accounting charges ("accounting charges") of $68.9 million. Accounting charges taken during 2000 included the write-down of $52.6 million of investment securities and additional increases in the Company's allowance for loan loss of $14.5 million. Due to the continued deterioration in the performance of collateral supporting specific investment securities, the Company wrote-off substantially all remaining book value on these investment securities during 2000, which included all investment securities secured by HLTV second trust deeds, investment securities secured by franchise mortgage receivables and certain sub-prime subordinated securities, all of which were acquired prior to 1998. Starting in 1998, the Company's investment strategy has been to only acquire or invest in investment securities that are secured by mortgage loans underwritten and purchased by IFC due to their superior historical performance. In addition, based on losses and delinquencies in the HLTV portfolio during 2000, the Company increased the loan loss allowance to provide for losses inherent in the remaining HLTV second trust deed portfolio. Lastly, IFC wrote off substantially all of its remaining investment securities, which were secured by franchise mortgage receivables, resulting in an after-tax charge to the Company of $1.0 million. Excluding accounting charges, net operating earnings was $14.7 million, or $0.54 per diluted common share, as compared to net operating earnings of $22.3 million, or $0.76 per diluted common share, during the same period of 1999. The decrease in net operating earnings during 2000 was primarily the result of a $6.7 million decrease in net interest income as compared to 1999. The decrease in net interest income during 2000 was primarily the result of rising short-term interest rates, which adversely affected net interest margins on Mortgage Assets. Although the decrease in short-term interest rates during the first quarter of 2001 had no effect on 2000 earnings, earnings throughout 2001 should improve as net interest margins on Mortgage Assets, primarily CMO collateral and loans held-for-investment, improve. Net Interest Income Net interest income decreased 23% to $23.0 million during 2000 as compared to $29.7 million during 1999. Interest income is primarily interest earned on Mortgage Assets and includes interest income earned on cash and cash equivalents and due from affiliates. Interest expense is primarily interest paid on borrowings on Mortgage Assets and includes interest expense paid on due to affiliates and senior subordinated debt. Mortgage Assets include CMO collateral, mortgage loans held-for-investment, finance receivables and investment securities. Borrowings on Mortgage Assets include CMO financing, reverse repurchase agreements and borrowings on investment securities. The decrease in net interest income during 2000 as compared to 1999 was primarily the result of smaller net interest margins on Mortgage Assets which decreased to 1.23% during 2000 as compared to 1.84% during 1999 as average Mortgage Assets increased 13% to $1.8 billion as compared to $1.6 billion, respectively. Net interest margins on average CMO collateral decreased to 0.47% during 2000 as compared to 0.79% during 1999 as the rapid increase in short-term interest rates during 2000 resulted in compression of net interest margins. As short-term interest rates increased rapidly during 2000, CMO financing costs, which are indexed to one-month LIBOR and adjust every month, increased at a faster pace than interest rates on CMO collateral, which primarily have the following characteristics: (1) adjustable rate loans that are indexed to six-month LIBOR and adjust every six months but are subject to periodic and lifetime interest rate caps and (2) mortgage loans that have fixed interest rates for the first two to three years of the loan and subsequently change to adjustable interest rate loans. Short-term interest rates increased during 2000 as one-month and six-month LIBOR averaged 6.42% and 6.65%, respectively, as compared to 5.25% and 5.53%, respectively, during 1999. In addition, the yield curve during most of 2000 was inverted, which means that interest rates in the short-end of the yield curve were higher than interest rates in the long-end of the yield curve. This inverted yield curve also contributed to compression of net interest margins as interest rates on mortgage loans set by the Mortgage Operations primarily use the ten-year Treasury yield as an index plus a margin. Therefore, mortgage loan rates were set using interest rates on the ten-year Treasury yield which increased at a slower rate than short-term interest rates on one-month LIBOR, which is used as the index to establish the borrowing rates on reverse repurchase agreements and CMO financing. The following table summarizes average balance, interest and weighted average yield on Mortgage Assets and borrowings for the years ended December 31, 2000 and 1999 and includes interest income on Mortgage Assets and interest expense related to borrowings on Mortgage Assets only (dollars in thousands): 40 For the year ended December 31, 2000 For the year ended December 31, 1999 --- --- Weighted Weighted Average Avg. % of Average Avg. % of Balance Interest Yield Portfolio Balance Interest Yield Portfolio ---------- ---------- -------- --------- --------- ---------- --------- --------- MORTGAGE ASSETS --------------- Subordinated securities collateralized by mortgages . $ 57,651 $ 7,249 12.57% 3.21% $ 87,107 $ 12,604 14.47% 5.56% Subordinated securities collateralized by other loans 2,871 273 9.51 0.16 7,433 834 11.22 0.47 ---------- ---------- ---------- ---------- Total investment securities 60,522 7,522 12.43 3.37 94,540 13,438 14.21 6.03 ---------- ---------- ---------- ---------- Loan receivables: CMO collateral .... 1,198,478 85,923 7.17 66.69 1,119,813 74,096 6.62 71.48 Mortgage loans held-for-investment .... 119,326 8,966 7.51 6.64 34,767 2,345 6.74 2.22 Finance receivables: Affiliated .... 284,070 28,044 9.87 15.80 232,741 19,566 8.41 14.86 Non-affiliated 134,741 14,280

10.60 7.50 84,783 7,779 9.18 5.41 ---------- ---------- ---------- ---------- Total finance receivables .. 418,811 42,324 10.11 23.30 317,524 27,345 8.61 20.27 ---------- ---------- ---------- ---------- Total Loan Receivables ..... 1,736,615 137,213 7.90 96.63 1,472,104 103,786 7.05 93.97 ---------- ---------- ---------- ---------- Total Mortgage Assets .... $1,797,137 $ 144,735 8.05% 100.00% $1,566,644 $ 117,224 7.48% 100.00% ========== ========== ========== ========== BORROWINGS ---------- CMO borrowings .... $1,100,151 $ 80,287 7.30% 67.06% $1,017,992 $ 65,212 6.41% 74.25% Reverse repurchase agreements-mortgages .... 513,987 39,216 7.63 31.33 331,179 21,545 6.51 24.16 Borrowings secured by investment securities .... 26,350 3,217 12.21 1.61 6,445 686 10.64 0.47 Reverse repurchase agreements-securities .... -- -- -- -- 15,377 998 6.49 1.12 ---------- ---------- ---------- ---------- Total Borrowings on Mortgage Assets .... $1,640,488 $ 122,720 7.48% 100.00% $1,370,993 $ 88,441 6.45% 100.00% ========== ========== ========== ========== Net Interest Spread (1) .... 0.57% 1.03% Net Interest Margin (2) .... 1.23% 1.84% ---------- (1) Calculated by subtracting the yield on total borrowings on Mortgage Assets from the yield on total Mortgage Assets. (2) Calculated by subtracting interest on total borrowings on Mortgage Assets from interest on total Mortgage Assets and dividing the result by the average balance of total Mortgage Assets. Interest income on Mortgage Assets: Interest income on CMO collateral increased 16% to $85.9 million during 2000 as compared to $74.1 million during 1999 as average CMO collateral increased 9% to $1.2 billion as compared to $1.1 billion, respectively. Average CMO collateral increased as the Long-Term Investment Operations issued CMOs totaling $943.6 million during 2000, which were collateralized by $952.8 million of mortgages, as compared to CMOs totaling $298.1 million, which were collateralized by $316.2 million of mortgages, during 1999. The issuance of new CMO collateral was partially offset by mortgage loan prepayments, which were $309.7 million during 2000 as compared to $490.0 million during 1999. Prepayments on CMO collateral was 25% CPR during 2000 as compared to 37% CPR during 1999 as rising interest rates during 2000 and the acquisition of loans with prepayment penalties slowed down the pace of loan prepayments during 2000. The acquisiton of $213.9 million, or 50%, of mortgages acquired during 2000 by the Long-Term Investment Operations with prepayment penalties and $222.9 million, or 35%, of mortgages acquired with prepayment penalties during 1999 contributed to less volatility in loan prepayments during 2000. The Company expects that the higher percentage of mortgages acquired for long-term investment with prepayment penalties will continue to lead to less volatility in loan prepayment rates. 41 An increase in the weighted average yield on CMO collateral also contributed to an overall increase in interest income on CMO collateral during 2000 as compared to 1999. The weighted average yield on CMO collateral increased to 7.17% during 2000 as compared to 6.62% during 1999. The increase in yield on CMO collateral during 2000 was primarily due to an increase in interest rates and a reduction in prepayment rates and therefore the amortization of net premiums paid in acquiring the mortgage loans held as CMO collateral. During 2000, the Company amortized net premiums on CMO collateral of $10.6 million as compared to $14.4 million during 1999 as loan prepayment rates decreased during 2000. On a go-forward basis, the Company has less exposure to premium amortization as net premiums on CMO collateral as of December 31, 2000 was $22.8 million as compared to $28.8 million at December 31, 1999. Interest income on mortgage loans held-for-investment increased 291% to $9.0 million during 2000 as compared to $2.3 million during 1999 as average mortgage loans held-for-investment increased 243% to $119.3 million as compared to $34.8 million, respectively. Average mortgage loans held-for-investment increased during 2000 as the Long-Term Investment Operations held and accumulated mortgage loans over a longer period of time before completing CMOs as compared to during 1999 when the Company's focus was more towards increased liquidity and reduced leverage. Additionally, the increase in interest income on mortgage loans held-for-investment during 2000 benefited by an increase in the weighted average yield, which increased to 7.51% during 2000 as compared to 6.74% during 1999 as interest rates rose. Interest income on mortgage loans held-for-investment also includes the effect of amortization of net premiums paid in acquiring the mortgage loans. As of December 31, 2000, net discounts on mortgage loans held-for-investment was $208,000 as compared to net premiums of $2.0 million as of December 31, 1999. Interest income on finance receivables increased 55% to $42.3 million during 2000 as compared to $27.3 million during 1999 as average finance receivables increased 32% to $418.8 million as compared to $317.5 million, respectively. Average finance receivables increased during 2000 as IFC acquired and originated $2.1 billion of mortgage loans as compared to loan production of $1.7 billion during 1999, which resulted in an increase in average finance receivables to $284.0 million as compared to $232.7 million, respectively. In addition, average finance receivable to non-affiliates increased by 59% to $134.7 million during 2000 as compared to $84.8 million during 1999 as IWLG added customers during 2000. Interest income on finance receivables was also positively affected by an increase in weighted average yield, which increased to 10.11% during 2000 as compared to 8.61% during 1999 as the average prime rate rose during 2000. The prime rate is the index the Company uses to determine interest rates on finance receivables. Average prime during 2000 was 9.23% as compared to 8.00% during 1999. Interest income on investment securities decreased 44% to $7.5 million during 2000 as compared to $13.4 million during 1999 as average investment securities decreased 36% to $60.5 million as compared to $94.5 million, respectively. Average investment securities decreased as the Company wrote-off $52.6 million of investment securities during 2000. Interest income on investment securities was also negatively affected by a decrease in the weighted average yield on investment securities, which decreased to 12.43% during 2000 as compared to 14.21% during 1999. The weighted average yield on investment securities decreased during 2000 as the Company wrote-off higher yielding investment securities secured by HLTV second trust deed loans, investment securities secured by franchise mortgage receivables and certain sub-prime subordinated securities, which deteriorated during the first half of 2000. Interest expense on borrowings: Interest expense on CMO borrowings increased 23% to $80.3 million during 2000 as compared to $65.2 million during 1999 as average borrowings on CMO collateral increased 10% to $1.1 billion as compared to $1.0 billion, respectively. Average CMO borrowings increased as the Long-Term Investment Operations issued CMOs totaling $943.6 million during 2000 as compared to CMOs totaling $298.1 million during 1999, which was partially offset by mortgage loan prepayments of $309.7 million during 2000 as compared to $490.0 million during 1999. Interest expense on CMO borrowings also increased as the weighted average yield on CMO borrowings increased to 7.30% during 2000 as compared to 6.41% during 1999 as average one-month LIBOR, which is the index used to determine rates on adjustable rate CMO borrowings, was higher during 2000 as compared to 1999. Average one-month LIBOR was 6.42% during 2000 as compared to 5.25% during 1999. In addition, interest expense on CMO borrowings is affected by the amortization of securitization costs. Securitization costs are incurred when a CMO is issued and securitization costs are capitalized and amortized over the life of the CMO borrowings as an adjustment to the yield. During 2000, the Company amortized securitization costs of $4.7 million as compared to $4.2 million during 1999 due to the increase in CMOs issued during 2000. As of December 31, 2000, unamortized 42 securitization costs were $14.1 million as compared to unamortized securitization costs of $11.9 million at December 31, 1999. Interest expense on reverse repurchase borrowings, which are used to fund the acquisition of mortgage loans and finance receivables, increased 82% to $39.2 million during 2000 as compared to $21.5 million during 1999 as average reverse repurchase agreements increased 55% to $514.0 million as compared to $331.2 million, respectively. The increase in average reverse repurchase borrowings was primarily related to the previously discussed increase in average finance receivables to IFC and IWLG's external customers. The Warehouse Lending Operations uses reverse repurchase agreements with investment banks to fund its short-term loans to affiliates, primarily IFC, and non-affiliates. The weighted average yield of reverse repurchase agreements collateralized by mortgage loans increased to 7.63% during 2000 as compared to 6.51% during 1999 as average one-month LIBOR, which is the index used by the Company's lenders to determine interest rates on reverse repurchase borrowings, increased during 2000 as compared to 1999. Interest expense on borrowings secured by investment securities increased 88% to $3.2 million during 2000 as compared to $1.7 million during 1999 as average borrowings increased 21% to $26.4 million as compared to $21.8 million, respectively. During 1999, the Company issued notes collateralized by a portion of its investment securities portfolio to provide a more stable, long-term financing source for these assets as compared to previously used short-term reverse repurchase agreements. The weighted average yield on borrowings secured by investment securities increased to 12.21% during 2000 as compared to 10.64% during 1999. Non-Interest Income Non-interest income decreased to $2.5 million during 2000 as compared to $6.9 million during 1999. Non-interest income decreased primarily due to a decrease in equity in net earnings (loss) of IFC. Equity in net earnings (loss) of IFC decreased to a loss of $(1.8) million during 2000 as compared to net earnings of $4.3 million during 1999. In addition to the decrease in earnings at IFC, servicing income decreased by $680,000 as income from the collection of prepayment penalties decreased in conjunction with the decrease in loan prepayments. The decrease in earnings at IFC and servicing fees was partially offset by in increase of $2.4 million in other income, which was the result of litigation settlement and an increase in fees from increased warehouse line activity by IFC and IWLG's external customers. Equity in Net Earnings (Loss) of IFC Equity in net earnings (loss) of IFC decreased to a loss of $(1.8) million during 2000 as compared to earnings of $4.3 million during 1999 primarily due to a decrease of $7.4 million in gain on sale of loans. The Company records 99% of the earnings or losses from IFC, as the Company owns 100% of IFC's preferred stock, which represents 99% of the economic interest in IFC. For more information on the results of operations of IFC, refer to "--Results of Operations--Impac Funding Corporation." Non-Interest Expense Non-interest expense increased to $60.9 million during 2000 as compared to $8.7 million during 1999 primarily due to a $51.6 million increase in write-down of investment securities. Write-down of investment securities increased to $53.6 million during 2000 as compared to $2.0 million during 1999 as the Company substantially wrote-off all remaining book value of investment securities secured by HLTV second trust deeds, investment securities secured by franchise mortgage receivables and certain sub-prime subordinated securities, all of which were acquired prior to 1998. After excluding the write-down of investment securities, non-interest expense increased 9% to $7.3 million as compared to $6.7 million during 1999, which was the result of a $787,000 write-down of securitization costs from the collapse of four previous CMOs into new CMOs completed during 2000. Credit Exposures Non-performing Assets. Non-performing assets consist of loans that are 90 days or more delinquent ("non-accrual loans"), including loans in foreclosure and delinquent bankruptcies, and real estate acquired in settlement of loans, or 43 other real estate owned. It is the Company's policy to place a mortgage loan on non-accrual status when a loan becomes 90 days delinquent. Any previously accrued interest will be reversed from income. Non-accrual loans are included in mortgage loans held-for-sale at IFC and mortgage loans held-for-investment and CMO collateral at IMH and IMH Assets. The outstanding unpaid principal balance of non-performing assets totaled $49.9 million at December 31, 2000 as compared to $63.3 million at December 31, 1999. The decrease in non-performing assets was primarily due to the sale of delinquent mortgage loans held-for-investment at IMH, which included 125 Loans, and mortgage loans held-for-sale at IFC. The carrying amount of other real estate owned, after writing down the mortgage loan to the broker's price opinion or appraised value, was $4.7 million and $8.8 million at December 31, 2000 and 1999, respectively. The Company recorded losses on the disposition of other real estate owned of $1.8 million and $2.2 million during 2000 and 1999, respectively. The Company monitors its sub-servicers to make sure that they perform loss mitigation, foreclosure and collection functions according to the Company's written policies. This includes an effective and aggressive collection effort in order to minimize mortgage loans from becoming non-performing assets. However, when resolving non-performing assets, the Company's sub-servicers are required to take timely and aggressive action. The sub-servicer is required to determine collectibility under various circumstances, which will result in maximum financial benefit to the Company. This is accomplished by either working with the borrower to bring the loan current or by foreclosing and liquidating the property. The Company performs ongoing reviews of loans that display weaknesses and believes it maintains adequate loss allowances on the mortgage loans. The following table summarizes the unpaid principal balance of the Company's non-performing assets included in its mortgage loan portfolios for the periods shown (in thousands): At December 31, ------------------- 2000 1999 ------- ------- Mortgage Loans Held-for-Sale: Non-accrual .... $ 3,680 $ 2,572 Other real estate owned .... 148 -- ------- ------- Total mortgage loans held-for-sale .... 3,828 2,572 ------- ------- Mortgage Loans Held-for-Investment: Non-accrual .... 10,197 8,229 In process foreclosures .... 3,168 306 ------- ------- Total mortgage loans held-for-investment .... 13,365 8,535 ------- ------- CMO collateral: Non-accrual .... 28,798 42,792 Other real estate owned .... 3,883 9,411 ------- ------- Total CMO collateral .... 32,681 52,203 ------- ------- Total mortgage loan portfolios .... $49,874 $63,310 ======= ======= Delinquent Loans. When a borrower fails to make required payments on a loan and does not cure the delinquency within 60 days, the Company generally records a notice of default and commences foreclosure proceedings. If the loan is not reinstated within the time permitted by law for reinstatement, the property may then be sold at a foreclosure sale. In foreclosure sales, the Company generally acquires title to the property. At December 31, 2000, loans that were delinquent 60 days or more, as a percentage of the outstanding servicing balance of the mortgage loan portfolios, was 4.89% as compared to 5.43% at December 31, 1999. This includes loans in the long-term investment portfolio. Loans that are 30 days delinquent may experience seasonality and servicing transfer issues so they are therefore excluded. The following table summarizes the unpaid principal balance of the Company's delinquent mortgage loans included in its mortgage loan portfolios for the periods shown (in thousands): 44 At December 31, -------------------- 2000 1999 -------- -------- Mortgage Loans Held-for-Sale: 60-89 days delinquent .... $ 861 $ 1,838 90 or more days delinquent (1) .... 3,680 2,572 -------- -------- Total mortgage loans held-for-sale .... 4,541 4,410 -------- -------- Mortgage Loans Held-for-Investment: 60-89 days delinquent .... 115 1,453 90 or more days delinquent (1) .... 10,197 8,229 -------- -------- Total mortgage loans held-for-investment .... 10,312 9,682 -------- -------- CMO collateral: 60-89 days delinquent .... 25,098 12,398 90 or more days delinquent (1) .... 28,798 42,792 -------- -------- Total

CMO collateral .... 53,896 55,190 -------- -------- Total mortgage loan portfolios .... $ 68,749 $ 69,282 ======== ======== ---------- (1) Includes loans in foreclosure and delinquent bankruptcies. Provision for Loan Losses. The Company's total allowance for loan losses expressed as a percentage of Gross Loan Receivables which includes loans held-for-investment, CMO collateral and finance receivables, increased to 0.28% at December 31, 2000 as compared to 0.27% at December 31, 1999. The Company recorded net loan loss provisions of $18.8 million during 2000 as compared to $5.5 million during 1999. The amount provided for loan losses during 2000 increased primarily due to the subsequent disposition or write-off of 125 Loans. The allowance for loan losses is determined primarily on the basis of management's judgment of net loss potential including specific allowances for known impaired loans, changes in the nature and volume of the portfolio, value of the collateral and current economic conditions that may affect the borrowers' ability to pay. Year Ended December 31, 1999 as compared to Year Ended December 31, 1998 Results of Operations Net earnings for the year ended December 31, 1999 of $22.3 million, or $0.76 per diluted common share, compared to a net loss of $(5.9) million, or $(0.25) per diluted common share, for 1998. The loss for 1998 was primarily due to a global liquidity crisis in the mortgage-backed securitization market, which occurred during the latter half of 1998. The deterioration of the mortgage-backed securitization market created liquidity problems as the Company's lenders made margin calls on their repurchase agreements. In order to meet margin calls and reduce borrowings on its outstanding reverse repurchase agreements, the Company sold mortgage loans and mortgage-backed securities at significant losses. In addition, the Company recorded impairment charges on its investment securities and recorded a loss on the sale of its equity investment in ICH. However, as the mortgage-backed securitization market stabilized during 1999, the Company returned to overall profitability, which in large part was due to the profitability on the sale of its mortgage loans at IFC. Net Interest Income Net interest income decreased 29% to $29.7 million during 1999 as compared to $42.0 million during 1998. The decrease in net interest income during 1999 as compared to 1998 was primarily the result of lower average Mortgage Assets, which decreased 20% to $1.6 billion during 1999 as compared to $2.0 billion during 1998. Average Mortgage Assets decreased during 1999 as compared to 1998 principally due to the sale of mortgage loans during the fourth quarter of 1998 in order to increase liquidity and meet margin calls. The Company continued to raise liquidity and reduce leverage throughout 1999 as IFC completed monthly whole loan sales on a servicing released basis. As such, 45 the Long-Term Investment Operations' loan acquisitions from IFC decreased 26% to $638.3 million as compared to $866.7 million acquired during 1998. Additionally, due to IFC's decreased loan production and the shorter accumulation and holding period between monthly whole loan sales, average finance receivables to affiliates, primarily IFC, decreased 42% to $232.7 million during 1999 as compared to $403.9 million during 1998. Net interest income also decreased as the net interest margin on Mortgage Assets decreased to 1.84% during 1999 as compared to 2.14% during 1998. The decrease in net interest margin on Mortgage Assets was primarily the result of a decrease in the net interest margin on CMO collateral to 0.79% during 1999 as compared to 1.26% during 1998. The decrease in the net interest margin on CMO collateral during 1999 was primarily due to an increase in amortization of net premiums as a result of higher loan prepayments. CMO collateral significantly affects changes in net interest income as it represents the largest percentage of total Mortgage Assets. Average CMO collateral accounted for 71% of total average Mortgage Assets during 1999 and 63% of total average Mortgage Assets during 1998. The following table summarizes average balance, interest and weighted average yield on Mortgage Assets and borrowings for the years ended December 31, 1999 and 1998 and includes interest income on Mortgage Assets and interest expense related to borrowings on Mortgage Assets only (dollars in thousands): For the year ended December 31, 1999 For the year ended December 31, 1998 -- -- Weighted Weighted Average Avg. % of Average Avg. % of Balance Interest Yield Portfolio Balance Interest Yield Portfolio ---------- ---------- -------- --------- --------- ---------- --------- --------- MORTGAGE ASSETS --------------- Subordinated securities collateralized by mortgages .... $ 87,107 $ 12,604 14.47% 5.56% $ 88,544 $ 11,219 12.67% 4.47% Subordinated securities collateralized by other loans .. 7,433 834 11.22 0.47 5,364 709 13.22 0.27 ---------- ---------- ---------- ---------- Total investment securities available-for-sale........... 94,540 13,438 14.21 6.03 93,908 11,928 12.70 4.74 ---------- ---------- ---------- ---------- Loan receivables: CMO collateral .... 1,119,813 74,096 6.62 71.48 1,244,458 92,011 7.39 62.87 Mortgage loans held-for- investment .... 34,767 2,345 6.74 2.22 149,131 14,373 9.64 7.54 Finance receivables: Affiliated .... 232,741 19,566 8.41 14.86 403,935 34,166 8.46 20.41 Non-affiliated .... 84,783 7,779 9.18 5.41 87,855 8,242 9.38 4.44 Total finance receivables ..... 317,524 27,345 8.61 20.27 491,790 42,408 8.62 24.85 Total Receivables Loan .... 1,472,104 103,786 7.05 93.97 1,885,379 148,792 7.89 95.26 ----------

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Average CMO collateral decreased as the Long-Term Investment Operations issued CMOs totaling $298.1 million during 1999, which were collateralized by $316.2 million of mortgages, as compared to 46 CMOs totaling $768.0 million, which were collateralized by $788.2 million of mortgages, during 1998. Average CMO collateral also decreased due to higher mortgage loan prepayments, which increased 16% to $490.0 million during 1999 as compared to $424.1 million during 1998. CPR on CMO collateral was 37% CPR during 1999 as compared to 30% CPR during 1998. However, $222.9 million, or 35%, of mortgages acquired during 1999 by the Long-Term Investment Operations, had prepayment penalties as compared to $147.6 million, or 18%, of mortgages acquired with prepayment penalties during 1998. The Company expects that the higher percentage of mortgages acquired for long-term investment with prepayment penalties will lead to a reduction in overall prepayments. A decrease in the weighted average yield on CMO collateral also contributed to an overall decrease in interest income on CMO collateral during 1999 as compared to 1998. The weighted average yield on CMO collateral decreased to 6.62% during 1999 as compared to 7.39% during 1998. The decrease in yield on CMO collateral during 1999 was primarily due to amortization of net premiums paid in acquiring the mortgage loans held as CMO collateral and a decrease in short-term interest rates, which are used as an index to determine interest rate adjustments on adjustable rate CMO collateral. During 1999, the Company amortized net premiums on CMO collateral of $14.4 million as compared to $11.7 million during 1998. Amortization of net premiums on CMO collateral increased during 1999 as compared to 1998 primarily due to the increase in the CPR, as previously mentioned. However, during 1999 IFC limited premiums paid on loans without prepayment penalties. During 1999, IFC acquired mortgage loans at a weighted average price paid of 101.5 as compared to a weighted average price paid of 102.3 during 1998. As of December 31, 1999, net premiums on CMO collateral was $28.8 million as compared to $39.4 million at December 31, 1998. Interest income on mortgage loans held-for-investment decreased 84% to $2.3 million during 1999 as compared to $14.4 million during 1998 as average mortgage loans held-for-investment decreased 77% to $34.8 million as compared to $149.1 million, respectively. Average mortgage loans held-for-investment decreased due to a decrease in mortgage loan acquisitions by the Long-Term Investment Operations during 1999 as compared to 1998. Mortgage loans acquired from IFC by the Long-Term Investment Operations decreased 26% to $638.3 million as compared to $866.7 million acquired during 1998. As the Company focused on increased liquidity and reduced leverage during 1999, the Long-Term Investment Operations reduced its acquisition of mortgage loans to be held for long-term investment and concentrated on selling mortgage loans at IFC. Additionally, the decrease in the weighted average yield on mortgage loans held-for-investment during 1999 as compared to 1998 contributed to the decrease in interest income. The weighted average yield decreased to 6.74% during 1999 as compared to 9.64% during 1998. The decrease in the yield on mortgage loans held-for-investment during 1999 was primarily due to the sale of high-yielding 125 Loans by the Long-Term Investment Operations to IFC in December of 1998 and a decrease in mortgage rates during 1999. The majority of 125 Loans that were held by the Long-Term Investment Operations were sold to IFC. Interest income on mortgage loans held-for-investment includes the effect of amortization of net premiums paid in acquiring the mortgage loans. As of December 31, 1999, net premiums on mortgage loans held-for-investment was $2.0 million as compared to $482,000 as of December 31, 1998. Interest income on finance receivables decreased 36% to $27.3 million during 1999 as compared to $42.4 million during 1998 as average finance receivables decreased 35% to $317.5 million as compared to $491.8 million, respectively. The decrease in interest income on finance receivables during 1999 was primarily the result of monthly whole loan sales by IFC as compared to quarterly securitizations during 1998 and a decrease in loan acquisitions during 1999 as compared to 1998. IFC's loan accumulation and holding period shortened during 1999 as the Company sought to minimize interest rate and market risk exposure on its mortgage loans held-for-sale and maintain strong liquidity levels through monthly whole loan sales. In addition, IFC's loan acquisitions decreased to $1.7 billion during 1999 as compared to $2.2 billion during 1998. As such, average outstanding finance receivables to affiliates (primarily IFC) decreased to $232.7 million during 1999 as compared to $403.9 million during 1998, which resulted in a decrease in interest income to $19.6 million as compared to $34.2 million, respectively. The weighted average yield on affiliated finance receivables decreased to 8.41% during 1999 as compared to 8.46% during 1998 as the average prime rate, which is the index the Company uses to determine interest rates on finance receivables, was lower during 1999 as compared to 1998. Interest income on finance receivables to non-affiliates decreased 5% to $7.8 million during 1999 as compared to $8.2 million during 1998 as average outstanding finance receivables to non-affiliates decreased to $84.8 million as compared to $87.9 million, respectively. Interest income on finance receivables to non-affiliates also decreased as the weighted average yield decreased to 9.18% during 1999 as compared to 9.38% during 1998 as the average prime rate was lower in 1999 as compared to 1998. 47 Interest income on investment securities increased 13% to $13.4 million during 1999 as compared to $11.9 million during 1998 as average investment securities increased 1% to $94.5 million as compared to $93.9 million, respectively. Interest income on investment securities primarily increased during 1999 as the weighted average yield on investment securities increased to 14.21% during 1999 as compared to 12.70% during 1998. The yield on investment securities increased during 1999 as compared to 1998 as the Long-Term Investment Operations acquired $18.3 million of securities from IFC that had a higher weighted average yield than the weighted average yield of the total investment securities portfolio and also due to a change in yield estimates on the remaining securities portfolio. Interest expense on borrowings: Interest expense on CMO borrowings decreased 15% to $65.2 million during 1999 as compared to $76.3 million during 1998 as average borrowings on CMO collateral decreased 17% to $1.0 billion as compared to $1.2 billion, respectively. Average CMO borrowings decreased as the Long-Term Investment Operations issued CMOs totaling $298.1 million during 1999 as compared to CMOs totaling $768.0 million during 1998. The increase in loan prepayments also contributed to the overall decrease in average CMO borrowings during 1999 as compared to 1998. The weighted average yield of CMO borrowings decreased to 6.41% during 1999 as compared to 6.61% during 1998 as average one-month LIBOR, which is the index used to determine rates on adjustable rate CMO borrowings, was lower during 1999 as compared to 1998. In addition, interest expense on CMO borrowings is affected by the amortization of securitization costs. Securitization costs are incurred when a CMO is issued and securitization costs are capitalized and amortized over the life of the CMO borrowings as an adjustment to the yield. During 1999, the Company amortized securitization costs of $4.2 million as compared to $2.6 million during 1998 due to an increase in loan prepayments during 1999 as compared to 1998. As of December 31, 1999, unamortized securitization costs were $11.9 million as compared to unamortized securitization costs of $12.3 million at December 31, 1998. Interest expense on reverse repurchase borrowings, which are used to fund the acquisition of mortgage loans and finance receivables, decreased 47% to $21.5 million during 1999 as compared to $40.4 million during 1998 as average reverse repurchase agreements decreased 45% to $331.2 million as compared to $605.5 million, respectively. The decrease in average finance receivables was primarily related to the previously discussed decrease in average finance receivables to IFC. The Warehouse Lending Operations uses reverse repurchase agreements with investment banks to fund its short-term loans to affiliates, primarily IFC, and non-affiliates. As IFC shortened the accumulation and holding period on its mortgage loans held-for-sale and acquired fewer loans during 1999 as compared to 1998, IFC required lower borrowing levels during 1999. The weighted average yield of reverse repurchase agreements collateralized by mortgage loans decreased to 6.51% during 1999 as compared to 6.68% during 1998 as average one-month LIBOR, which is the index used by the Company's lenders to determine interest rates on reverse repurchase borrowings, decreased during 1999 as compared to 1998. During most of 1999, the Company used investment securities as collateral to borrow under reverse repurchase agreements to fund the purchase of mortgage-backed securities and to act as an additional source of liquidity for the Company's operations. During October 1999, the Company issued notes collateralized by a portion of its investment securities portfolio to provide a more stable financing source for these assets. Therefore, combined interest expense on reverse repurchase agreements and borrowings secured by investment securities remained unchanged at $1.7 million during 1999 and 1998. The combined average balance on reverse repurchase agreements and borrowings secured by investment securities decreased 16% to $21.8 million as compared to $26.1 million, respectively. The weighted average yield on these combined borrowings decreased to 6.49% during 1999 as compared to 6.53% during 1998. Non-Interest Income Non-interest income increased to $6.9 million during

1999 as compared to $(13.5) million during 1998. Non-interest income increased primarily due to an increase in equity in net earnings (loss) of IFC. Equity in net earnings (loss) of IFC improved during 1999 as compared to 1998 due to increased profitability from the sale of mortgage loans. In addition, IFC recorded non-cash write-downs on MSRs and investment securities held-for-sale during the fourth quarter of 1998. As discussed previously, loss on loan sales and asset write-downs were due to a deterioration of the mortgage-backed securitization market, which occurred during the latter part of 1998. As the mortgage market stabilized during 1999, IFC returned to overall profitability, which in large part was due to profitability on loan sales. 48 Equity in Net Earnings (Loss) of IFC Equity in net earnings (loss) of IFC increased to $4.3 million during 1999 as compared to $(13.9) million during 1998. The Company records 99% of the earnings or losses from IFC, as the Company owns 100% of IFC's preferred stock, which represents 99% of the economic interest in IFC. For more information on the results of operations of IFC, refer to "--Results of Operations--Impac Funding Corporation." Equity in Net Loss of ICH The Company's equity in net loss of ICH decreased to none for 1999 as compared to a loss of $(998,000) for 1998. The Company recorded no earnings or loss from ICH during 1999 as the Company sold its holdings of ICH Common Stock during the fourth quarter of 1998. Prior to the fourth quarter of 1998, the Company recorded equity in net earnings (loss) in ICH by virtue of the Company's ownership of 9.8% of ICH's voting Common Stock and 100% of Class A non-voting Common Stock. Non-Interest Expense Non-interest expense decreased to $8.7 million during 1999 as compared to $30.0 million during 1998. Non-interest expense decreased primarily due to a decrease in write-down of investment securities, loss on equity investment and general and administrative and other expense. Write-down of investment securities decreased to $2.0 million during 1999 as compared to $14.1 million during 1998 as the mortgage market recovered from the liquidity problems that occurred during the latter half of 1998. Loss on equity investment decreased to zero during 1999 as compared to $9.1 million during 1998 as the Company sold 100% of its Common Stock investment in ICH at a loss during the fourth quarter of 1998. General and administrative and other expense decreased to $1.3 million during 1999 as compared to $2.3 million during 1998 as the Company sold its remaining 50% ownership interest in a commercial office building, where the Company maintains its current headquarters, to ICH during the fourth quarter of 1998. Expenses related to the 50% ownership interest in the property decreased to none during 1999 as compared to $622,000 during 1998. Credit Exposures Non-performing Assets. The outstanding unpaid principal balance of non-performing assets totaled $63.3 million at December 31, 1999 as compared to $80.7 million at December 31, 1998. The decrease in non-performing assets was primarily due to the sale of delinquent mortgage loans held-for-sale at IFC. Of the total non-performing assets at December 31, 1999 and 1998, other real estate owned represented $9.7 million and $9.2 million, respectively, in unpaid principal balance. The carrying amount of other real estate owned, after writing down the mortgage loan to the broker's price opinion or appraised value, was $8.8 million and $8.5 million at December 31, 1999 and 1998, respectively. The Company recorded losses on the disposition of other real estate owned of $2.2 million and $1.7 million during 1999 and 1998, respectively. The following table summarizes the unpaid principal balance of the Company's non-performing assets included in its mortgage loan portfolios for the periods shown (in thousands): 49 At December 31, -------------------- 1999 1998 -------------- Mortgage Loans Held-for-Sale: Non-accrual .... $ 2,572 $15,328 Other real estate owned .... -- -- ------- ------- Total mortgage loans held-for-sale .... 2,572 15,328 ------- ------- Mortgage Loans Held-for-Investment: Non-accrual .... 8,229 6,870 In process foreclosures .... 306 1,437 ------- ------- Total mortgage loans held-for-investment .... 8,535 8,307 ------- ------- CMO collateral: Non-accrual .... 42,792 49,305 Other real estate owned .... 9,411 7,739 ------- ------- Total CMO collateral .... 52,203 57,044 ------- ------- Total mortgage loan portfolios .... $63,310 $80,679 ======= ======= Delinquent Loans. At December 31, 1999, loans that were delinquent 30 days or more, as a percentage of the outstanding servicing balance of the mortgage loan portfolios, was 10.98% as compared to 12.80% at December 31, 1998. The following table summarizes the unpaid principal balance of the Company's delinquent mortgage loans included in its mortgage loan portfolios for the periods shown (in thousands): At December 31, --------------------- 1999 1998 -------- -------- Mortgage Loans Held-for-Sale: 60-89 days delinquent .... $ 1,838 $ 1,448 90 or more days delinquent (1) .... 2,572 15,328 ---------------- Total mortgage loans held-for-sale .... 4,410 16,776 -------- -------- Mortgage Loans Held-for-Investment: 60-89 days delinquent .... 1,453 271 90 or more days delinquent (1) .... 8,229 6,870 -------- -------- Total mortgage loans held-for-investment .... 9,682 7,141 -------- -------- CMO collateral: 60-89 days delinquent .... 12,398 18,695 90 or more days delinquent (1) ....

42,792 49,305 -------- -------- Total CMO collateral .... 55,190 68,000 -------- -------- Total mortgage loan portfolios .... $ 69,282 $ 91,917 ======== ======== ---------- (1) Includes loans in foreclosure and delinquent bankruptcies. Provision for Loan Losses. The Company's total allowance for loan losses expressed as a percentage of Gross Loan Receivables which includes loans held-for-investment, CMO collateral and finance receivables, decreased to 0.27% at December 31, 1999 as compared to 0.47% at December 31, 1998. The Company recorded net loan loss provisions of $5.5 million during 1999 as compared to $4.4 million during 1998. The amount provided for loan losses during 1999 increased primarily due to an increase in foreclosures and the subsequent disposition of other real estate owned. 50 RESULTS OF OPERATIONS-- IMPAC FUNDING CORPORATION Year Ended December 31, 2000 as compared to Year Ended December 31, 1999 Results of Operations Net earnings (loss) decreased to a loss of $(1.8) million during the year ended December 31, 2000 as compared to net earnings of $4.3 million during the same period of 1999. The decrease in net earnings was primarily due to a decrease of $7.4 million in gain on sale of loans, a decrease of $1.7 million in net interest income (loss) and the accrual of a $1.6 million tax liability. Net Interest Income (Loss) Net interest income (loss) decreased to a loss of $(1.4) million during 2000 as compared to net interest income of $272,000 during 1999 as average mortgage loans held-for-sale increased 23% to $294.6 million as compared to $240.1 million, respectively. Average mortgage loans held-for-sale increased as the Mortgage Operations increased total loan acquisitions and originations by 24% to $2.1 billion during 2000 as compared to $1.7 billion during 1999. However, the decrease in net interest income was due to the rapid increase in short-term interest rates during 2000. During 2000, the yield on mortgage loans held-for-sale increased to 9.50% as compared to 8.48% during 1999 while the yield on borrowings increased to 9.88% as compared to 8.30%, respectively. Net interest margins on mortgage loans held-for-sale decreased to (0.02)% during 2000 as compared to 0.50% during 1999. Net interest margins decreased during 2000 due to rapid increases in short-term interest rates and inversion of the yield curve, which occurred during 2000. This inverted yield curve contributed to compression of net interest margins as interest rates on mortgage loans set by the Mortgage Operations primarily use the ten-year Treasury yield as an index plus a margin. Therefore, mortgage loan rates were set using interest rates on the ten-year Treasury yield which increased at a slower rate than short-term interest rates on borrowings. Non-Interest Income Non-interest income decreased to $27.1 million during 2000 as compared to $33.3 million during 1999 as gain on sale of loans decreased to $19.7 million on loan sales and securitizations of $1.4 billion as compared to gains of $27.1 million on loan sales and securitizations of $1.2 billion, respectively. Gain on sale of loans decreased during 2000 as a result of reduced profitability on loans sold as compared to loan sales closed during 1999. During 1999, IFC sold mortgage loans on a whole loan basis for cash, as opposed to sales through asset-backed securitizations, which occurred during 2000. IFC securitized $1.3 billion in REMICs during 2000 as compared to $360.1 million in REMICs during 1999. The decrease in gain on sale of loans was partially offset by an increase in loan servicing income during 2000 as compared to 1999. Loan servicing income increased to $6.3 million during 2000 as compared to $5.2 million during 1999 as IFC's master servicing portfolio increased to $4.0 billion at December 31, 2000 as compared to $2.9 billion at December 31, 1999. Non-Interest Expense Non-interest expense increased to $26.7 million during 2000 as compared to $26.0 million during 1999. Non-interest expense during 2000 was positively affected by a decrease of $2.7 million in write-down of investment securities and a decrease of $1.1 million in impairment of MSRs, which were offset by an increase of $2.5 million in personnel expense and an increase of $1.0 million in general and administrative and other expense. Write-down of investment securities decreased to $1.5 million during 2000 as compared to $4.3 million during 1999 as IFC wrote-off substantially all remaining book value of investment securities secured by franchise loan receivables. Personnel expense increased by 34% to $9.8 million as compared to $7.3 million during 1999 primarily due to an increase in staff as correspondent and wholesale loan production volumes increased by 29%. Personnel expense also includes compensation paid to Bank related personnel who were terminated during 2000 when IFC withdrew its application to acquire a Bank. The increase in general and administrative and other expense is primarily the result of interest on an accrued tax liability. 51 Year Ended December 31, 1999 as compared to Year Ended December 31, 1998 Result of Operations IFC recorded net earnings of $4.3 million during 1999 as compared to a net loss of $(14.0) million during 1998. Earnings increased during 1999 as compared to 1998 primarily as the mortgage market stabilized and recovered from the liquidity crisis, which occurred during the latter part of 1998. As the mortgage market recovered during 1999, IFC returned to overall profitability, which in large part was due to the profitability on the sale of its mortgage loans. During 1998, IFC sold loans at significant losses to meet margin calls and raise liquidity. In addition, IFC recorded non-cash write-down on MSRs and investment securities.

Net Interest Income Net interest income decreased to $272,000 during 1999 as compared to $7.8 million during 1998 as average mortgage loans held-for-sale decreased 50% to $240.1 million as compared to $476.1 million, respectively. Average mortgage loans held-for-sale decreased due to the shorter accumulation and holding period of mortgage loans held-for-sale and a decrease in mortgage loan acquisitions. During 1999, IFC primarily sold loans monthly on a whole loan basis as opposed to quarterly securitizations, which occurred during 1998. Monthly whole loan sales were completed during 1999 in order to reduce interest rate and market risk exposures and to maintain strong liquidity levels. In addition, mortgage loan acquisitions decreased 23% to $1.7 billion during 1999 as compared to mortgage loan acquisitions of $2.2 billion during 1998. Mortgage loan acquisitions decreased during 1999 as compared to 1998 due to the residual effects of the deterioration of the mortgage-backed securitization market, which occurred during the latter part of 1998. In response to the liquidity crisis, IFC raised interest rates on its loan programs and decreased the amount of premiums paid on its loan acquisitions, which caused some of IFC's correspondent sellers to use other sources for the funding of their mortgage loans. During 1999, IFC continued to rebuild its mortgage loan acquisitions to previous levels by offering its sellers competitive and flexible mortgage products. As such, mortgage loan acquisitions increased 48% to $548.2 million during the fourth quarter of 1999 as compared to $370.5 million during the fourth quarter of 1998. Non-Interest Income Non-interest income increased to $33.3 million during 1999 as compared to $(5.7) million during 1998 as gain on sale of loans increased to $27.1 million during 1999 as compared to $(11.7) million during 1998. In line with the Company's overall strategy to reduce interest rate and market risk exposure and to maintain strong liquidity levels, IFC sold mortgage loans on a whole loan basis for cash during 1999, as opposed to sales through asset-backed securitizations for non-cash gains, which occurred during 1998. During 1999, IFC sold mortgages totaling $824.1 million, on a servicing released basis, to third party investors as compared to loan sales of $856.2 million during 1998. The sale of loans on a servicing released basis during 1999 reduced IFC's exposure to further prepayment risk. IFC also securitized $360.1 million in REMICs during 1999 as compared to $907.5 million in REMICs during 1998. The increase in gain on sale of loans was partially offset by a decrease in loan servicing income during 1999 as compared to 1998. Loan servicing income decreased to $5.2 million during 1999 as compared to $7.1 million during 1998 as IFC sold MSRs and completed loan sales on a servicing released basis. Total unpaid principal balance of mortgage loans at the time MSRs were sold was $2.3 billion. Non-Interest Expense Non-interest expense increased 5% to $26.0 million during 1999 as compared to $24.8 million during 1998. Non-interest expense during 1999 was positively affected by decreases in personnel expense and impairment and amortization of MSRs. Personnel expense decreased 18% to $7.3 million as compared to $8.9 million during 1998. Personnel expense decreased primarily due to a reduction in staff which occurred during the fourth quarter of 1998 and carried into 1999. During the fourth quarter of 1998, IFC reduced staff in anticipation of decreased loan acquisitions due to the deterioration of the mortgage-backed securitization market. The reduction in staff also contributed to increased liquidity from operating activities. Impairment of MSRs decreased to $1.1 million during 1999 as compared to $3.7 million during 1998 as the mortgage market recovered during 1999. Impairment of MSRs recorded in 1998 was primarily due to the deterioration of the mortgage-backed securitization market. Amortization of 52 MSRs decreased to $5.3 million as compared to $6.4 million as IFC sold MSRs and completed whole loan sales on a servicing released basis. The decreases in personnel expense and impairment and amortization of MSRs were offset by increases in write-down on securities and general and administrative and other expense. Write-down on securities increased to $4.3 million during 1999 as compared to zero during 1998. The write-down on securities was due to the complete write-off of an investment security deemed to have no value. The increase in general and administrative and other expense during 1999 was primarily due to costs associated with the operation of the wholesale and retail origination division, which began operations in 1999, and costs associated with the application of the Bank charter. Liquidity and Capital Resources Overview Historically, the Company's business operations are primarily funded by monthly interest and principal payments from its mortgage loan and investment securities portfolios, adjustable- and fixed rate CMO financing, reverse repurchase agreements secured by mortgage loans, borrowings secured by mortgage-backed securities, proceeds from the sale of mortgage loans and the issuance of REMICs and proceeds from the issuance of Common Stock through secondary stock offerings, DRSPP, and its structured equity shelf program ("SES Program"). The acquisition of mortgage loans and mortgage-backed securities by the Long-Term Investment Operations are primarily funded by monthly principal and interest payments, reverse repurchase agreements, CMO financing, and proceeds from the sale of Common Stock. The acquisition of mortgage loans by the Mortgage Operations are funded by reverse repurchase agreements, the sale of mortgage loans and mortgage-backed securities and the issuance of REMICs. Short-term warehouse financing (finance receivables) provided by the Warehouse Lending Operations are primarily funded by reverse repurchase agreements. During 2000, the Company issued no new shares of Common Stock through stock offerings, DRSPP or through its SES Program. During 1999, the Company suspended the issuance of any new shares of Common Stock under the DRSPP. The Company's ability to meet its long-term liquidity requirements is subject to the renewal of its credit and repurchase facilities and/or obtaining other sources of financing, including additional debt or equity from time to time. Any decision by the Company's lenders and/or investors to make additional funds available to the Company in the future will depend upon a number of factors, such as the Company's compliance with the terms of its existing credit arrangements, the Company's financial performance, industry and market trends in the Company's various businesses, the general availability of and rates applicable to financing and investments, such lenders' and/or investors' own resources and policies concerning loans and investments, and the relative attractiveness of alternative investment or lending opportunities. Results of Liquidity during 2000 The deterioration of the mortgage-backed securitization market that resulted in margin calls by the Company's lenders and caused significant liquidity disruptions during the latter half of 1998 and into 1999 recovered during 2000 as the Company's warehouse lenders made no margin calls. However, the market disruptions during 1998 caused several public companies to file for protection from their creditors under the U.S. Bankruptcy Code. This had the effect of causing reduced investor confidence with certain sectors of the financial services industry, particularly Mortgage REITs, which in turn caused stock prices to fall sharply. As a result of this decline in stock prices, the Company has been unable to access the capital markets and raise additional cash, which in turn required the Company to restructure its balance sheet and generate cash internally to meet its funding needs. IMH and IFC maintained consolidated average cash balances during 2000 of $20.8 million as compared to $20.5 million during 1999 as consolidated average assets, after intercompany eliminations, increased to $1.9 billion from $1.7 billion, respectively. A significant provider of additional operating liquidity during 2000 was the collapse of five previously issued CMOs into two new CMO structures, which provided approximately $32.6 million of capital. This capital represented equity that was invested in the previous CMOs and was released and reinvested in the Company's Long-Term Investment Operations. In addition, the collapse of the previous CMOs improved capital leverage, lower borrowing costs and reduced amortization exposure on the $144.0 million of previous CMO collateral. 53 During 2000, IFC provided additional liquidity from the sale of servicing rights through the completion of REMICs on a servicing released basis. IFC sold servicing rights on $1.3 billion of unpaid principal balance from the completion of five REMIC securitizations on a servicing released basis during 2000. In order to mitigate interest rate and market risk, the Mortgage Operations completed two REMIC securitizations during the fourth quarter of 2000. The Company believes this will require less capital and will provide more liquidity with less interest rate and price volatility as the accumulation and holding period of mortgage loans is reduced. IFC's goal is to continue completing two REMIC securitizations per quarter during 2001 to reduce interest rate and market risk. IFC also signed a flow agreement with an investment bank during January 2001, which allows IFC to forward price its REMIC transactions and achieve greater stability in the execution of its securitizations. Liquidity provided by balance sheet restructuring and operating activites was used to repurchase $2.3 million of the Company's Common Stock, pay preferred and cash dividends of $13.7 million and grow the balance sheet. However, the Company did not declare a common stock dividend during the fourth quarter of 2000 and plans to utilize its tax loss carry forwards during 2001. The Company believes that it is prudent to take advantage of its tax loss carry forwards and retain capital to continue the expansion and growth of its core operating businesses. The Company believes that the retention of earnings will allow the Company to increase its assets and book value during 2001. The Company will likely need to pay common stock dividends in 2002 as the tax loss carry forwards are expected to be completely used. The Company believes that current liquidity levels, available financing facilities, liquidity provided by operating activities and the retention of earnings, as projected for 2001, will adequately provide for the Company's projected funding needs and asset growth. However, any future margin calls and, depending upon the state of the mortgage industry, terms of any sale of Mortgage Assets may adversely affect the Company's ability to maintain adequate liquidity levels or may subject the Company to future losses. Sources of Liquidity Long-Term Investment Operations: The Long-Term Investment Operations uses CMO borrowings to finance substantially all of its mortgage loan portfolio. Terms of the CMO borrowings require that an independent third party custodian hold the mortgages. The maturity of each class is directly affected by the rate of principal prepayments on the related collateral. Equity in the CMOs is established at the time the CMOs are issued at levels sufficient to achieve desired credit ratings on the securities from rating agencies. The amount of equity invested in

CMOs by the Long-Term Investment Operations is also determined by the Company based upon the anticipated return on equity as compared to the estimated proceeds from additional debt issuance. Total credit loss exposure is limited to the equity invested in the CMOs at any point in time. At December 31, 2000, the Long-Term Investment Operations had $1.3 billion of CMO borrowings used to finance $1.4 billion of CMO collateral. During 1999, the Company re-securitized a portion of its mortgage-backed securities portfolio with principal only notes. As of December 31, 2000, the Long-Term Investment Operations had $21.1 million outstanding under these notes, which were secured by $21.9 million in fair market value of mortgage-backed securities. The Company still has the ability to borrow funds under the reverse repurchase agreements secured by investment securities. Mortgage Operations: The Mortgage Operations has entered into warehouse line agreements to obtain financing of up to $600.0 million from the Warehouse Lending Operations to provide IFC mortgage loan financing during the period that IFC accumulates mortgage loans until the mortgage loans are securitized or sold. The margins on IFC's reverse repurchase agreements are based on the type of collateral provided and generally range from 95% to 99% of the fair market value of the collateral. The interest rates on the borrowings are indexed to prime, which was 8.50% at December 31, 2000. As of December 31, 2000, the Mortgage Operations had $267.0 million outstanding under the warehouse line agreements. During 2000, the Mortgage Operations securitized $1.3 billion of mortgage loans as REMICs and sold $62.6 million, in unpaid principal balance, of mortgage loans to third party investors. In addition, IFC sold $430.8 million, in unpaid principal balance, of mortgage loans to the Long-Term Investment Operations during 2000. 54 Warehouse Lending Operations: The Warehouse Lending Operations finances the acquisition of mortgage loans by the Long-Term Investment Operations and Mortgage Operations primarily through borrowings on reverse repurchase agreements with third party lenders. IWLG has an uncommitted repurchase facility with a major investment bank to finance the Warehouse Lending Operations as needed. Terms of the reverse repurchase agreement requires that the mortgages be held by an independent third party custodian giving the Warehouse Lending Operations the ability to borrow against the collateral as a percentage of the outstanding principal balance. The borrowing rates vary from 85 basis points to 200 basis points over one-month LIBOR, depending on the type of collateral provided. The margins on the reverse repurchase agreement is based on the type of mortgage collateral provided and generally range from 70% to 98% of the fair market value of the collateral. At December 31, 2000, the Warehouse Lending Operations had $398.7 million outstanding on the reverse repurchase facility. Cash Flows Operating Activities - During 2000, net cash provided by operating activities was $26.7 million. Cash provided by operating activities was primarily from loan loss provisions of $18.8 million and amortization of premium and securitization costs of $15.3 million. Investing Activities - During 2000, net cash used in investing activities was $302.5 million. Cash used in investing activities was primarily used to acquire CMO collateral and mortgage loans held-for-investment and to fund an increase in outstanding finance receivables. Financing Activities - During 2000, net cash provided by financing activities was $273.5 million. Cash provided by financing activities was primarily from CMO borrowings, net of repayments, which was partially offset by a decrease in borrowings on reverse repurchase agreements. Inflation The Consolidated Financial Statements and Notes have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased costs of the Company's operations. Unlike industrial companies, nearly all of the assets and liabilities of the Company's operations are monetary in nature. As a result, interest rates have a greater impact on the Company's operations' performance than do the effects of general levels of inflation. Inflation affects the Company's operations primarily through its effect on interest rates, since interest rates normally increase during periods of high inflation and decrease during periods of low inflation. During periods of increasing interest rates, demand for mortgage loans and a borrower's ability to qualify for mortgage financing in a purchase transaction may be adversely affected. During periods of decreasing interest rates, borrowers may prepay their mortgages, which in turn may adversely affect the Company's yield and subsequently the value of its portfolio of Mortgage Assets. 55 PART III ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS The information required by this Item 13 is hereby incorporated by reference to Impac Mortgage Holdings, Inc.'s definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of Impac Mortgage Holdings, Inc.'s 2000 fiscal year. Impac Funding Corporation has entered into an insurance commitment program with Radian Guaranty, Inc. Frank Filipps, a director of Impac Mortgage Holdings, Inc., is the Chairman and Chief Executive Officer of Radian Group, Inc. (NYSE- RDN) and its principal subsidiary, Radian Guaranty, Inc. Radian Guaranty has agreed to insure up to $2.2 billion worth of mortgage loans acquired or originated by Impac Funding Corporation that meet certain credit criteria. Impac Funding Corporation pays Radian on a monthly basis. The amount paid depends on the number of mortgage loans insured by Radian and the credit quality of the mortgage loans. For the year ended December 31, 2000, Impac Funding Corporation paid an aggregate of $4.6 million to Radian in connection with the insurance program. 56 PART IV ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K (a) All schedules have been omitted because they are either not applicable, not required or the information required has been disclosed in the Consolidated Financial Statements and related Notes to Consolidated Financial Statements at page F-1, or otherwise included in this Form 10-K. (b) Reports on Form 8-K--None (c) Exhibits 23.1 Consent of KPMG LLP for Impac Mortgage Holdings, Inc. 23.2 Consent of KPMG LLP for Impac Funding Corporation 57 SIGNATURES Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amendment to the report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Newport Beach, State of California, on the 15th day of October, 2001. IMPAC MORTGAGE HOLDINGS, INC. by /s/ RICHARD J. JOHNSON ------------------------------ Richard J. Johnson Executive Vice President and Chief Financial Officer 58