Simple Truths

Impac Mortgage Holdings, Inc.
2002 Annual Report

To Our Shareholders,

Our industry has enjoyed two lucrative years driven by record low interest rates and a frenzy of real estate purchases and refinances. In 2002, Impac Mortgage Holdings, Inc. (the "Company" or "Impac") delivered our most impressive accomplishments to date. We reported our tenth consecutive quarter of profitability and growth. We increased our net earnings, taxable income and return on equity by more than 50 percent each and nearly doubled the Company's market cap to $521 million at year's end from $270 million a year earlier.

As a company, we measure our success in our dividends and yield, just as you, our shareholders, do. In 2002, we significantly increased our declared dividends to $1.76 per share, for an annual yield of 17 percent. That mark places us among the highest yielding in our peer group, and we believe that consistent dividends will lead to long-term stock appreciation.

Consistent Performance

A key measure of our success is our ability to maintain the consistency and reliability of our income, regardless of interest rate cycles. Therefore, recognizing that the current market conditions may not last, we resisted the temptation to pursue short-term profits at the expense of future earnings. Instead, we adhered to and strengthened the business model we have designed for long-term stability and growth. The proven tenets of our model are to diversify our business, mitigate our risks, improve our efficiencies, manage our costs and sustain long-term, value-added relationships with our customers.

Business Diversification

We continue to build on three core businesses that are synergistic yet also balance one another through changing interest rate cycles. They include the Long-Term Investment Operations which earns spread income from investing primarily in Alt-A residential mortgage loans generated by our Mortgage Operations. The Mortgage Operations, the nation's fourth[1] largest acquirer and originator of Alt-A mortgage loans, primarily earns revenues from sale of loans to third party investors. And the Warehouse Lending Operations, the 13th[2] largest in the nation, provides short-term financing of mortgage loans and earns fees and spread income on the difference between our cost of capital and interest earned between their closing and their settlement with the final investor.

During this period of record loan volumes, the Company rather than selling loans at our Mortgage Operations for short-term cash gains has focused on building its balance sheet for more long-term earnings. At year's end, total mortgage assets increased 133 percent to $6.3 billion as compared to $2.7 billion a year ago. Income generated from the balance sheet accounted for about 80 percent of the net earnings of our Company. These contributions decrease our dependence on Mortgage Operations earnings, which are generally more sensitive to changes in interest rates.

Furthermore, to bring additional diversification the Company recently added two new businesses. The first was Novelle Financial Services Inc. ("Novelle") which began its operations during the fall of 2001. This wholly owned subsidiary of the Mortgage Operations originates sub-prime residential mortgages through a network of nationwide wholesale brokers and subsequently sells its loans to non-affiliated third-party investors for cash gains. Last year Novelle originated just over $400 million in subprime mortgages and contributed after tax earnings of $1.7 million which reflected an average return on our investment of 69 percent. This year we expect to grow the operations of Novelle to approximately $700 million

[1] *National Mortgage News*, December 31, 2002

[2] *National Mortgage News*, December 31, 2001 (most recent information available)

in subprime mortgages, again to be sold for cash gains.

Our other business, Impac Multifamily Capital Corporation ("IMCC") was formed as a subsidiary of the Long-Term Investment Operations to originate primarily multifamily mortgages with high credit quality, conservative loan to value ratios and adjustable rate mortgages with balances ranging from $250,000 to $1.5 million. The multifamily mortgages provide greater asset diversification, with higher interest rate spreads and substantially longer lives than residential mortgages. We expect IMCC to originate in excess of $300 million in multifamily mortgages during 2003, all of which will be retained for long-term investment.

Risk Management

Because most of our earnings are derived from spread income earned at our Long-Term Investment Operations, a significant risk is an abrupt change in short-term interest rates which could cause compression of our margins. To mitigate this risk, we use a variety of financial derivative instruments as hedges to protect our income. As a result of these hedges, as short-term interest rates rise we expect our margins to remain relatively stable.

Other threats to consistent, predictable earnings are defaults and prepayments of mortgage loans. Thus, we have strengthened our investment portfolio by acquiring mortgage loans with high credit profiles and low effective loan to values ratios. We invest primarily in loans with prepayment penalties, which keeps mortgage assets on the balance sheet longer, lengthens amortization of mortgage acquisition costs and ensures more predictable future cash flows. We concentrate on what we believe to be better performing purchase versus refinance transactions, maintain low average loan balances and invest in dispersed geographical locations. Furthermore, we maintain a conservative loan loss reserve policy and carry primary mortgage insurance on our higher loan-to-value mortgages.

Beyond safeguards on our investments, we have reduced our operating costs by maintaining centralized operations. Combining our expertise and resources in one location creates innovative synergies and enables us to scale up or down and shift our focus as circumstances warrant.

Long-Term Value-Added Relationships

Rather than rely on price-driven relationships, which tend to dissipate with the rise and fall of the market, our product innovations and applications of technologies have enabled us to drive down costs, eliminate errors and ensure faster and more consistent performance—all of which help to strengthen and bind long-term value-added customer relationships. We believe that relationship building should translate into more sustainable loan volume.

To both manage costs and establish efficient and long-lasting customer relationships, we introduced four new Web-based systems in 2002. First was iDASLg2 (Impac's Direct Access System for Lending Generation2). The system ensures consistent and objective evaluation of loan applications nearly instantaneously. What sets our system apart is the user friendly and dynamic Web interfaces that prompt users with virtually no training required. The system's success is perhaps best evidenced by our largest customers, who, since its introduction last fall, have commissioned us to private-label the system for them as well.

The other new systems are the proprietary pricing module, (I Price/U Price.), where I is for

Impac and U is for the client company's name; the Flier Design Center, which customizes marketing campaigns for e-mail or faxing; and the CIS, or Customer Information System, which tracks all transaction information, relationship history, quality statistics and account status data between Impac and our customers. We use the data to evaluate and correct inefficiencies in our customer service, and customers access their own files to track their transactions and loan level performance records.

Strategy and Objectives for 2003

Again, we will measure our success by our ability to continue to return reliable dividends to our shareholders in all types of market conditions. Our strategy for 2003 includes the continued focus on investing in high credit quality Alt-A residential mortgages and maintaining conservative interest rate and credit risk management.

Growth of the long-term investment portfolio is expected to be facilitated by a modest increase in loan acquisitions and origination volume at our Mortgage Operations. We believe that given the current geopolitical climate, interest rates should remain relatively stable for the remainder of the year. Looking further down the road, we believe that we will be ultimately less affected by a decline in the refinance market because we have historically focused on purchase money transactions. Furthermore, if historical trends continue, the Alt-A market as a percentage of the total mortgage origination industry should grow as borrowers seek alternatives to traditional loan programs. Finally, as the fourth largest Alt-A lender in the nation, we are confident that we can continue to grow market share by focusing on niche products, superior customer service and innovative technological and marketing solutions rather than just the best price.

We are enthusiastic about our 2003 business prospects. Our business continues to thrive on our staff's creativity and productivity, and the innovative corporate culture that supports them. Since inception, we have encouraged teamwork and held to a management structure that allows for proactive planning and operational improvements. Our employees are among the very best in the industry, and we believe we are correctly preparing, motivating, compensating and recognizing each toward excelling not only in their respective roles but toward the entire Company's success.

On behalf of the executive management team, we thank our shareholders and customers, who have supported us during our re-building process, and our employees, who year-after-year turn challenges into opportunities. We look forward to sharing our long-term accomplishments with you.

Sincerely,

Joseph R. Tomkinson
Chairman and Chief Executive Officer

William S. Ashmore
President and Chief Operating Officer

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