

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2000 or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 0-19861

**IMPAC MORTGAGE HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of  
incorporation or organization)

**33-0675505**

(I.R.S. Employer  
Identification No.)

**1401 Dove Street, Newport Beach, California 92660**

(Address of principal executive offices)

**(949) 475-3600**

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock \$0.01 par value	American Stock Exchange

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

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

On March 27, 2001, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$83.4 million, based on the closing sales price of the Common Stock on the American Stock Exchange. For purposes of the calculation only, in addition to affiliated companies, all directors and executive officers of the registrant have been deemed affiliates. The number of shares of Common Stock outstanding as of March 27, 2001 was 20,385,456.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Definitive Proxy Statement issued in connection with the 2001 Annual Meeting of Stockholders of the Registrant are incorporated by reference into Part III.

**IMPAC MORTGAGE HOLDINGS, INC.**

**2000 FORM 10-K ANNUAL REPORT**

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## PART I

Certain information contained in this Report constitutes forward-looking statements under the Securities Act and the Exchange Act. These forward-looking statements can be identified by the use of forward-looking terminology including, but not limited to, “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 that might cause such differences include, but are not limited to, those discussed in “Item 1. Business—Risk Factors” as well as those discussed elsewhere in this Report.

### ITEM 1. BUSINESS

Impac Mortgage Holdings, Inc. was incorporated in Maryland in August 1995. References to the “Company” refer to Impac Mortgage Holdings, Inc. (“IMH”) and its subsidiaries, IMH Assets Corporation (“IMH Assets”), Impac Warehouse Lending Group, Inc. (“IWLG”), and Impac Funding Corporation, (together with its wholly-owned subsidiary Impac Secured Assets Corporation, (“IFC”). References to IMH refer to Impac Mortgage Holdings, Inc. as a separate entity from IMH Assets, IWLG and IFC.

#### General

Impac Mortgage Holdings, Inc. is a mortgage real estate investment trust (“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.

#### Long-Term Investment Operations

The Long-Term Investment Operations, conducted by IMH and IMH Assets, a wholly-owned specialty purpose entity through which IMH conducts its Collateralized Mortgage Obligations (“CMO”) borrowings, invests primarily in non-conforming residential mortgage loans and mortgage-backed securities secured by or representing interests in such loans and, to a lesser extent, in second mortgage loans. Non-conforming residential mortgage loans are residential mortgages that generally do not qualify for purchase by government-sponsored agencies such as the Federal National 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.

### *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:

	<u>At December 31, 2000</u>	<u>At December 31, 1999</u>
A Loans.....	90.3 %	89.1 %
B/C Loans .....	9.7	10.9
	<u>100.0 %</u>	<u>100.0 %</u>

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 criteria by credit rating agencies for securities backed by non-conforming 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 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 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 Chief Operating Officer, 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

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 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 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 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 December 31, 2000	Year ended 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 .....	<u>\$ 2,112.7</u>	<u>\$ 1,671.7</u>
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 .....	<u>\$ 2,112.7</u>	<u>\$ 1,671.7</u>
Average Loan Size .....	<u>\$ 155,000</u>	<u>\$ 156,000</u>

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, or 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."

*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 \$1 million 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.

*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/Service 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 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.

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 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):

At December 31, 2000      At December 31, 1999

	<u>Principal Balance of Loans</u>	<u>% of Master Servicing Portfolio</u>	<u>Principal Balance of Loans</u>	<u>% of Master Servicing Portfolio</u>
Loans delinquent for:				
60-89 days .....	\$ 65.8	1.63%	\$ 30.8	1.07%
90 days .....	26.0	0.64	21.1	0.73
	<u>91.8</u>	<u>2.27</u>	<u>51.9</u>	<u>1.80</u>
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 .....	<u>\$ 171.4</u>	<u>4.24%</u>	<u>\$ 125.8</u>	<u>4.37%</u>

*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 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 December 31, 2000	Year ended 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 .....	<u>\$ 2,428.9</u>	<u>\$ 2,393.4</u>
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.

## **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.

## **Risk Factors**

In addition to the other information in this Form 10-K, the following factors should be considered in evaluating the Company and its business.

### ***Inability to Generate Liquidity May Adversely Affect Our Operations***

We must access liquidity to continue our operations, grow our asset base and pay dividends. We have traditionally derived our liquidity from three sources:

- financing facilities provided to us by others to acquire mortgage assets;
- whole loan sales and securitizations of acquired mortgage loans; and
- sale of equity securities.

*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:

- higher than expected credit losses on many companies' securitization interests, and
- the widening of returns expected by institutional investors on securitization interests over the prevailing Treasury rate.

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 financing facilities. However, the large influx 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 are 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. 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 less than favorable terms. In addition, 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 markets;
- the credit quality of the mortgage loans originated or purchased by our Mortgage Operations;
- the volume of our mortgage loan originations and purchases; and
- our ability to obtain credit enhancement.

If we are unable to profitably securitize a significant number of our mortgage loans in a particular financial reporting period, then it could result in 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 losses. We cannot assure you that we will be able to continue to profitably sell our loans on a whole loan basis, or at all.

Gains on sales from our securitizations have historically represented a substantial portion of our earnings. Our ability to complete securitizations is dependent upon general conditions in the securities and secondary markets and the credit quality of the mortgage loans. In addition, delays in closing sales of our loans increases our risk by increasing the warehousing period for the loans, further exposing our company to credit risk.

The market for first loss risk securities (securities that first take a loss when mortgages are not paid by the borrowers) is generally limited. In connections with our securitizations, we will endeavor to sell all securities subjecting us to a first loss risk. If we cannot sell these securities, then we may be required to hold them for an extended period, subjecting us to a first loss risk.

#### *Inability to Access Capital Markets May Adversely Affect Our Liquidity and Operations*

Although we believe our current operating cash flows are sufficient to fund our lending activities and the growth of our mortgage assets, to repay our financing facilities and to pay cash dividends, we continue to explore alternatives for increasing our liquidity through additional asset sales and capital raising efforts. However, 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. If we cannot raise cash by selling debt and 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.

REIT provisions of the Internal Revenue Code require us to distribute to our stockholders substantially all of our taxable income. These provisions restrict our ability to retain earnings and renew capital for our business activities. We may decide in future periods 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 large portion of our dividends to stockholders consisted 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 dividends, if any, paid by us to our stockholders.

#### ***Our Prior History is Not Reflective of Future Performance***

Our historical financial performance is of limited relevance in predicting our future performance. We began our operations in November 1995. Our future operating results will depend largely upon our ability to expand our long-term investment operations, our conduit operations and our warehouse lending operations. We cannot assure you that we will be able to successfully grow or that our operations will be profitable in the future. We cannot assure you that any prior rates of growth can be sustained or that they are indicative of future results. It is unlikely that any of our future dividends will be equal to or more than those dividends we have paid in the past.

The loans we purchased to date and included in our securitizations have been outstanding for a relatively short period of time and our delinquency and loss experience to date may not be indicative of future results. It is unlikely that we will be able to maintain our delinquency and loan loss ratios at their present levels as our portfolio becomes more seasoned.

#### ***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 mortgage-backed securities. 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 collateralized mortgage obligation collateral exposes our operations to greater credit losses than the use of securitization techniques that are treated as sales. In creating a collateralized mortgage obligation, we 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 decreases and we would have to adjust the value of the investment in 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 collateralized borrowings, our lenders could force us to liquidate the collateral. If the value of the collateral is less than the amount borrowed, we would 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.

### *Risk of Lack of Return of Investment on Liquidation*

We have pledged a substantial portion of our assets to secure the repayment of collateralized mortgage obligations issued in securitizations, our financing facilities or 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 were liquidated.

### *Interest Rate Fluctuations May Adversely Affect Our Operating Results*

Our operations, each as a mortgage loan originator and 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 decrease the amount of mortgages available to be acquired 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 mortgage loans at lower long-term interest rates. Increased loan prepayments could lead to a reduction in the number of loans we service, the fees we receive for loan servicing and our loan servicing 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.

### *Risks of Repricing of Assets and Liabilities*

Our principal source of revenue is net interest income or net interest spread, 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 significant portion of the mortgage assets held by our long-term investment operations are adjustable rate mortgages or bear interest based upon short-term interest rate indices. We generally fund these mortgage assets with borrowings. To the extent that there is a difference between the interest rate index used to determine the interest rate on our adjustable rate mortgage assets and the interest rate index used to determine the borrowing rate for our related financing, our business may be negatively impacted.

#### *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. 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.

#### *Payment Caps*

Some of our adjustable rate mortgages may be subject to payment caps meaning some portion of the interest accruing on the mortgage is deferred and added to the principal outstanding. Our borrowings do not have similar provisions. This could cause us to receive less cash on our adjustable rate assets than the interest due on our related borrowings. Also, the increased principal amount outstanding as a result of interest deferral may result in a higher rate of defaults on these loans.

#### ***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 loans we originate;
- differences between our cost of funds on borrowings and the average interest rates earned on our loans;
- inability 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 Highly Volatile***

Historically, the market price of our common stock has been extremely volatile. During 2000, our stock reached a high of \$4.38 and a low of \$1.83. On December 31, 2000, the closing sale price was \$2.95. The market price of our common stock is likely to continue to be highly volatile and could be significantly affected by factors including:

- availability of liquidity;
- volatility in the securitization market;
- whole loan sale pricing;
- margin calls by warehouse lenders;
- actual or anticipated fluctuations in our operating results;
- interest rates;
- 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 stocks 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.

***Prepayments of Mortgage Loans May Adversely Affect Our Operations***

Mortgage prepayments generally increase 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 and general economic conditions. Most of our adjustable rate mortgages and those backing mortgage-backed securities are originated within six 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, we would not have received interest at the fully-indexed rate during such period. 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 currently 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 any mortgage loans that we acquired at a premium are prepaid, generally accepted accounting principles require us to immediately write-off any remaining capitalized premium amount, which would decrease our interest income.

***Value of Our Portfolio of Mortgage-Backed Securities May be Adversely Affected***

We invest in mortgage-backed securities known as “interest-only,” “principal-only,” residual interest and subordinated securities. These securities are either created through our own securitizations or those of third parties. 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 all or that we could recoup our initial investment.

We also bear the risk of loss on any mortgage-backed securities we purchase in the secondary mortgage market. If third parties have been contracted to insure against these types of losses, we would be dependent in part upon the creditworthiness and claims paying ability of the insurer and the timeliness of reimbursement in the event of a default on

the underlying obligations. The insurance coverage for various types of losses is limited, and we bear the risk of any losses in excess of the limitation or outside of the insurance coverage.

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. Borrowers may obtain private mortgage insurance, but we only require this insurance in limited circumstances. 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 (such as losses occurring from earthquakes or floods). 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. In addition, since defaulted mortgage loans are not considered eligible collateral under our borrowing arrangements, we bear the risk of being required to finance these loans with funds other than borrowed funds until they are ultimately liquidated.

#### *Greater Risks from Non-Conforming Mortgage Loans*

Non-conforming residential mortgage loans are residential mortgages that do not qualify for purchase by government sponsored agencies such as the Fannie Mae and Freddie Mac. Our operations may be negatively affected due to our investments in non-conforming loans or securities evidencing interests in such loans. Credit risks associated with non-conforming mortgage loans are greater than conforming mortgage loans. The interest rates we charge on non-conforming loans are often higher than those charged for conforming loans. The purchase market of non-conforming loans has typically provided for higher interest rates in order to compensate for the lower liquidity. Due to the lower level of liquidity in the non-conforming loan market, we may realize higher returns upon securitization of loans than would be realized upon securitization of conforming loans. However, lower levels of liquidity may cause us to hold loans or other mortgage-related assets supported by these loans. 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.

#### *Second Mortgages Entail Greater Risks*

Our security interest in the property securing second mortgages is subordinated to the interest of the first mortgage holder. If the value of the property is equal to or less than the amount needed to repay the borrower's 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 subordinated interests are secured by properties in California. Certain parts of California have experienced an economic downturn in past years and have suffered 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 the sellers of mortgage loans, we cannot assure you that they will honor their obligations. We also engaged 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 sellers.

### ***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.

### ***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. Although our hedging program currently qualifies for hedge accounting under generally accepted accounting principles, we cannot assure you that our hedging transactions will offset our risks of loss, and we could incur significant losses.

### ***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;
- regional and national economic conditions;
- fluctuations in residential property values; and
- general 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 impacted.

***Intense Competition for Mortgage Loans May Adversely Affect Our Operations***

We compete in purchasing non-conforming 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.

Consolidation in the mortgage banking industry may adversely affect us by reducing the number of current sellers to 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.

***If We Fail to Maintain Our REIT Status We May be Subject to Taxation as a Regular Corporation***

*Consequences if We Fail to Qualify as a REIT*

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 could 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.

### **Consequences if We Fail to Qualify as a REIT**

#### *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.

#### *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 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) we are subject to the rules relating to taxable mortgage pools or we are a “pension-held REIT,” or (2) a tax-exempt stockholder has incurred debt to purchase or hold our common stock is not exempt from Federal income taxation under certain special sections of the Internal Revenue Code, or (3) the residual REMIC interests we buy generate “excess inclusion income,” then distributions to and, in the case of a stockholder described in (2), 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 may be classified as a “taxable mortgage pool” under the Internal Revenue Code. If any part of our company was treated as a taxable mortgage pool, then our REIT status would not be impaired, but a portion of the taxable income we generated may, under regulations to be issued by the Treasury Department, be characterized as “excess inclusion” income and allocated to our stockholders. 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. 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;
- offer securities in exchange for property; and
- offer to 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 intend 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.

***Risk Relating to Preferred Stock***

Our charter authorizes our board of directors to issue shares of preferred stock and to classify or reclassify any unissued shares of common stock or preferred stock into one or more classes or series of stock. The preferred stock may be issued from time to time with terms as determined by our board of directors. Our preferred stock is available for our possible future financing of acquisitions and for our general corporate purposes without further stockholder authorization. In October 1998, our board announced a dividend to all common stockholders of rights for certain shares of our Series A Junior Preferred Stock. Our Series A Junior Preferred Stock has terms and conditions which could have the effect of delaying, deferring or preventing a hostile change in control of our company. Our board could authorize the issuance of shares of another class or series of preferred stock with terms and conditions which could also have the effect of delaying, deferring or preventing a change in control of our company which could involve a premium price for holders of common stock or otherwise be in their best interest. The preferred stock, if issued, may have a preference on dividend payments, which could reduce the assets we have available to make distributions to our common stockholders.

***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 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,
- 66% of the votes entitled to be cast by holders of outstanding voting shares other than shares held by 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 stockholder vote. 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 at least 20% of the voting power in electing directors. 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 be held within 50 days 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 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
- any 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 50% or more 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 \$149,000 per month. The Company believes that these facilities will adequately provide for the Company's future growth needs.

#### **ITEM 3. LEGAL PROCEEDINGS**

On August 4, 2000, a complaint captioned *Michael P. and Shellie Gilmor v. Preferred Credit Corporation and Impac Funding Corporation, et. al.* was filed in the Circuit Court of Clay County, Missouri, Case No. CV100-6512CC (a later duplicate action was filed under the same caption in the same court). The plaintiffs are contending a purported class action lawsuit that the defendants violated Missouri's Second Loans Act and Merchandising Practices Act by charging certain unauthorized origination fees, finders' fees, mortgage broker or broker fees, or closing fees and costs on second mortgage loans, and thereby committed conversion from the illegal charge of interest or such costs or fees. IFC was a purchaser of second mortgage loans originated by Preferred Credit Corporation which the plaintiffs contend are included in this lawsuit. The plaintiffs are seeking damages that include a permanent injunction enjoining the defendants, its successors and any and all persons acting in concert from, directly or indirectly, engaging in the wrongful acts described therein. It also seeks disgorgement or restitution of all improperly collected charges and the imposition of an equitable constructive trust over such amounts for the benefit of the plaintiffs, the right to rescind the loan transactions, and a right to offset any finance charges, closing costs, points or other loan fees paid against the principal amounts due on the loans, actual damages, punitive damages, reasonable attorney's fees, pre- and post- judgment interest and costs and expenses. In connection with their claim of conversion, the plaintiffs are seeking \$50.0 million in punitive damages. Damages are unspecified and the punitive damages in connection with the other claims are not specified. 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 this suit.

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 materially adverse effect on the Company.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to the security holders to be voted on during the fourth quarter of 2000.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is listed on the American Stock Exchange ("AMEX") under the symbol IMH. The following table summarizes the high, low and closing sales prices for IMH's Common Stock as reported by the AMEX for the periods indicated:

	2000			1999		
	High	Low	Close	High	Low	Close
First Quarter .....	\$ 4.25	\$ 3.13	\$ 3.50	\$ 6.19	\$ 4.00	\$ 5.00
Second Quarter .....	4.38	3.06	4.31	6.13	4.38	5.06
Third Quarter.....	4.19	2.38	2.70	6.13	3.88	4.63
Fourth Quarter.....	3.20	1.83	2.95	4.81	3.38	4.13

On March 27, 2001, the last reported sale price of the Common Stock on the AMEX was \$4.18 per share. As of March 27, 2001, there were 369 holders of record (including holders who are nominees for an undetermined number of beneficial owners) of the Company's Common Stock.

*Dividend Reinvestment and Stock Purchase Plan.* Pursuant to IMH's Dividend Reinvestment and Stock Purchase Plan ("DRSPP" or the "Plan"), stockholders can acquire additional shares of IMH Common Stock by reinvesting their cash dividends at a 0% to 5% discount of the average high and low market prices as reported on the AMEX on the Investment Date (as described in the Plan) to the extent shares are issued by IMH. Stockholders may also purchase additional shares of IMH Common Stock through the cash investment option at a 0% to 5% discount of the average high and low market prices as reported on the AMEX during the three trading days preceding the Investment Date. In July 1999, the Company suspended its DRSPP.

*Share Repurchase Program.* During 2000, the Company's Board of Directors authorized the Company to repurchase up to \$3.0 million of the Company's Common Stock, \$.01 par value, in open market purchases from time to time at the discretion of the Company's management; the timing and extent of the repurchases will depend on market conditions. The Company intends to effect such repurchases, if any, in compliance with the Rule 10b-18 under the Securities Exchange Act of 1934. 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.

*Stockholder Rights Plan.* On October 7, 1998, the Company's Board of Directors adopted a Stockholder Rights Plan in which Preferred Stock Purchase Rights were distributed as a dividend at the rate of one Right for each outstanding share of Common Stock. The dividend distribution was made on October 19, 1998 payable to stockholders of record on that date. The Rights are attached to the Company's Common Stock. The Rights will be exercisable and trade separately only in the event that a person or group acquires or announces the intent to acquire 10 percent or more of the Company's Common Stock. Each Right will entitle stockholders to buy one-hundredth of a share of a new series of junior participating Preferred Stock at an exercise price of \$30.00. If the Company is acquired in a merger or other transaction after a person has acquired 10 percent or more of Company outstanding Common Stock, each Right will entitle the stockholder to purchase, at the Right's then-current exercise price, a number of the acquiring Company's common shares having a market value of twice such price. In addition, if a person or group acquires 10 percent or more of the Company's Common Stock, each Right will entitle the stockholder (other than the acquiring person) to purchase, at the Right's then-current exercise price, a number of shares of the Company's Common Stock having a market value of twice such price. Following the acquisition by a person of 10 percent or more of the Company's Common Stock and before an acquisition of 50 percent or more of the Common Stock, the Board of Directors may exchange the Rights (other than the Rights owned by such person) at an exchange ratio of one share of Common Stock per Right. Before a person or group acquires beneficial ownership of 10 percent or more of the Company's Common Stock, the Rights are redeemable for \$.0001 per right at the option of the Board of Directors. The Rights will expire on October 19, 2008. The Rights distribution is not taxable to stockholders. The Rights are intended to enable all the Company stockholders to realize the long-term value of their investment in the Company.

## Dividends

To maintain its qualification as a REIT, IMH intends to make annual distributions to stockholders equal to or greater than its taxable income in accordance with the Internal Revenue code, which may not necessarily equal net income as calculated in accordance with generally accepted accounting principles (“GAAP”), determined without regard to the deduction for dividends paid and excluding any net capital gains. Any taxable income remaining after the distribution of the regular quarterly or other dividends will be distributed annually on or prior to the date of the first regular quarterly dividend payment date of the following taxable year. The dividend policy is subject to revision at the discretion of the Board of Directors. All distributions in excess of those required for IMH to maintain REIT status will be made by IMH at the discretion of the Board of Directors and will depend on the taxable earnings of IMH, the financial condition of IMH, and such other factors as the Board of Directors deems relevant. The Board of Directors has not established a minimum distribution level.

Distributions to stockholders will generally be taxable as ordinary income, although a portion of such distributions may be designated by IMH as capital gain or may constitute a tax-free return of capital. IMH annually furnishes to each of its stockholders a statement setting forth distributions paid during the preceding year and their characterization as ordinary income, capital gains or return of capital. Of the total dividends paid during 2000 and 1999, approximately \$13.7 million and \$4.8 million, respectively, represented a tax-free return of capital.

The following table summarizes dividends paid or declared by IMH:

<u>Period Covered</u>	<u>Stockholder Record Date</u>	<u>Per Share Dividend Amount</u>
Quarter ended March 31, 1999 .....	April 9, 1999	\$0.10
Quarter ended June 30, 1999 .....	June 30, 1999	\$0.12
Quarter ended September 30, 1999 .....	September 30, 1999	\$0.13
Quarter ended December 31, 1999 .....	January 3, 2000	\$0.13
Quarter ended March 31, 2000 .....	April 10, 2000	\$0.12
Quarter ended June 30, 2000 .....	July 6, 2000	\$0.12
Quarter ended September 30, 2000 .....	October 11, 2000	\$0.12

The Company did not declare a dividend for the quarter ended December 31, 2000.

## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated statements of operations data for each of the years in the five-year period ended December 31, 2000, and the consolidated balance sheet data for the five-year period ended December 31, 2000 were derived from the Company’s and IFC’s consolidated financial statements audited by KPMG LLP (“KPMG”), independent auditors, whose reports appear on pages F-2 and F-33, respectively. Such selected financial data should be read in conjunction with the consolidated financial statements and the notes to the consolidated financial statements starting on page F-1 and with Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

**IMPAC MORTGAGE HOLDINGS, INC.**  
(dollar amounts in thousands, except per share data)

	Year Ended December 31,				
	2000	1999	1998	1997	1996
<b>Statement of Operations Data:</b>					
Net interest income:					
Total interest income .....	\$ 147,079	\$ 119,458	\$ 163,658	\$ 109,533	\$ 63,673
Total interest expense.....	124,096	89,795	121,695	76,577	44,144
Net interest income.....	22,983	29,663	41,963	32,956	19,529
Provision for loan losses.....	18,839	5,547	4,361	6,843	4,350
Net interest income after loan loss provision.....	4,144	24,116	37,602	26,113	15,179
Non-interest income:					
Equity in net earnings (loss) of IFC.....	(1,762)	4,292	(13,876)	8,316	903
Equity in net loss of ICH.....	—	—	(998)	(239)	—
Loss on sale of mortgage loans .....	—	—	(3,111)	—	—
Gain on sale of securities .....	—	93	427	648	—
Other income .....	4,275	2,517	4,019	1,601	593
Total non-interest income .....	2,513	6,902	(13,539)	10,326	1,496
Non-interest expense:					
Write-down on securities available-for-sale .....	53,576	2,037	14,132	—	—
General and administrative and other operating expense.....	7,314	6,664	6,788	1,851	1,449
Loss on equity investment of ICH.....	—	—	9,076	—	—
Advisory fees .....	—	—	—	6,242	3,347
Termination agreement expense.....	—	—	—	44,375	—
Total non-interest expense.....	60,890	8,701	29,996	52,468	4,796
Net earnings (loss) .....	<u>\$ (54,233)</u>	<u>\$ 22,317</u>	<u>\$ (5,933)</u>	<u>\$ (16,029)</u>	<u>\$ 11,879</u>
Net earnings (loss) per share— basic .....	<u>\$ (2.70)</u>	<u>\$ 0.83</u>	<u>\$ (0.25)</u>	<u>\$ (0.99)</u>	<u>\$ 1.34</u>
Net earnings (loss) per share— diluted .....	<u>\$ (2.70)</u>	<u>\$ 0.76</u>	<u>\$ (0.25)</u>	<u>\$ (0.99)</u>	<u>\$ 1.32</u>
Dividends declared per share .....	<u>\$ 0.36</u>	<u>\$ 0.48</u>	<u>\$ 1.46</u>	<u>\$ 1.68</u>	<u>\$ 1.61</u>
Net earnings (loss) per share before management termination expense (1) .....	<u>\$ (2.70)</u>	<u>\$ 0.76</u>	<u>\$ (0.25)</u>	<u>\$ 1.74</u>	<u>\$ 1.32</u>

(1) Per share amounts exclude the effect of expenses related to the termination in December 1997 (the "Termination Agreement Expense") of the Company's Management Agreement with Imperial Credit Advisors, Inc. ("ICAI"), an affiliate of Imperial Credit Industries, Inc. ("ICII").

	At December 31,				
	2000	1999	1998	1997	1996
<b>Balance Sheet Data:</b>					
Investment securities available-for-sale .....	\$ 36,921	\$ 93,206	\$ 93,486	\$ 67,011	\$ 63,506
Mortgage loans held-for-investment and CMO collateral.....	1,389,716	1,313,112	1,181,847	1,052,610	502,658
Finance receivables .....	405,438	197,119	311,571	533,101	362,312
Investment in Impac Funding Corporation.....	15,762	17,372	13,246	27,122	9,896
Investment in Impac Commercial Holdings, Inc....	—	—	—	17,985	—
Total assets .....	1,898,838	1,675,430	1,665,504	1,752,812	972,355
CMO borrowings.....	1,291,284	850,817	1,072,316	741,907	474,513
Reverse repurchase agreements.....	398,653	539,687	323,625	755,559	357,716
Total liabilities .....	1,720,398	1,436,586	1,413,898	1,523,782	843,165
Total stockholders' equity .....	178,440	238,844	251,606	229,030	129,190

**IMPAC FUNDING CORPORATION**  
(dollar amounts in thousands, except Operating Data)

	Year Ended December 31,				
	2000	1999	1998	1997	1996
<b>Statement of Operations Data:</b>					
Net interest income:					
Total interest income .....	\$ 28,649	\$ 21,225	\$ 48,510	\$ 48,020	\$ 32,799
Total interest expense.....	30,056	20,953	40,743	41,628	31,751
Net interest income (expense).....	(1,407)	272	7,767	6,392	1,048
Non-interest income:					
Gain (loss) on sale of loans.....	19,727	27,098	(11,663)	19,414	7,747
Loan servicing income .....	6,286	5,221	7,071	4,109	1,250
Gain (loss) on sale of investment securities .....	51	—	(706)	550	—
Mark-to-market loss on investment securities .....	—	—	(805)	—	—
Other income .....	1,054	979	420	93	—
Total non-interest income (loss).....	27,118	33,298	(5,683)	24,166	8,997
Non-interest expense:					
General and administrative and other operating expense.....	19,634	14,965	14,385	10,047	7,154
Amortization of mortgage servicing rights .....	5,179	5,331	6,361	2,827	613
Write-down of securities available-for-sale .....	1,537	4,252	—	—	—
Provision for repurchases .....	371	385	367	3,148	687
Impairment of mortgage servicing rights .....	—	1,078	3,722	—	—
Total non-interest expense.....	26,721	26,011	24,835	16,022	8,454
Earnings (loss) before income taxes .....	(1,010)	7,559	(22,751)	14,536	1,591
Income taxes (benefit).....	770	3,227	(8,738)	6,136	679
Net earnings (loss).....	<u>\$ (1,780)</u>	<u>\$ 4,332</u>	<u>\$ (14,013)</u>	<u>\$ 8,400</u>	<u>\$ 912</u>
<b>At December 31,</b>					
	2000	1999	1998	1997	1996
<b>Balance Sheet Data:</b>					
Mortgage loans held-for-sale .....	\$ 275,570	\$ 68,084	\$ 252,568	\$ 620,549	\$ 334,104
Mortgage servicing rights .....	10,938	15,621	14,062	15,568	8,785
Total assets .....	317,163	116,246	313,872	656,944	399,171
Borrowings from IWLG.....	266,994	66,125	192,900	454,840	327,422
Other borrowings.....	—	181	67,058	148,307	—
Due to affiliates .....	14,500	14,500	24,382	6,198	54,803
Total liabilities .....	301,242	98,698	301,009	629,548	389,175
Total shareholders' equity .....	15,921	17,548	12,863	27,396	9,996
<b>Operating Data (in millions):</b>					
Mortgage loan acquisitions (volume).....	\$ 2,113	\$ 1,672	\$ 2,249	\$ 2,571	\$ 1,542
Master servicing portfolio at period-end .....	4,043	2,879	3,714	3,029	1,550
Servicing portfolio at period-end .....	2,429	2,393	3,714	3,029	1,550