

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from to .

Commission File Number: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

33-0675505
(I.R.S. Employer
Identification No.)

1950 Jamboree Road, Irvine, California 92612
(Address of principal executive offices)

(949) 475-3600
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer o

Accelerated filer

Non-accelerated filer o
(Do not check if a smaller reporting company)

Smaller reporting company x

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

There were 7,768,748 shares of common stock outstanding as of November 12, 2010.

IMPAC MORTGAGE HOLDINGS, INC.

**FORM 10-Q QUARTERLY REPORT
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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)

| | September 30, 2010 <u>(Unaudited)</u> | December 31, 2009 |
|--|---|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 10,601 | \$ 25,678 |
| Restricted cash | 1,003 | 1,253 |
| Short-term investments | — | 5,002 |
| Trust assets | | |
| Investment securities available-for-sale | 1,254 | 813 |
| Securitized mortgage collateral | 6,070,577 | 5,666,122 |
| Derivative assets | 39 | 146 |
| Real estate owned | 106,042 | 142,364 |
| Total trust assets | <u>6,177,912</u> | <u>5,809,445</u> |
| Assets of discontinued operations | 672 | 4,480 |
| Other assets | 30,429 | 27,054 |
| Total assets | <u>\$ 6,220,617</u> | <u>\$ 5,872,912</u> |
| LIABILITIES | | |
| Trust liabilities | | |
| Securitized mortgage borrowings | \$ 6,061,000 | \$ 5,659,865 |
| Derivative liabilities | 89,028 | 126,603 |
| Total trust liabilities | <u>6,150,028</u> | <u>5,786,468</u> |

| | | |
|--|-----------|-----------|
| Long-term debt | 10,822 | 9,773 |
| Note payable | 8,125 | 31,060 |
| Liabilities of discontinued operations | 14,125 | 19,152 |
| Other liabilities | 11,284 | 11,026 |
| Total liabilities | 6,194,384 | 5,857,479 |

Commitments and contingencies

STOCKHOLDERS' EQUITY

| | | |
|---|--------------|--------------|
| Series A junior participating preferred stock, \$0.01 par value; 2,500,000 shares authorized; none issued and outstanding | — | — |
| Series B 9.375% redeemable preferred stock, \$0.01 par value; liquidation value \$16,639; 2,000,000 shares authorized, 665,592 noncumulative shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively | 7 | 7 |
| Series C 9.125% redeemable preferred stock, \$0.01 par value; liquidation value \$35,127; 5,500,000 shares authorized; 1,405,086 noncumulative shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively | 14 | 14 |
| Common stock, \$0.01 par value; 200,000,000 shares authorized; 7,768,746 and 7,698,146 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively | 78 | 77 |
| Additional paid-in capital | 1,076,328 | 1,075,707 |
| Net accumulated deficit: | | |
| Cumulative dividends declared | (822,520) | (822,520) |
| Retained deficit | (227,674) | (237,852) |
| Net accumulated deficit | (1,050,194) | (1,060,372) |
| Total stockholders' equity | 26,233 | 15,433 |
| Total liabilities and stockholders' equity | \$ 6,220,617 | \$ 5,872,912 |

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (in thousands, except per share data) (Unaudited)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|--|---|------------|--|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| INTEREST INCOME | \$ 230,927 | \$ 341,323 | \$ 759,016 | \$ 1,508,230 |
| INTEREST EXPENSE | 229,256 | 339,417 | 755,020 | 1,499,729 |
| Net interest income | 1,671 | 1,906 | 3,996 | 8,501 |
| NON-INTEREST INCOME: | | | | |
| Change in fair value of net trust assets, excluding REO | 9,573 | 46,325 | 12,701 | 234,167 |
| Losses from REO | (10,147) | (43,160) | (6,290) | (218,083) |
| Non-interest (loss) income - net trust assets | (574) | 3,165 | 6,411 | 16,084 |
| Change in fair value of long-term debt | 1,168 | 341 | 952 | 682 |
| Mortgage and real estate services fees | 15,521 | 13,514 | 42,523 | 32,296 |
| Other | 39 | (107) | (56) | (333) |
| Total non-interest income | 16,154 | 16,913 | 49,830 | 48,729 |
| NON-INTEREST EXPENSE: | | | | |
| General and administrative | 4,869 | 4,603 | 14,278 | 15,053 |
| Personnel expense | 10,683 | 9,413 | 31,132 | 26,050 |
| Total non-interest expense | 15,552 | 14,016 | 45,410 | 41,103 |
| Earnings from continuing operations before income taxes | 2,273 | 4,803 | 8,416 | 16,127 |
| Income tax expense from continuing operations | 14 | — | 143 | 2,018 |
| Earnings from continuing operations | 2,259 | 4,803 | 8,273 | 14,109 |
| (Loss) earnings from discontinued operations, net of tax | (1,285) | (1,776) | 1,905 | (8,366) |
| Net earnings | 974 | 3,027 | 10,178 | 5,743 |
| Cash dividends on preferred stock | — | — | — | (7,443) |
| Earnings (loss) available to common stockholders before redemption of preferred stock (Note 4) | \$ 974 | \$ 3,027 | \$ 10,178 | \$ (1,700) |
| Earnings (loss) per common share - basic: | | | | |
| Earnings from continuing operations | \$ 0.29 | \$ 0.63 | \$ 1.07 | \$ 0.88 |
| (Loss) earnings from discontinued operations | (0.16) | (0.23) | 0.25 | (1.10) |
| Earnings (loss) available to common stockholders before redemption of preferred stock (Note 4) | \$ 0.13 | \$ 0.40 | \$ 1.32 | \$ (0.22) |

Earnings (loss) per common share - diluted:

| | | | | |
|--|----------------|----------------|----------------|------------------|
| Earnings from continuing operations | \$ 0.27 | \$ 0.60 | \$ 0.99 | \$ 0.88 |
| (Loss) earnings from discontinued operations | (0.15) | (0.22) | 0.23 | (1.10) |
| Earnings (loss) available to common stockholders before redemption of preferred stock (Note 4) | <u>\$ 0.12</u> | <u>\$ 0.38</u> | <u>\$ 1.22</u> | <u>\$ (0.22)</u> |

See accompanying notes to consolidated financial statements

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

| | For the Nine Months Ended September 30, | |
|--|--|--------------------|
| | 2010 | 2009 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Earnings | \$ 10,178 | \$ 5,743 |
| Losses from real estate owned | 6,290 | 218,083 |
| Amortization and impairment of deferred charge, net | — | 1,998 |
| Change in fair value of net trust assets, excluding REO | (101,706) | (392,962) |
| Change in fair value of long-term debt | (952) | (682) |
| Accretion of interest income and expense | 307,710 | 553,813 |
| Stock-based compensation | 472 | 3,297 |
| Change in REO impairment reserve | (12,462) | (106,021) |
| Net change in other assets and liabilities | (3,338) | 3,051 |
| Net cash (used in) provided by operating activities of discontinued operations | (3,226) | 20,956 |
| Net cash provided by operating activities | 202,966 | 307,276 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net change in securitized mortgage collateral | 563,708 | 663,938 |
| Net change in mortgages held-for-investment | 148 | 406 |
| Purchase of premises and equipment | (1,274) | (378) |
| Maturity (purchase) of short-term investments | 5,000 | (5,041) |
| Net principal change on investment securities available-for-sale | 117 | 3,889 |
| Proceeds from the sale of real estate owned | 175,707 | 596,423 |
| Net cash provided by investing activities of discontinued operations | 1,907 | 14,148 |
| Net cash provided by investing activities | 745,313 | 1,273,385 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayment of warehouse borrowings | (580) | — |
| Borrowings under warehouse agreement | 2,024 | — |
| Settlement of trust preferred securities | — | (4,275) |
| Repurchase of preferred stock | — | (1,259) |
| Preferred stock dividends paid | — | (7,443) |
| Principal payments on notes payable | (22,935) | — |
| Repayment of securitized mortgage borrowings | (941,985) | (1,537,530) |
| Proceeds from exercise of stock options | 20 | — |
| Net cash used in financing activities of discontinued operations | — | (37,622) |
| Net cash used in financing activities | (963,456) | (1,588,129) |
| Net change in cash and cash equivalents | (15,177) | (7,468) |
| Cash and cash equivalents at beginning of period | 25,850 | 46,228 |
| Cash and cash equivalents at end of period - Continuing Operations | 10,601 | 37,893 |
| Cash and cash equivalents at end of period - Discontinued Operations | 72 | 867 |
| Total cash and cash equivalents at end of period | \$ 10,673 | \$ 38,760 |
| NON-CASH TRANSACTIONS (Continuing and Discontinued Operations): | | |
| Common stock issued per marketing service agreement | \$ 129 | \$ — |
| Transfer of loans held-for-sale and held-for-investment to real estate owned | — | 12,540 |
| Transfer of securitized mortgage collateral to real estate owned | 129,907 | 279,368 |
| Net effect of consolidation of net trust assets from adoption of accounting principle | 119,631 | — |
| Net effect of consolidation of net trust liabilities from adoption of accounting principle | (119,631) | — |

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except share and per share data or as otherwise indicated)

Note 1.—Summary of Business, Financial Statement Presentation, Market Conditions and Liquidity

Business Summary

Impac Mortgage Holdings, Inc. (the Company or IMH) is a Maryland corporation incorporated in August 1995 and has the following subsidiaries: Integrated Real Estate Service Corporation (IRES), IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG) and Impac Funding Corporation (IFC).

The Company's continuing operations include the long-term mortgage portfolio (residual interests in securitizations determined as total trust assets minus total trust liabilities in the consolidated balance sheets) and the mortgage and real estate fee-based business activities conducted by IRES. The discontinued operations include the former non-conforming mortgage and retail operations conducted by IFC and subsidiaries, and warehouse lending operations conducted by IWLG.

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

Financial Statement Presentation

The accompanying unaudited consolidated financial statements of IMH and its subsidiaries (as defined above) have been prepared in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These interim period condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the United States Securities and Exchange Commission (SEC).

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

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

Recently Adopted Accounting Pronouncements

In February 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-9 "Amendments to Certain Recognition and Disclosure Requirements" (ASU 2010-9). The ASU amends FASB Accounting Standards Codification Topic 855 "Subsequent Events" to address certain implementation issues related to an entity's requirement to perform and disclose subsequent events procedures. ASU 2010-9 requires (a) SEC filers and (b) conduit debt obligors for conduit debt securities that are traded in a public market to evaluate subsequent events through the date the financial statements are issued. All other entities are required to evaluate subsequent events through the date the financial statements are available to be issued. ASU 2010-9 exempts SEC filers from disclosing the date through which subsequent events have been evaluated. For the Company, ASU 2010-9 is effective immediately for financial statements that are to be issued or revised. The adoption of ASU 2010-9 did not have an impact on the Company's consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-6 "Improving Disclosures About Fair Value Measurements" (ASU 2010-6). The ASU amends Codification Topic 820 "Fair Value Measurements and Disclosures" to add new disclosure requirements for transfers into and out of Levels 1 and 2 fair value measurements, as well as separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 fair value measurements. ASU 2010-6 also clarifies existing fair value disclosures regarding the level of disaggregation and inputs and valuation techniques used to measure fair value. ASU 2010-6 is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. ASU 2010-6 only adds new disclosures requirements and as a result, its adoption did not have an impact on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets—An Amendment of FASB Statement 140" which eliminates the concept of qualifying special purpose entity's (QSPEs) and provides additional criteria transferors must use to evaluate transfers of financial assets. This standard modifies certain guidance contained in FASB ASC 860 "Transfers and Servicing" and is adopted into the Codification through the issuance of ASU 2009-16 "Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets." In order to determine whether a transfer is accounted for as a sale, the transferor must assess whether it and all of its consolidated entities have surrendered control of the financial assets. The standard also requires financial assets and liabilities retained from a transfer accounted for as a sale to be initially recognized at fair value. The Company adopted this standard effective January 1, 2010 with no impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," which amends several key consolidation provisions related to variable interest entities (VIEs). This standard amends guidance contained in FASB ASC 810 "Consolidation" and is adopted into the Codification through the issuance of ASU 2009-17 "Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable

Interest Entities.” Former QSPEs will be evaluated for consolidation based on the provisions of FASB ASC 810-10-25, which changes the approach to determining a VIE’s primary beneficiary and requires companies to more frequently reassess whether they must consolidate or deconsolidate VIEs. The accounting standard requires a qualitative, rather than quantitative, analysis to determine the primary beneficiary of a VIE for consolidation purposes. The primary beneficiary of a VIE is the enterprise that has (a) the power to direct the VIE activities that most significantly affect the VIE’s economic performance, and (b) the right to receive benefits of the VIE that could potentially be significant to the VIE or the obligation to absorb losses of the VIE that could potentially be significant to the VIE. This standard is effective for fiscal years and interim periods beginning after November 15, 2009 and applies to all current QSPEs and VIEs, and all VIEs created after the effective date. In accordance with this standard, the Company may consolidate QSPEs and VIEs at carrying value or elect the fair value option. The Company intends to elect the fair value option, in which all of the financial assets and liabilities of certain designated QSPEs and VIEs would be recorded at fair value upon the adoption of this standard and continue to be recorded at fair value thereafter with changes in fair value reported in earnings.

In connection with the adoption of this standard on January 1, 2010, the Company consolidated \$253.7 million of trust assets and trust liabilities at fair value. Additionally, the Company deconsolidated \$134.1 million of trust assets and liabilities at fair value. The following is a summary of the impact of adopting the new consolidation provisions of FASB ASC 810.

| | (prior to adoption) December 31, 2009 | Variable Interest Entities | | (after adoption) January 1, 2010 |
|--|---|----------------------------|----------------|--|
| | | Consolidated | Deconsolidated | |
| Investment securities available-for-sale | \$ 813 | \$ (298) | \$ — | \$ 515 |
| Securitized mortgage collateral | 5,666,122 | 249,523 | (132,615) | 5,783,030 |
| REO | 142,364 | 4,499 | (1,478) | 145,385 |
| Securitized mortgage borrowings | (5,649,865) | (244,683) | 134,065 | (5,760,483) |
| Derivative liabilities, net | (126,457) | (9,041) | 28 | (135,470) |
| Net trust assets | <u>\$ 32,977</u> | <u>—</u> | <u>—</u> | <u>\$ 32,977</u> |

There was no overall impact on stockholders’ equity as a result of the consolidation and deconsolidation of these trust assets and liabilities on January 1, 2010.

Income Taxes and Deferred Charge

Effective January 1, 2009, the Company revoked its election to be taxed as a REIT. As a result of revoking this election, the Company is subject to income taxes as a regular (Subchapter C) corporation.

The Company recorded income tax expense of \$14 thousand and \$143 thousand for the three and nine months ended September 30, 2010, respectively. Income tax expense for the three and nine months ended September 30, 2009 was zero and \$2.0 million, respectively. The income tax expense for 2010 is the result of state income taxes. The income tax expense for 2009 is primarily the result of the amount of the deferred charge amortized and/or impaired resulting from credit losses, which does not result in any tax liability required to be paid. The deferred charge represents the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is included in other assets in the accompanying consolidated balance sheets and is amortized as a component of income tax expense in the accompanying consolidated statement of operations over the estimated life of the mortgages retained in the securitized mortgage collateral.

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As of December 31, 2009, the Company had estimated federal and California net operating loss carryforwards in the amount of \$835.8 million and \$837.3 million, respectively, of which \$277.6 million (federal) relate to discontinued operations. Federal and state net operating loss (NOL) carryforwards begin to expire in 2020 and 2013, respectively. The Company recorded a full valuation allowance against the deferred tax assets as it believes that as of September 30, 2010 it is more likely than not that the deferred tax assets will not be recoverable.

During the fourth quarter of 2009, the Company received a federal income tax refund in the amount of \$8.9 million as a result of an election to carryback NOLs five years pursuant to 2009 federal legislation, *The Worker, Homeownership, and Business Assistance Act of 2009*. The Company files income tax returns in the U.S. federal and various state jurisdictions. The Company is subject to routine income tax audits in the various jurisdictions. A subsidiary of the Company is currently under examination by the Internal Revenue Service for tax year 2008. Management believes that there are no unresolved issues or claims likely to be material to our financial position. As of September 30, 2010, the Company has no material uncertain tax positions.

Repurchase Reserve

When the Company sells loans through whole loan sales it is required to make normal and customary representations and warranties about the loans to the purchaser. The Company’s whole loan sale agreements generally require it to repurchase loans if the Company breaches a representation or warranty given to the loan purchaser. In addition, the Company may be required to repurchase loans as a result of borrower fraud or if a payment default occurs on a mortgage loan shortly after its sale. The repurchase reserve is an estimate of losses from expected repurchases, and is based, in part, on the recent settlement of claims. During the third quarter, consistent with other mortgage lenders, the Company received repurchase requests from Fannie Mae for loans funded primarily in 2007 resulting in a repurchase reserve of \$8.7 million at September 30, 2010 as compared to \$11.0 million at December 31, 2009.

Legal Proceedings

The Company is party to litigation and claims which arise in the ordinary course of business.

Please refer to IMH’s reports on Form 10-K for the year ended December 31, 2009 and Forms 10-Q for the quarters ended June 30, 2010 and March 31, 2010 for a description of litigation and claims.

Market Conditions and Liquidity

The housing market showed signs of improvement earlier in the year as housing prices were stabilizing in many markets and began to recover in others due to the low interest rate environment and the first-time homebuyer tax credit. Since the expiration of the homebuyer tax credit in May 2010, home sales have declined in the third quarter of 2010 and inventory levels have increased. The housing market is not expected to improve until job and income growth increase.

Mortgage and credit market conditions remained weak in the third quarter of 2010 due primarily to a continued weak labor market. Existing uncertainties surrounding the housing market, economy and regulatory environment will continue to present challenges for the Company. The ongoing economic stress or further deterioration of general economic conditions could prolong or increase borrower defaults leading to deteriorating performance of the Company's portfolio.

A number of factors make it difficult to predict when a sustained recovery in the housing and credit markets will occur. Concerns about the future of the U.S. economy, including the pace and magnitude of recovery from the recent economic recession, consumer confidence, volatility in energy prices, volatility experienced by the credit markets including the possibility that the recent European sovereign debt crisis will spread and trends in corporate earnings will continue to influence the U.S. economic recovery and the capital markets. In particular, improvement in unemployment rates and a sustained recovery of the housing market remain critical components of a broader U.S. economic recovery. Further weakening in these components as well as in consumer confidence may result in additional deterioration in consumer payment patterns and credit quality. Although consumer confidence has improved from the levels seen early in 2009, it remains low on a historical basis. Weak consumer fundamentals, including declines in wage income, reduced consumer spending, declines in wealth and a difficult job market continue to depress consumer confidence. Additionally, there is uncertainty related to the recently announced monetary policy under the Federal government's quantitative easing program and uncertainty as to the impact on the economy and consumer confidence whether the remaining actions taken by the government will restore faith in the capital markets and stimulate consumer spending. These conditions in combination with general economic weakness and the impact of recent and proposed regulatory changes will continue to affect our results of operations, the degree of which is largely dependent upon the nature and timing of the economic recovery.

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The ability to meet our long-term liquidity requirements is subject to several factors, such as generating fees from our mortgage and real estate fee-based business activities and realizing cash flows from our long-term mortgage portfolio. Our future financial performance and success are dependent in large part upon our ability to grow our mortgage and real estate fee-based business activities, including providing services to third parties and expanding our mortgage lending operations. We believe that current cash balances, cash flows from mortgage and real estate services fees generated from our long-term mortgage portfolio, and residual interest cash flows from our long-term mortgage portfolio are adequate for our current operating needs. However, the mortgage and real estate services market is volatile, highly competitive and subject to increased regulation. The Company's ability to successfully compete in the mortgage and real estate services industry may be challenging as its business activities are recently established and many competitors have recently entered or have established businesses delivering similar services. Additionally, the mortgage lending environment is extremely competitive and highly regulated. The future success of our mortgage lending operations will depend on a number of factors, including how well we compete, housing market conditions, economic recovery and financial regulatory reform. If we are unsuccessful, we may be unable to satisfy our future operating costs and liabilities, including repayment of the note payable and long-term debt.

Note 2.—Fair Value of Financial Instruments

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

For securitized mortgage collateral and securitized mortgage borrowings, the underlying Alt-A residential and commercial loans and mortgage-backed securities market have experienced significant declines in market activity, along with a lack of orderly transactions. The Company's methodology to estimate fair value of these assets and liabilities include the use of internal pricing techniques such as the net present value of future expected cash flows (with observable market participant assumptions, where available) discounted at a rate of return based on the Company's estimates of market participant requirements. The significant assumptions utilized in these internal pricing techniques, which are based on the characteristics of the underlying collateral, include estimated credit losses, estimated prepayment speeds and appropriate discount rates. The following table presents the estimated fair value of financial instruments included in the consolidated financial statements as of the dates indicated:

| | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Assets | | | | |
| Cash and cash equivalents | \$ 10,601 | \$ 10,601 | \$ 25,678 | \$ 25,678 |
| Restricted cash | 1,003 | 1,003 | 1,253 | 1,253 |
| Short-term investments | — | — | 5,002 | 5,002 |
| Investment securities available-for-sale | 1,254 | 1,254 | 813 | 813 |
| Securitized mortgage collateral | 6,070,577 | 6,070,577 | 5,666,122 | 5,666,122 |
| Derivative assets | 39 | 39 | 146 | 146 |
| Liabilities | | | | |
| Securitized mortgage borrowings | 6,061,000 | 6,061,000 | 5,659,865 | 5,659,865 |
| Derivative liabilities | 89,028 | 89,028 | 126,603 | 126,603 |
| Long-term debt | 10,822 | 10,822 | 9,773 | 9,773 |
| Note payable | 8,125 | 7,911 | 31,060 | 27,789 |

The fair value amounts above have been estimated by management using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop the estimates of fair value in both inactive and orderly markets. Accordingly, the estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The carrying amount of cash and cash equivalents and restricted cash approximates fair value. The fair value of short-term investments was determined using quoted prices in active markets.

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Refer to *Recurring Fair Value Measurements* below for a description of the valuation methods used to determine the fair value of investment securities available for sale, securitized mortgage collateral and borrowings, derivative assets and liabilities and long-term debt.

Note payable is recorded at amortized cost. Fair value of note payable is determined using a discounted cash flow model which factors in expected changes in interest rates and the Company's own credit risk.

Fair Value Hierarchy

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

FASB ASC 820-10-35 specifies a hierarchy of valuation techniques based on whether the inputs to those techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1—Quoted prices (unadjusted) in active markets for identical instruments or liabilities that an entity has the ability to assess at measurement date.
- Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices that are observable for an asset or liability, including interest rates and yield curves observable at commonly quoted intervals, prepayment speeds, loss severities, credit risks and default rates; and market-corroborated inputs.
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when estimating fair value.

As a result of the lack of observable market data resulting from inactive markets, the Company has classified its investment securities available-for-sale, securitized mortgage collateral and borrowings, net derivative liabilities and long-term debt as Level 3 fair value measurements at September 30, 2010 and December 31, 2009. Level 3 assets and liabilities were 100% of total assets and total liabilities measured at estimated fair value at September 30, 2010 and December 31, 2009.

Recurring Fair Value Measurements

We assess our financial instruments on a quarterly basis to determine the appropriate classification within the fair value hierarchy, as defined by ASC Topic 810. Transfers between fair value classifications occur when there are changes in pricing observability levels. Transfers of financial instruments among the levels occur at the beginning of the reporting period. There were no material transfers between our Level 1 and Level 2 classified instruments during the three and nine months ended September 30, 2010. The adoption of ASU 2009-17 resulted in the Company consolidating and deconsolidating certain trust assets and liabilities at fair value as of January 1, 2010. The details of the effect of the adoption of this standard are illustrated in Note 1.—Summary of Business, Significant Accounting Policies and Legal Proceedings.

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The following tables present the Company's assets and liabilities that are measured at estimated fair value on a recurring basis, including financial instruments for which the Company has elected the fair value option at September 30, 2010 and December 31, 2009, based on the fair value hierarchy:

| | Recurring Fair Value Measurements | | | | | |
|--|-----------------------------------|---------|--------------|-------------------|---------|--------------|
| | September 30, 2010 | | | December 31, 2009 | | |
| | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 |
| Assets | | | | | | |
| Investment securities available-for-sale | \$ — | \$ — | \$ 1,254 | \$ — | \$ — | \$ 813 |
| Securitized mortgage collateral | — | — | 6,070,577 | — | — | 5,666,122 |
| Total assets at fair value | \$ — | \$ — | \$ 6,071,831 | \$ — | \$ — | \$ 5,666,935 |
| Liabilities | | | | | | |
| Securitized mortgage borrowings | \$ — | \$ — | \$ 6,061,000 | \$ — | \$ — | \$ 5,659,865 |
| Derivative liabilities, net (1) | — | — | 88,989 | — | — | 126,457 |
| Long-term debt | — | — | 10,822 | — | — | 9,773 |
| Total liabilities at fair value | \$ — | \$ — | \$ 6,160,811 | \$ — | \$ — | \$ 5,796,095 |

- (1) At September 30, 2010, derivative liabilities, net included \$39 thousand in derivative assets and \$89.0 million in derivative liabilities, included within trust assets and trust liabilities, respectively. At December 31, 2009, derivative liabilities, net included \$146 thousand in derivative assets and \$126.6 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

The following tables present a reconciliation for all assets and liabilities measured at estimated fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2010 and 2009:

| | Level 3 Recurring Fair Value Measurements | | | | |
|--|---|---------------------------------|---------------------------------|-----------------------------|----------------|
| | For the three months ended September 30, 2010 | | | | |
| | Investment securities available-for-sale | Securitized mortgage collateral | Securitized mortgage borrowings | Derivative liabilities, net | Long-term debt |
| Fair value, June 30, 2010 | \$ 1,269 | \$ 6,215,213 | \$ (6,200,592) | \$ (100,723) | \$ (11,357) |
| Total gains (losses) included in earnings: | | | | | |
| Interest income (1) | 90 | 120,487 | — | — | — |
| Interest expense (1) | — | — | (203,594) | — | (633) |
| Change in fair value | (66) | (44,287) | 66,194 | (12,268) | 1,168 |
| Total gains (losses) included in earnings | 24 | 76,200 | (137,400) | (12,268) | 535 |
| Transfers in and/or out of Level 3 | — | — | — | — | — |
| Purchases, issuances and settlements | (39) | (220,836) | 276,992 | 24,002 | — |
| Fair value, September 30, 2010 | \$ 1,254 | \$ 6,070,577 | \$ (6,061,000) | \$ (88,989) | \$ (10,822) |
| Unrealized gains (losses) still held (2) | \$ 971 | \$ (4,949,059) | \$ 6,772,511 | \$ (89,889) | \$ 59,941 |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.7 million for the three months ended September 30, 2010, as reflected in the accompanying consolidated statement of operations.
- (2) Represents the amount of unrealized gains (losses) relating to assets and liabilities classified as Level 3 that are still held and reflected in the fair values at September 30, 2010.

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| | Level 3 Recurring Fair Value Measurements | | | | |
|--|---|---------------------------------|---------------------------------|-----------------------------|----------------|
| | For the three months ended September 30, 2009 | | | | |
| | Investment securities available-for-sale | Securitized mortgage collateral | Securitized mortgage borrowings | Derivative liabilities, net | Long-term debt |
| Fair value, June 30, 2009 | \$ 1,332 | \$ 6,018,391 | \$ (6,080,637) | \$ (184,672) | \$ (9,797) |
| Total gains (losses) included in earnings: | | | | | |
| Interest income (1) | — | 139,958 | — | — | — |
| Interest expense (1) | — | — | (312,226) | — | (318) |
| Change in fair value | 1,160 | (79,422) | 152,960 | (28,373) | 341 |
| Total gains (losses) included in earnings | 1,160 | 60,536 | (159,266) | (28,373) | 23 |
| Transfers in and/or out of Level 3 | — | — | — | — | — |
| Purchases, issuances and settlements | (1,443) | (311,548) | 495,178 | 48,432 | 375 |
| Fair value, September 30, 2009 | \$ 1,049 | \$ 5,767,379 | \$ (5,744,725) | \$ (164,613) | \$ (9,399) |
| Unrealized gains (losses) still held (2) | \$ 709 | \$ (6,748,258) | \$ 8,144,739 | \$ (166,793) | \$ 61,721 |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.9 million for the three months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.
- (2) Represents the amount of unrealized gains (losses) relating to assets and liabilities classified as Level 3 that are still held at September 30, 2009

| | Level 3 Recurring Fair Value Measurements | | | | |
|--|--|---------------------------------|---------------------------------|-----------------------------|----------------|
| | For the nine months ended September 30, 2010 | | | | |
| | Investment securities available-for-sale | Securitized mortgage collateral | Securitized mortgage borrowings | Derivative liabilities, net | Long-term debt |
| Fair value, December 31, 2009 | \$ 813 | \$ 5,666,122 | \$ (5,659,865) | \$ (126,457) | \$ (9,773) |
| Total gains (losses) included in earnings: | | | | | |
| Interest income (1) | 203 | 374,686 | — | — | — |
| Interest expense (1) | — | — | (680,598) | — | (2,001) |
| Change in fair value | 653 | 606,477 | (552,853) | (41,576) | 952 |
| Total gains (losses) included in earnings | 856 | 981,163 | (1,233,451) | (41,576) | (1,049) |
| Adoption of ASU 2009-17 (2) | (298) | 116,907 | (110,618) | (9,013) | — |
| Transfers in and/or out of Level 3 | — | — | — | — | — |
| Purchases, issuances and settlements | (117) | (693,615) | 942,934 | 88,057 | — |
| Fair value, September 30, 2010 | \$ 1,254 | \$ 6,070,577 | \$ (6,061,000) | \$ (88,989) | \$ (10,822) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$4.0 million for the nine months ended September 30, 2010, as reflected in the accompanying consolidated statement of operations.
- (2) Amounts represent the consolidation and deconsolidation of trust assets and liabilities as a result of the adoption of ASU 2009-17 on January 1, 2010.

| | Level 3 Recurring Fair Value Measurements | | | | |
|--|--|---------------------------------|---------------------------------|-----------------------------|----------------|
| | For the nine months ended September 30, 2009 | | | | |
| | Investment securities available-for-sale | Securitized mortgage collateral | Securitized mortgage borrowings | Derivative liabilities, net | Long-term debt |
| Fair value, December 31, 2008 | \$ 2,068 | \$ 5,894,424 | \$ (6,193,984) | \$ (273,547) | \$ (15,403) |
| Total gains (losses) included in earnings: | | | | | |
| Interest income (1) | — | 850,079 | — | — | — |
| Interest expense (1) | — | — | (1,403,248) | — | (644) |
| Change in fair value | 2,870 | (33,818) | 313,827 | (48,712) | 682 |
| Total gains (losses) included in earnings | 2,870 | 816,261 | (1,089,421) | (48,712) | 38 |
| Transfers in and/or out of Level 3 | — | — | — | — | — |
| Purchases, issuances and settlements | (3,889) | (943,306) | 1,538,680 | 157,646 | 5,966 |
| Fair value, September 30, 2009 | \$ 1,049 | \$ 5,767,379 | \$ (5,744,725) | \$ (164,613) | \$ (9,399) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$8.5 million for the nine months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.

The following tables present the changes in recurring fair value measurements included in net earnings (loss) for the three and nine months ended September 30, 2010 and 2009:

| | Recurring Fair Value Measurements | | | | |
|--|--|----------------------|-------------------------|-----------------|--------------------|
| | Changes in Fair Value Included in Net Earnings | | | | |
| | For the three months ended September 30, 2010 | | | | |
| | Interest Income (1) | Interest Expense (1) | Change in Fair Value of | | Total |
| | | | Net Trust Assets | Long-term Debt | |
| Investment securities available-for-sale | \$ 90 | \$ — | \$ (66) | \$ — | \$ 24 |
| Securitized mortgage collateral | 120,487 | — | (44,287) | — | 76,200 |
| Securitized mortgage borrowings | — | (203,594) | 66,194 | — | (137,400) |
| Derivative instruments, net | — | — | (12,268)(2) | — | (12,268) |
| Long-term debt | — | (633) | — | 1,168 | 535 |
| Total | \$ 120,577 | \$ (204,227) | \$ 9,573 | \$ 1,168 | \$ (72,909) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.7 million for the three months ended September 30, 2010, as reflected in the accompanying consolidated statement of operations.
- (2) Included in this amount is \$12.0 million in changes in the fair value of derivative instruments, offset by \$24.3 million in cash payments from the securitization trusts for the three months ended September 30, 2010.

| | Recurring Fair Value Measurements | | | | |
|--|---|----------------------|-------------------------|----------------|---------------------|
| | Changes in Fair Value Included in Net Loss | | | | |
| | For the three months ended September 30, 2009 | | | | |
| | Interest Income (1) | Interest Expense (1) | Change in Fair Value of | | Total |
| | | | Net Trust Assets | Long-term Debt | |
| Investment securities available-for-sale | \$ — | \$ — | \$ 1,160 | \$ — | \$ 1,160 |
| Securitized mortgage collateral | 139,958 | — | (79,422) | — | 60,536 |
| Securitized mortgage borrowings | — | (312,226) | 152,960 | — | (159,266) |
| Derivative instruments, net | — | — | (28,373)(2) | — | (28,373) |
| Long-term debt | — | (318) | — | 341 | 23 |
| Total | \$ 139,958 | \$ (312,544) | \$ 46,325 | \$ 341 | \$ (125,920) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.9 million for the three months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.
- (2) Included in this amount is \$20.4 million in changes in the fair value of derivative instruments, offset by \$48.8 million in cash payments from the securitization trusts for the three months ended September 30, 2009.

| | Recurring Fair Value Measurements | | | | |
|--|--|----------------------|-------------------------|----------------|-------------|
| | Changes in Fair Value Included in Net Earnings | | | | |
| | For the nine months ended September 30, 2010 | | | | |
| | Interest Income (1) | Interest Expense (1) | Change in Fair Value of | | Total |
| | | | Net Trust Assets | Long-term Debt | |
| Investment securities available-for-sale | \$ 203 | \$ — | \$ 653 | \$ — | \$ 856 |
| Securitized mortgage collateral | 374,686 | — | 606,477 | — | 981,163 |
| Securitized mortgage borrowings | — | (680,598) | (552,853) | — | (1,233,451) |
| Derivative instruments, net | — | — | (41,576)(2) | — | (41,576) |

| | | | | | |
|----------------|-------------------|---------------------|--------------------------------|---------------|---------------------|
| Long-term debt | — | (2,001) | — | 952 | (1,049) |
| Total | \$ 374,889 | \$ (682,599) | \$ 12,701⁽³⁾ | \$ 952 | \$ (294,057) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$4.0 million for the nine months ended September 30, 2010, as reflected in the accompanying consolidated statement of operations.
- (2) Included in this amount is \$47.4 million in changes in the fair value of derivative instruments, offset by \$89.0 million in cash payments from the securitization trusts for the nine months ended September 30, 2010.
- (3) For the nine months ended September 30, 2010, change in the fair value of trust assets, excluding REO was \$12.7 million. Excluded from the \$101.7 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$89.0 million in cash payments from the securitization trusts related to the Company's net derivative liabilities.

| | Recurring Fair Value Measurements | | | | |
|--|--|-----------------------|---------------------------------|----------------|---------------------|
| | Changes in Fair Value Included in Net Loss | | | | |
| | For the nine months ended September 30, 2009 | | | | |
| | Interest Income (1) | Interest Expense (1) | Change in Fair Value of | | Total |
| | | | Net Trust Assets | Long-term Debt | |
| Investment securities available-for-sale | \$ — | \$ — | \$ 2,870 | \$ — | \$ 2,870 |
| Securitized mortgage collateral | 850,079 | — | (33,818) | — | 816,261 |
| Securitized mortgage borrowings | — | (1,403,248) | 313,827 | — | (1,089,421) |
| Derivative instruments, net | — | — | (48,712) ⁽²⁾ | — | (48,712) |
| Long-term debt | — | (644) | — | 682 | 38 |
| Total | \$ 850,079 | \$ (1,403,892) | \$ 234,167⁽³⁾ | \$ 682 | \$ (318,964) |

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$8.5 million for the nine months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.
- (2) Included in this amount is \$110.1 million in changes in the fair value of derivative instruments, offset by \$158.8 million in cash payments from the securitization trusts for the nine months ended September 30, 2009.
- (3) For the nine months ended September 30, 2009, change in the fair value of net trust assets, excluding REO was \$234.2 million. Excluded from the \$393.0 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$158.8 million in cash payments from the securitization trusts related to the Company's net derivative liabilities.

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

Investment securities available-for-sale—The Company elected to carry all of its investment securities available-for-sale at fair value. The investment securities consist primarily of non-investment grade mortgage-backed securities. The fair value of the investment securities is measured based upon the Company's expectation of inputs that other market participants would use. Such assumptions include judgments about the underlying collateral, prepayment speeds, future credit losses, forward interest rates and certain other factors. Given the market disruption and lack of observable market data as of September 30, 2010 and December 31, 2009, the estimated fair value of the investment securities available-for-sale was measured using significant internal expectations of market participants' assumptions.

Securitized mortgage collateral—The Company elected to carry all of its securitized mortgage collateral at fair value. These assets consist primarily of non-conforming mortgage loans securitized between 2002 and 2007. Fair value measurements are based on the Company's internal models used to compute the net present value of future expected cash flows, with observable market participant assumptions, where available. The Company's assumptions include its expectations of inputs that other market participants would use in pricing these assets. These assumptions include judgments about the underlying collateral, prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors. As of September 30, 2010, securitized mortgage collateral had an unpaid principal balance of \$11.0 billion, compared to an estimated fair value of \$6.1 billion. The aggregate unpaid principal balance exceeds the fair value by \$4.9 billion at September 30, 2010. As of September 30, 2010, the unpaid principal balance of loans 90 days or more past due was \$2.0 billion compared to an estimated fair value of \$0.6 billion. The aggregate unpaid principal balances of loans 90 days or more past due exceed the fair value by \$1.4 billion at September 30, 2010.

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Securitized mortgage borrowings—The Company elected to carry all of its securitized mortgage borrowings at fair value. These borrowings consist of individual tranches of bonds issued by securitization trusts and are primarily backed by non-conforming mortgage loans. Fair value measurements include the Company's judgments about the underlying collateral and assumptions such as prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors. As of September 30, 2010, securitized mortgage borrowings had an outstanding principal balance of \$12.8 billion compared to an estimated fair value of \$6.1 billion. The aggregate outstanding principal balance exceeds the fair value by \$6.7 billion at September 30, 2010.

Long-term debt—The Company elected to carry all of its long-term debt (consisting of trust preferred securities and junior subordinated notes) at fair value. These securities are measured based upon an analysis prepared by management, which considered the Company's own credit risk, including settlements with trust preferred debt holders and discounted cash flow analysis. As of September 30, 2010, long-term debt had an unpaid principal balance of \$70.5 million compared to an estimated fair value of \$10.8 million. The aggregate unpaid principal balance exceeds the fair value by \$59.7 million at September 30, 2010.

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

standing, to the extent applicable; thus, the valuation of the derivative instrument includes the estimated value of the net credit differential between the counterparties to the derivative contract.

Nonrecurring Fair Value Measurements

The Company is required to measure certain assets and liabilities at estimated fair value from time to time. These fair value measurements typically result from the application of specific accounting pronouncements under GAAP. The fair value measurements are considered nonrecurring fair value measurements under FASB ASC 820-10.

The following tables present financial and non-financial assets and liabilities measured using nonrecurring fair value measurements at September 30, 2010 and 2009, respectively:

| | Nonrecurring Fair Value Measurements | | | Total Gains (Losses) | |
|----------------------|--------------------------------------|---------|---------|----------------------------|---------------------------|
| | September 30, 2010 | | | For the Three Months Ended | For the Nine Months Ended |
| | Level 1 | Level 2 | Level 3 | September 30, 2010 (5) | September 30, 2010 (5) |
| Loans held-for-sale | \$ — | \$ — | \$ — | \$ — | \$ (218) |
| REO (1) | — | 69,488 | — | (10,258) | (9,430) |
| Lease liability (2) | — | — | (2,353) | (44) | 357 |
| Deferred charge (3) | — | — | 13,144 | — | — |
| Intangible asset (4) | — | — | 1,000 | — | — |

- (1) Amounts are included in continuing operations. For the three months ended September 30, 2010, the \$10.3 million loss related to additional impairment write-downs during the period is within continuing operations. For the nine months ended September 30, 2010, the \$9.4 million loss during the period included \$9.8 million of additional impairment write-downs and \$355 thousand in recoveries within continuing and discontinued operations, respectively.
- (2) Amounts are included in discontinued operations. For the three and nine months ended September 30, 2010, the Company recorded \$44 thousand in losses and \$357 thousand in recoveries resulting from changes in lease liabilities as a result of changes in our expected minimum future lease payments, respectively.
- (3) Amounts are included in continuing operations. For the three and nine months ended September 30, 2010, the Company recorded zero in income tax expense resulting from impairment write-downs based on changes in estimated cash flows and lives of the related mortgages retained in the securitized mortgage collateral.
- (4) Amount is included in other assets in the accompanying consolidated balance sheets.
- (5) Total gains (losses) reflect gains and losses from all nonrecurring measurements during the period.

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| | Non-recurring Fair Value Measurements | | | Total Gains (Losses) | |
|-------------------------|---------------------------------------|---------|-----------|----------------------------|---------------------------|
| | September 30, 2009 | | | For the Three Months Ended | For the Nine Months Ended |
| | Level 1 | Level 2 | Level 3 | September 30, 2009 | September 30, 2009 |
| Loans held-for-sale (1) | \$ — | \$ — | \$ 79,505 | \$ — | \$ (7,517) |
| REO (2) | — | 116,694 | — | (25,285) | (120,523) |
| Lease liability (3) | — | — | (3,924) | (28) | 2,531 |
| Deferred charge (4) | — | — | 13,144 | — | (1,998) |

- (1) Includes \$332 thousand and \$79.2 million of loans held-for-sale within continuing and discontinued operations, respectively, at September 30, 2009.
- (2) Includes \$112.8 million and \$3.9 million in REO within continuing and discontinued operations, respectively, at September 30, 2009 which had additional impairment write-downs subsequent to the date of foreclosure. For the three months ended September 30, 2009, the \$25.3 million loss related to additional impairment write-downs during the period included \$24.5 million and \$0.8 million within continuing and discontinued operations, respectively. For the nine months ended September 30, 2009, the \$120.5 million loss related to additional impairment write-downs during the period included \$117.9 million and \$2.6 million within continuing and discontinued operations, respectively.
- (3) Amounts are included in discontinued operations. For the three and nine months ended September 30, 2009, the Company recorded \$28 thousand in losses and \$2.5 million in gains resulting from changes in lease liabilities as a result of changes in our expected minimum future lease payments, respectively.
- (4) Amounts are included in continuing operations. For the three and nine months ended September 30, 2009, the Company recorded zero and \$2.0 million, respectively, in income tax expense resulting from impairment writedowns based on changes in estimated cash flows and lives of the related mortgages retained in the securitized mortgage collateral.

Loans held-for-sale—Loans held-for-sale for which the fair value option was not elected are carried at the lower of cost or market (LOCOM). When available, such measurements are based upon what secondary markets offer for portfolios with similar characteristics, and are considered Level 2 measurements. If market pricing is not available, such measurements are significantly impacted by the Company's expectations of other market participants' assumptions, and are considered Level 3 measurements. The Company utilizes internal pricing processes to estimate the fair value of loans held-for-sale, which is based on recent loan sales and estimates of the fair value of the underlying collateral. Loans held-for-sale, which are primarily included in assets of discontinued operations, are considered Level 3 fair value measurements at September 30, 2010.

Real estate owned—REO consists of residential real estate acquired in satisfaction of loans. Upon foreclosure, REO is adjusted to the estimated fair value of the residential real estate less estimated selling and holding costs, offset by expected contractual mortgage insurance proceeds to be received, if any. Subsequently, REO is recorded at the lower of carrying value or estimated fair value less costs to sell. Fair values of REO are generally based on observable market inputs, and considered Level 2 measurements at September 30, 2010.

Lease liability—In connection with the discontinuation of our non-conforming mortgage, retail mortgage, warehouse lending and commercial operations, a significant amount of office space that was previously occupied is no longer being used by the Company. The Company has subleased a significant amount of this office space. The Company has recorded a liability, included within discontinued operations, representing the present value of the

minimum lease payments over the remaining life of the lease, offset by the expected proceeds from sublet revenue related to this office space. This liability is based on present value techniques that incorporate the Company's judgments about estimated sublet revenue and discount rates. Therefore, this liability is considered a Level 3 measurement at September 30, 2010.

Deferred charge—Deferred charge represents the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is amortized as a component of income tax expense over the estimated life of the mortgages retained in the securitized mortgage collateral. The Company evaluates the deferred charge for impairment quarterly using internal estimates of estimated cash flows and lives of the related mortgages retained in the securitized mortgage collateral. If the deferred charge is determined to be impaired, it is amortized as a component of income tax expense. Deferred charge is considered a Level 3 measurement at September 30, 2010.

Intangible asset—Intangible assets deemed to have an indefinite life are tested annually for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment losses are recognized if carrying amount of an intangible asset exceeds its estimated fair value. Intangible asset, which is included in other assets of continuing operations, is considered a Level 3 measurement at September 30, 2010.

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Note 3.—Stock Options

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

| | Nine Months Ended September 30, 2009 | |
|--|--|---------|
| Risk-free interest rate | | 2.86% |
| Expected lives (in years) | | 5.50 |
| Expected volatility (1) | | 259.16% |
| Expected dividend yield (2) | | 0.00% |
| Grant date fair value of share options | \$ | 0.53 |

- (1) Expected volatility is based on the historical volatility of the Company's stock over the expected life of the stock option.
(2) Expected dividend yield is zero because a dividend on the common stock was not probable over the expected life of the options granted during the nine months ended September 30, 2009.

There were no options granted during the nine months ended September 30, 2010.

The following table summarizes activity, pricing and other information for the Company's stock options for the nine months ended September 30, 2010:

| | Number of Shares | Weighted- Average Exercise Price (\$) |
|---|---------------------|--|
| Options outstanding at January 1, 2010 | 1,294,585 | \$ 13.47 |
| Options granted | — | — |
| Options exercised | 40,600 | 0.53 |
| Options forfeited / cancelled | 142,335 | 63.81 |
| Options outstanding at September 30, 2010 | 1,111,650 | \$ 7.50 |
| Options exercisable at September 30, 2010 | 1,111,650 | \$ 7.50 |

As of September 30, 2010, there was no unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Company's stock-based incentive compensation plan.

In October 2010, the Company issued approximately 196 thousand stock options at a strike price of \$2.80, which will vest over three years. The October 2010 option grant resulted in approximately \$548 thousand of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Company's stock-based incentive compensation plan. This cost is expected to be recognized over three years.

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Note 4.—Reconciliation of Earnings Per Share

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

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|----------|--|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Numerator for basic earnings (loss) per share: | | | | |
| Earnings from continuing operations | \$ 2,259 | \$ 4,803 | \$ 8,273 | \$ 14,109 |
| Cash dividends on cumulative redeemable preferred stock | — | — | — | (7,443) |
| (Loss) earnings from discontinued operations | (1,285) | (1,776) | 1,905 | (8,366) |

| | | | | |
|--|---------|----------|-----------|------------|
| Earnings (loss) per share available to common stockholders before redemption of preferred stock (1) | \$ 974 | \$ 3,027 | \$ 10,178 | \$ (1,700) |
| Denominator for basic earnings (loss) per share (2): | | | | |
| Weighted average number of common shares outstanding during the period | 7,760 | 7,618 | 7,727 | 7,618 |
| Denominator for diluted earnings per share (2): | | | | |
| Weighted average number of common shares outstanding during the period | 7,760 | 7,618 | 7,727 | 7,618 |
| Net effect of dilutive stock options | 584 | 384 | 601 | — |
| Diluted weighted average common shares | 8,344 | 8,002 | 8,328 | 7,618 |
| Earnings (loss) per common share - basic: | | | | |
| Earnings from continuing operations | \$ 0.29 | \$ 0.63 | \$ 1.07 | \$ 0.88 |
| (Loss) earnings from discontinued operations | (0.16) | (0.23) | 0.25 | (1.10) |
| Earnings (loss) per share available to common stockholders before redemption of preferred stock (1) | | | | |
| | \$ 0.13 | \$ 0.40 | \$ 1.32 | \$ (0.22) |
| Earnings (loss) per common share - diluted: | | | | |
| Earnings from continuing operations | \$ 0.27 | \$ 0.60 | \$ 0.99 | \$ 0.88 |
| (Loss) earnings from discontinued operations | (0.15) | (0.22) | 0.23 | (1.10) |
| Earnings (loss) per share available to common stockholders before redemption of preferred stock (1) | | | | |
| | \$ 0.12 | \$ 0.38 | \$ 1.22 | \$ (0.22) |

(1) As discussed below, the difference between the carrying value of the tendered preferred stock (\$106.1 million) and the amount paid for the shares (\$1.3 million) was recognized as a decrease in retained deficit in 2009. Including the redemption, total basic earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$14.16 and \$13.54, respectively. Including the redemption, total diluted earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$13.48 and \$13.54, respectively.

(2) Share amounts presented in thousands.

In June 2009, the Company completed the Offer to Purchase and Consent Solicitation (the "Offer to Purchase") of all of its 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock (which are sometimes collectively hereinafter referred to as the Preferred Stock). The aggregate purchase price for the Preferred Stock was \$1.3 million. In addition, in connection with completing the Offer to Purchase the Company paid \$7.4 million of accumulated but unpaid dividends on its Preferred Stock. With the total cash payment of \$8.7 million, the Company eliminated \$109.5 million of liquidation preference on its Preferred Stock. After the completion of the Offer to Purchase, the Company has outstanding \$52.3 million liquidation preference of Series B and Series C Preferred Stock. As this transaction is considered a redemption for accounting purposes, in accordance with FASB ASC 505-10 and 260-10-S99, the difference between the carrying value of the tendered preferred stock (\$106.1 million) and the amount paid for the shares (\$1.3 million) was recognized as a decrease in retained deficit in 2009. Including the redemption, total basic earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$14.16 and \$13.54, respectively. Including the redemption, total diluted earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$13.48 and \$13.54, respectively.

For the three and nine months ended September 30, 2010, stock options to purchase 338 thousand shares were outstanding but not included in the above weighted average share calculations because they were anti-dilutive.

For the three and nine months ended September 30, 2009, stock options to purchase 504 thousand and 1.3 million shares, respectively, were outstanding but not included in the above weighted average share calculations because they were anti-dilutive.

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Note 5.—Segment Reporting

The Company has three reporting segments, consisting of the long-term mortgage portfolio, mortgage and real estate services and discontinued operations. The following tables present the selected financial data and operating results by reporting segment for the periods indicated:

| | Long-term Portfolio | Mortgage and Real Estate Services | Discontinued Operations | Reclassifications (1) | Consolidated |
|--|------------------------|---|----------------------------|-----------------------|--------------|
| Balance sheet items as of September 30, 2010: | | | | | |
| Cash and cash equivalents | \$ 375 | \$ 10,226 | \$ 72 | \$ (72) | 10,601 |
| Restricted cash | — | 1,003 | 391 | (391) | 1,003 |
| Securitized mortgage collateral | 6,070,577 | — | — | — | 6,070,577 |
| Other assets | 117,847 | 19,917 | 209 | (209) | 137,764 |
| Total assets | 6,188,799 | 31,146 | 672 | — | 6,220,617 |
| Total liabilities | 6,172,530 | 7,729 | 14,125 | — | 6,194,384 |
| Total stockholders' equity (deficit) | 16,269 | 23,417 | (13,453) | — | 26,233 |
| Balance sheet items as of December 31, 2009: | | | | | |
| Cash and cash equivalents | \$ 7,940 | \$ 17,738 | \$ 172 | \$ (172) | 25,678 |
| Restricted cash | — | 1,253 | 501 | (501) | 1,253 |
| Short-term investment | 5,002 | — | — | — | 5,002 |
| Securitized mortgage collateral | 5,666,122 | — | — | — | 5,666,122 |
| Loans held-for-sale | — | — | 2,371 | (2,371) | — |

| | | | | | |
|--------------------------------------|-----------|--------|----------|---------|-----------|
| Other assets | 162,829 | 7,548 | 1,436 | (1,436) | 170,377 |
| Total assets | 5,841,893 | 26,539 | 4,480 | — | 5,872,912 |
| Total liabilities | 5,831,936 | 6,391 | 19,152 | — | 5,857,479 |
| Total stockholders' equity (deficit) | 9,957 | 20,148 | (14,672) | — | 15,433 |

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| | Long-term Portfolio | Mortgage and Real Estate Services | Discontinued Operations | Reclassifications (1) | Consolidated |
|---|---------------------|-----------------------------------|-------------------------|-----------------------|---------------|
| Statement of Operations Items for the three months ended September 30, 2010: | | | | | |
| Net interest income | \$ 1,666 | \$ 5 | \$ 4 | \$ (4) | \$ 1,671 |
| Non-interest income- net trust assets | (574) | — | — | — | (574) |
| Mortgage and real estate services fees | — | 15,521 | — | — | 15,521 |
| Other non-interest income (expense) | 1,189 | 18 | (1,673) | 1,673 | 1,207 |
| Non-interest expense and income taxes | (4,364) | (11,202) | 384 | (384) | (15,566) |
| (Loss) earnings from continuing operations | <u>\$ (2,083)</u> | <u>\$ 4,342</u> | | | 2,259 |
| Loss from discontinued operations, net of tax | | | <u>\$ (1,285)</u> | | (1,285) |
| Net earnings | | | | | <u>\$ 974</u> |

| | | | | | |
|--|-------------------|------------------|-----------------|---------|------------------|
| Statement of Operations Items for the nine months ended September 30, 2010: | | | | | |
| Net interest income | \$ 3,980 | \$ 16 | \$ 48 | \$ (48) | \$ 3,996 |
| Non-interest income- net trust assets | 6,411 | — | — | — | 6,411 |
| Mortgage and real estate services fees | — | 42,523 | — | — | 42,523 |
| Other non-interest income | 876 | 20 | 460 | (460) | 896 |
| Non-interest expense and income taxes | (13,582) | (31,971) | 1,397 | (1,397) | (45,553) |
| (Loss) earnings from continuing operations | <u>\$ (2,315)</u> | <u>\$ 10,588</u> | | | 8,273 |
| Earnings from discontinued operations, net of tax | | | <u>\$ 1,905</u> | | 1,905 |
| Net earnings | | | | | <u>\$ 10,178</u> |

| | Long-term Portfolio | Mortgage and Real Estate Services | Discontinued Operations | Reclassifications (1) | Consolidated |
|---|---------------------|-----------------------------------|-------------------------|-----------------------|-----------------|
| Statement of Operations Items for the three months ended September 30, 2009: | | | | | |
| Net interest income | \$ 1,894 | \$ 12 | \$ 834 | \$ (834) | \$ 1,906 |
| Non-interest income- net trust assets | 3,165 | — | — | — | 3,165 |
| Mortgage and real estate services fees | — | 13,514 | — | — | 13,514 |
| Other non-interest income (expense) | 361 | (127) | (2,148) | 2,148 | 234 |
| Non-interest expense and income taxes | (5,422) | (8,594) | (462) | 462 | (14,016) |
| (Loss) earnings from continuing operations | <u>\$ (2)</u> | <u>\$ 4,805</u> | | | 4,803 |
| Loss from discontinued operations, net of tax | | | <u>\$ (1,776)</u> | | (1,776) |
| Net earnings | | | | | <u>\$ 3,027</u> |

| | | | | | |
|--|-----------------|------------------|-------------------|---------|-----------------|
| Statement of Operations Items for the nine months ended September 30, 2009: | | | | | |
| Net interest income (expense) | \$ 8,496 | \$ 5 | \$ (244) | \$ 244 | \$ 8,501 |
| Non-interest income- net trust assets | 16,084 | — | — | — | 16,084 |
| Mortgage and real estate services fees | — | 32,296 | — | — | 32,296 |
| Other non-interest income (expense) | 661 | (312) | (10,928) | 10,928 | 349 |
| Non-interest expense and income taxes | (22,962) | (20,159) | 2,806 | (2,806) | (43,121) |
| Earnings from continuing operations | <u>\$ 2,279</u> | <u>\$ 11,830</u> | | | 14,109 |
| Loss from discontinued operations, net of tax | | | <u>\$ (8,366)</u> | | (8,366) |
| Net earnings | | | | | <u>\$ 5,743</u> |

(1) Amounts represent reclassifications of activity in the discontinued operations segment into loss from discontinued operations, net of tax as presented in the accompanying consolidated statements of operations.

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Note 6.—Real Estate Owned (REO)

The Company's REO consisted of the following:

| | September 30, 2010 | December 31, 2009 |
|-----|--------------------|-------------------|
| REO | \$ 137,517 | \$ 176,800 |

| | | |
|--------------------|-------------------|-------------------|
| Impairment (1) | (31,403) | (34,080) |
| Ending balance | <u>\$ 106,114</u> | <u>\$ 142,720</u> |
| REO inside trusts | \$ 106,042 | \$ 142,364 |
| REO outside trusts | 72 | 356 |
| Total | <u>\$ 106,114</u> | <u>\$ 142,720</u> |

(1) Impairment represents the cumulative write-downs of REO to estimated net realizable value subsequent to foreclosure.

Note 7.—Long-term Debt

Trust Preferred Securities

The following table shows the remaining balance of Trust Preferred Securities issued as of September 30, 2010 and December 31, 2009:

| | September 30, 2010 | December 31, 2009 |
|--------------------------------|-----------------------|----------------------|
| Trust preferred securities (1) | \$ 8,500 | \$ 8,500 |
| Common securities | 263 | 263 |
| Fair value adjustment | (6,582) | (6,501) |
| Total | <u>\$ 2,181</u> | <u>\$ 2,262</u> |

(1) Stated maturity of July 30, 2035. Redeemable at par at any time after July 30, 2010. Requires quarterly distributions initially at a fixed rate of 8.55% per annum through July 30, 2010 and thereafter at a variable rate of three-month LIBOR plus 3.75% per annum.

Junior Subordinated Notes

The following table shows the remaining balance of junior subordinated notes issued as of September 30, 2010 and December 31, 2009:

| | September 30, 2010 | December 31, 2009 |
|-------------------------------|-----------------------|----------------------|
| Junior subordinated notes (1) | \$ 62,000 | \$ 62,000 |
| Fair value adjustment | (53,359) | (54,489) |
| Total | <u>\$ 8,641</u> | <u>\$ 7,511</u> |

(1) Stated maturity of March 2034. Requires quarterly distributions initially at a fixed rate of 2.00% through 2013 with increases of 1.00% per annum through 2017. Starting in 2018, the interest rates become variable at three-month LIBOR plus 3.75% per annum.

Note 8.—Note Payable

In October 2009, the Company entered into a settlement agreement (the Settlement Agreement) with its remaining reverse repurchase facility lender to settle the restructured financing. The Settlement Agreement retired the facility and removed any further exposure associated with the line or the loans that secured the line. Pursuant to the terms of the Settlement Agreement, the Company settled the \$140.0 million balance of the reverse repurchase line by (i) transferring the loans securing the line to the lender at their approximate carrying values, (ii) making in a cash payment of \$20.0 million and (iii) entering into a credit agreement with the lender (the Credit Agreement) for a \$33.9 million note payable. The borrowing under the Credit Agreement, which is to be paid over 18 months, bears interest at a rate of one-month LIBOR plus 350 basis points and requires a monthly principal and interest payment of \$1.5 million. An additional \$10.0 million principal payment was due and paid in April 2010 as part of the Credit Agreement. At September 30, 2010, the balance of the note payable was \$8.1 million.

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The borrowing under the Credit Agreement may be prepaid by the Company at any time. Proceeds from any of the following are required to be applied to the balance under the credit agreement: (i) the sale of any assets, excluding mortgage assets, (ii) the issuance of debt, excluding warehouse borrowings and (iii) the issuance of equity by the Company.

In addition to the restrictions above, the Credit Agreement requires the Company to maintain certain business and financial covenants until the borrowing is paid in full. These covenants place several restrictions on the Company and its operations, including limiting its ability to pay dividends, issue equity interests, make investments over certain amounts without prior consent or enter into any transaction to merge or consolidate. The covenants also require the Company to maintain cash and cash equivalents of \$10.0 million (based on certain calculations) and stockholders' equity greater than zero (based on certain calculations). At September 30, 2010, the Company was in compliance with these covenants.

Note 9.—Warehouse Line

In June 2010, the Company, through IRES and its subsidiaries, entered into a Master Repurchase Agreement with a regional bank providing a \$10 million warehouse facility. The warehouse facility will be used to fund and will be secured by conforming single family residential mortgage loans that are held for sale. As of September 30, 2010, there was \$1.4 million outstanding on this facility. The agreement expires June 2011. The rate is one month LIBOR plus 4.00% with a floor of 5.00%. Under the terms of the warehouse facility, IRES and its subsidiaries are required to maintain various financial and other covenants, including maintaining a minimum tangible net worth of \$17.0 million and cash or cash equivalents of at least \$5.0 million. At September 30, 2010, the Company was in compliance with these financial covenants.

Note 10.—Subsequent Events

Subsequent events have been evaluated through the date of this filing.

In October 2010, the Company completed the acquisition of 51% of AmeriHome Mortgage Corporation (AmeriHome) for \$1.8 million, whereby the Company made a \$950 thousand capital contribution to AmeriHome, paid \$150 thousand to the founder of AmeriHome, and entered into a note payable requiring \$20 thousand monthly payments for three years. As part of the transaction, the Company has an option to purchase an additional 39% ownership interest beginning January 1, 2011 for 1.5 times of 39% of the book value of AmeriHome plus \$550,000 in cash. In addition, the founder has an option to sell his 49% ownership beginning January 1, 2014, to the Company for 49% of book value. The book value of AmeriHome was approximately \$2.8 million at the time of the Company's purchase of 51% ownership interest.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Unless the context otherwise requires, the terms "Company," "we," "us," and "our" refer to Impac Mortgage Holdings, Inc. (the Company or IMH), a Maryland corporation incorporated in August 1995, and its subsidiaries, Integrated Real Estate Service Corporation (IRES), IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG) and Impac Funding Corporation (IFC).

Forward-Looking Statements

This report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements, some of which are based on various assumptions and events that are beyond our control, may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "likely," "should," "could," "seem to," "anticipate," or similar terms or variations on those terms or the negative of those terms. The forward-looking statements are based on current management expectations. Actual results may differ materially as a result of several factors, including, but not limited to the following: the ongoing volatility in the mortgage industry; our ability to successfully manage through the current market environment; our ability to meet liquidity needs from current cash flows or generate new sources of revenue; management's ability to successfully manage and grow the Company's mortgage and real estate fee-based business activities; the ability to make interest payments; increases in default rates or loss severities and mortgage related losses; the ability to satisfy conditions (payment and covenants) in the note payable with a major creditor; our ability to obtain additional financing and the terms of any financing that we do obtain; inability to effectively liquidate properties to mitigate losses; increase in loan repurchase requests and ability to adequately settle repurchase obligations; decreases in value of our residual interests that differ from our assumptions; the ability of our common stock to continue trading in an active market; the outcome of litigation or regulatory actions pending against us or other legal contingencies; our compliance with applicable local, state and federal laws and regulations and other general market and economic conditions.

For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the period ended December 31, 2009, the other reports we file under the Securities and Exchange Act of 1934. This document speaks only as of its date and we do not undertake, and specifically disclaim any obligation, to release publicly the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

The Mortgage Industry and Discussion of Relevant Fiscal Periods

The mortgage industry is continually vulnerable to current events that occur in the financial services industry. These events include changes in economic indicators, government regulation, interest rates, price competition, geographic shifts, disposable income, housing prices, market liquidity, market anticipation, and customer perception, as well as others. The factors that affect the industry change rapidly and can be unforeseeable.

Current events can diminish the relevance of "quarter over quarter" and "year-to-date over year-to-date" comparisons of financial information. In such instances, the Company attempts to present financial information in its Management's Discussion and Analysis of Financial Condition and Results of Operations that is the most relevant to its financial information.

Status of Operations, Liquidity and Capital Resources

Mortgage and real estate services

In 2009, the Company sought to create an integrated services platform to provide solutions to the mortgage and real estate markets. Pursuant to that, the Company initiated various mortgage and real estate fee-based business activities, including loan modifications, real estate disposition, monitoring and surveillance services, real estate brokerage and lending services and title and escrow services. The Company has been able to develop and enhance its service offerings in providing services to investors, servicers and individual borrowers primarily by focusing on loss mitigation and performance of our own long-term mortgage portfolio. These business activities have been developed as part of a centralized platform to operate synergistically to maximize their success. The Company has established the following business activities:

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- *Loss Mitigation*—The Company has established loss mitigation operations to provide loss mitigation services including loan modification and short sale services to its long-term mortgage portfolio, investors and institutions with distressed and delinquent residential and multifamily mortgage portfolios. In addition, we provide modification solutions to individual borrowers by interacting with loan servicers on behalf of the borrowers to assist them in lowering the monthly mortgage payments to an affordable level allowing them to remain in their

homes. The Company receives fees paid by the borrower for loan modification services performed for the borrower. During the first quarter of 2010, the Company established operations to market debt resolution services to consumers and assist them in entering a program that helps them repay their unsecured debt at a discount. However in October 2010, given recent regulation, the Company has decided not to pursue further offering debt resolution services.

- *Real Estate Owned (REO) Services*—The Company has established REO services operations to provide REO surveillance services to servicers and portfolio managers to assist them in maximizing loss mitigation performance in managing distressed mortgage portfolios and foreclosed real estate assets, along with disposition of such assets. In addition, we perform default surveillance and monitoring services for residential and multifamily mortgage portfolios for investors and servicers to assist them with overall portfolio performance.
- *Real Estate Brokerage*—The Company has established real estate brokerage operations which primarily serves the southern California area. The primary business of the real estate brokerage business is the listing and selling of REO and pre-foreclosure properties associated with short sales.
- *Mortgage Lending Operations*—The Company has established mortgage lending operations as it seeks to re-enter mortgage banking. The mortgage lending activities include earning fees for brokering loans to third-party lenders since 2008 and originating loans through our mortgage banking platform under the “Impac” brand name. We originated only a minimal amount of loans in 2009, and we have increased our loan originations, including brokering loans, to \$22.1 million for the first nine months of 2010. We expect to increase loan production further in the future through retail channels, wholesale channels and captive financing from the Company’s portfolio of transactions, focusing on originating only loans that are eligible for sale to HUD and other government-sponsored enterprises. In October 2010, the Company completed the acquisition of 51% of AmeriHome Mortgage Corporation (AmeriHome) which is an approved seller/servicer for Fannie Mae, Freddie Mac and HUD, in addition to being an approved Ginnie Mae issuer.
- *Title and Escrow*—During the fourth quarter of 2009, the Company received California Department of Insurance approval for our acquisition of a title insurance agency and escrow operations. Upon the approval, the Company acquired the operations effective December 31, 2009. The title insurance company services California and selected national markets to provide title insurance, escrow and settlement services to residential mortgage lenders, real estate agents, asset managers and REO companies in the residential market sector of the real estate industry. We deliver services through a proprietary integrated technology platform.

For the three and nine months ended September 30, 2010, mortgage and real estate services fees were \$15.5 million and \$42.5 million, respectively, as follows:

| | For the Three Months Ended September 30, 2010 | For the Nine Months Ended September 30, 2010 |
|---|--|---|
| Monitoring, surveillance and recovery fees | 7,342 | 20,150 |
| Title and escrow | 4,502 | 10,462 |
| Servicing income | 1,846 | 7,669 |
| Loan modification fees | 1,831 | 4,242 |
| Total mortgage and real estate services fees | \$ 15,521 | \$ 42,523 |

Although the Company intends to generate more fees by providing these services to third parties in the marketplace, the revenues from these businesses have primarily been generated from the Company’s long-term mortgage portfolio. Despite our efforts to expand these services, we have encountered challenges in selling these services to third-parties. Furthermore, since these businesses are recently established there remains uncertainty about their future success. During the first quarter of 2010, the Company began to expand the portfolio surveillance and recovery services operations and entered into an agreement with a third party to assist in credit risk management and portfolio surveillance services. However, we anticipate third party revenues may decline and there is no certainty that they will continue.

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In June 2010, the Company signed a definitive agreement with a regional bank providing the Company with a \$10 million warehouse facility. This facility provides the company with a funding source to originate residential conforming mortgage loans that are eligible for sale to HUD and other government-sponsored enterprises. As of September 30, 2010, there was \$1.4 million outstanding on this facility. The interest rate on the facility is one month LIBOR plus 4.00%, with a floor of 5.00%. The agreement expires June 2011.

Liquidity and capital resources

During the first nine months of 2010, the Company continued to fund its operations primarily from income generated from its long-term mortgage portfolio, which included mortgage and real estate services fees and cash flows from our residual interests in securitizations.

The ability to meet our long-term liquidity requirements is subject to several factors, such as generating fees from our mortgage and real estate fee-based business activities and realizing cash flows from our long-term mortgage portfolio. Our future financial performance and success are dependent in large part upon our ability to grow our mortgage and real estate fee-based business activities, including providing services to third parties and expanding our mortgage lending operations. We believe that current cash balances, cash flows from mortgage and real estate services fees generated from our long-term mortgage portfolio, and residual interest cash flows from our long-term mortgage portfolio are adequate for our current operating needs. However, the mortgage and real estate services market is volatile, highly competitive and subject to increased regulation. The Company’s ability to successfully compete in the mortgage and real estate services industry may be challenging as its business activities are recently established and many competitors have recently entered or have established businesses delivering similar services. Additionally, the mortgage lending environment is extremely competitive and highly regulated. The future success of our mortgage lending operations will depend on a number of factors, including how well we compete, housing market conditions, economic recovery and financial regulatory reform. If we are unsuccessful, we may be unable to satisfy our future operating costs and liabilities, including repayment of the note payable and long-term debt.

To understand the financial position of the Company better, we believe it is important to understand the composition of the Company’s stockholders’ equity (deficit) and to which component of the business it relates. At September 30, 2010, the equity (deficit) within our continuing and discontinued

operations was comprised of the following significant assets and liabilities:

| | Condensed Components of Stockholders' Equity (Deficit) | | |
|---------------------------------------|---|------------------------------------|------------------|
| | As of September 30, 2010 | | |
| | Continuing Operations | Discontinued Operations | Total |
| Cash | \$ 10,601 | \$ 72 | \$ 10,673 |
| Residual interests in securitizations | 27,884 | — | 27,884 |
| Note payable | (8,125) | — | (8,125) |
| Long-term debt (\$71,120 par) | (10,822) | — | (10,822) |
| Repurchase reserve | (25) | (8,707) | (8,732) |
| Lease liability (1) | — | (2,353) | (2,353) |
| Deferred charge | 13,144 | — | 13,144 |
| Net other assets (liabilities) | 7,029 | (2,465) | 4,564 |
| Stockholders' equity (deficit) | \$ 39,686 | \$ (13,453) | \$ 26,233 |

(1) Guaranteed by IMH.

Continuing operations

At September 30, 2010, cash within our continuing operations decreased to \$10.6 million from \$25.7 million at December 31, 2009. The primary sources of cash between periods were \$42.5 million in fees generated from the mortgage and real estate fee-based businesses and \$9.9 million from residual interests in securitizations. Offsetting the sources of cash were operating expenses totaling \$45.4 million and \$23.5 million in payments on the note payable.

Since our consolidated and unconsolidated securitization trusts are nonrecourse, we have netted trust assets and liabilities to present the Company's interest in these trusts more simply, which are considered our residual interests in securitizations. For unconsolidated securitizations our residual interests represent the fair value of investment securities available-for-sale. For consolidated securitizations, our residual interests are represented by the fair value of securitized mortgage collateral and real estate owned, offset by the fair value of securitized mortgage borrowings and net derivative liabilities. We receive cash flows from our residual interests in securitizations to the extent they are available after required distributions to bondholders and maintaining overcollateralization levels within the trusts. The estimated fair value of the residual interests, represented by the difference in the fair value of trust assets and trust liabilities, was \$27.9 million at September 30, 2010, compared to \$23.0 million at December 31, 2009.

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At September 30, 2010, our note payable decreased \$22.9 million from December 31, 2009, as a result of monthly payments totaling \$13.5 million comprising of principal and interest. Additionally, during April 2010, the Company made a \$10.0 million principal payment that was due per the terms of the note payable. As of September 30, 2010, the balance of the note was \$8.1 million and will mature in March of 2011.

At September 30, 2010, we had deferred charges of \$13.1 million, which is amortized as a component of income tax expense in the consolidated statements of operations over the estimated life of the mortgages retained in the securitized mortgage collateral. The deferred charges represent the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. This balance is recorded as required by GAAP and does not have any realizable cash value.

Net other assets include \$3.5 million in accounts receivable, \$3.1 million in premises and equipment, \$2.3 million in prepaid expenses and \$1.0 million in restricted cash.

Discontinued operations

The Company's most significant liabilities in discontinued liabilities at September 30, 2010 relate to its repurchase reserve and a lease liability associated with the former non-conforming mortgage operations.

In previous years when our discontinued operations sold loans to investors, we were required to make normal and customary representations and warranties about the loans we had previously sold to investors. Our whole loan sale agreements generally required us to repurchase loans if we breached a representation or warranty given to the loan purchaser. In addition, we also could be required to repurchase loans as a result of borrower fraud or if a payment default occurs on a mortgage loan shortly after its sale. The repurchase reserve is an estimate of losses from expected repurchases, and is based, in part, on the recent settlement of claims. During the third quarter, consistent with other mortgage lenders, we received repurchase requests from Fannie Mae for loans funded primarily in 2007 resulting in an increase in our repurchase reserve to \$8.7 million at September 30, 2010 as compared to \$7.6 million at June 30, 2010.

In connection with the discontinuation of our non-conforming mortgage, retail mortgage, warehouse lending and commercial operations, a significant amount of office space that was previously occupied is no longer being used by the Company. The Company has subleased a significant amount of this office space. At September 30, 2010, the Company had a liability of \$2.4 million included within discontinued operations, representing the present value of the minimum lease payments over the remaining life of the lease, offset by the expected proceeds from sublet revenue related to this office space.

Market Conditions

The housing market showed signs of improvement earlier in the year as housing prices were stabilizing in many markets and began to recover in others due to the low interest rate environment and the first-time homebuyer tax credit. Since the expiration of the homebuyer tax credit in May 2010, home sales have declined in the third quarter of 2010 and inventory levels have increased. The housing market is not expected to improve until job and income growth increase.

Mortgage and credit market conditions remained weak in the third quarter of 2010 due primarily to a continued weak labor market. Existing uncertainties surrounding the housing market, economy and regulatory environment will continue to present challenges for the Company. The ongoing

economic stress or further deterioration of general economic conditions could prolong or increase borrower defaults leading to deteriorating performance of the Company's portfolio.

In October 2010, certain large mortgage servicers announced investigations into their internal servicing operations. As reported, these investigations centered around foreclosure processing and, shortly thereafter, these servicers also announced the temporary national suspension of foreclosure activity. Some state attorney generals and various state and federal regulators and policymakers have since initiated inquiries concerning foreclosure procedures for single family mortgage loans. Certain courts have issued new rules relating to foreclosures and we anticipate that scrutiny of foreclosure documentation will increase. Also, in some areas, officials are requiring additional verification of information filed prior to the foreclosure proceeding. If these trends continue, there could be an extended delay in the processing of foreclosures, which could have an adverse effect upon the timing of foreclosure sales which may lead to higher loss severities and REO expenses.

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Despite positive job creation in the first half of 2010, the economy began to lose jobs again in the third quarter as job creation in the private sector, while positive, slowed and was more than offset by reductions in temporary government related jobs which has again raised fears as to how pronounced any economic recovery may be. U.S. unemployment rates, which have been a major factor in the deterioration of credit quality in the U.S., remained high at 9.6 percent in September 2010, an increase of 10 basis points during the quarter and a decrease of 40 basis points since December 2009. The increase in unemployment rates have generally been most pronounced in the markets which had previously experienced the highest appreciation in home values. Unemployment rates in 6 states are at or above 11%, including California and Florida. California and Florida represent 52% and 12% of the aggregate unpaid principal of the long-term portfolio, respectively, at September 30, 2010.

In addition to the weak labor market, we continue to be affected by the following trends:

- Overall levels of delinquencies remain elevated;
- Loss severity rates remain relatively high, as market conditions, such as home prices and the rate of home sales remain weak;
- Growth in the number of loans in the foreclosure process as well as prolonged foreclosure timelines related to deficiencies in foreclosure practices of servicers as discussed above;
- Mortgage loan originations from 2005 to 2008 continue to perform worse than originations from prior periods;
- Real estate markets in a large portion of the United States continue to be affected by stagnation or declines in property values experienced over the last three years;
- Home prices remain under pressure due to elevated foreclosure levels even though they have begun to stabilize in most markets, including some parts of California; and
- Tighter lending standards by mortgage lenders which affects the ability of borrowers to refinance existing mortgage loans.

A number of factors make it difficult to predict when a sustained recovery in the housing and credit markets will occur. Concerns about the future of the U.S. economy, including the pace and magnitude of recovery from the recent economic recession, consumer confidence, volatility in energy prices, volatility experienced by the credit markets including the possibility that the recent European sovereign debt crisis will spread and trends in corporate earnings will continue to influence the U.S. economic recovery and the capital markets. In particular, improvement in unemployment rates and a sustained recovery of the housing market remain critical components of a broader U.S. economic recovery. Further weakening in these components as well as in consumer confidence may result in additional deterioration in consumer payment patterns and credit quality. Although consumer confidence has improved from the levels seen early in 2009, it remains low on a historical basis. Weak consumer fundamentals, including declines in wage income, reduced consumer spending, declines in wealth and a difficult job market continue to depress consumer confidence. Additionally, there is uncertainty related to the recently announced monetary policy under the Federal government's quantitative easing program and uncertainty as to the impact on the economy and consumer confidence whether the remaining actions taken by the government will restore faith in the capital markets and stimulate consumer spending. These conditions in combination with general economic weakness and the impact of recent and proposed regulatory changes will continue to affect our results of operations, the degree of which is largely dependent upon the nature and timing of the economic recovery.

Ambac Financial Group, Inc. (Ambac) provides bond guaranty insurance for thirteen of the Company's consolidated securitizations. In November 2010, Ambac filed for bankruptcy protection. As the related securitization trusts are nonrecourse to the Company, it is not required to replace or otherwise settle bond guaranty insurance within the consolidated trusts. Furthermore, in determining the fair value of securitized mortgage borrowings, the Company excludes consideration of bond guaranty insurance payments in accordance with FASB ASC 820-10-35-18A. In addition to Ambac, other insurance companies have issued bond guaranty insurance policies for certain securities within the Company's securitized mortgage borrowings. Other bond insurers are experiencing similar financial difficulties. Bankruptcy filings by Ambac and other bond insurance companies could materially affect industry-wide market prices for collateralized mortgage bonds.

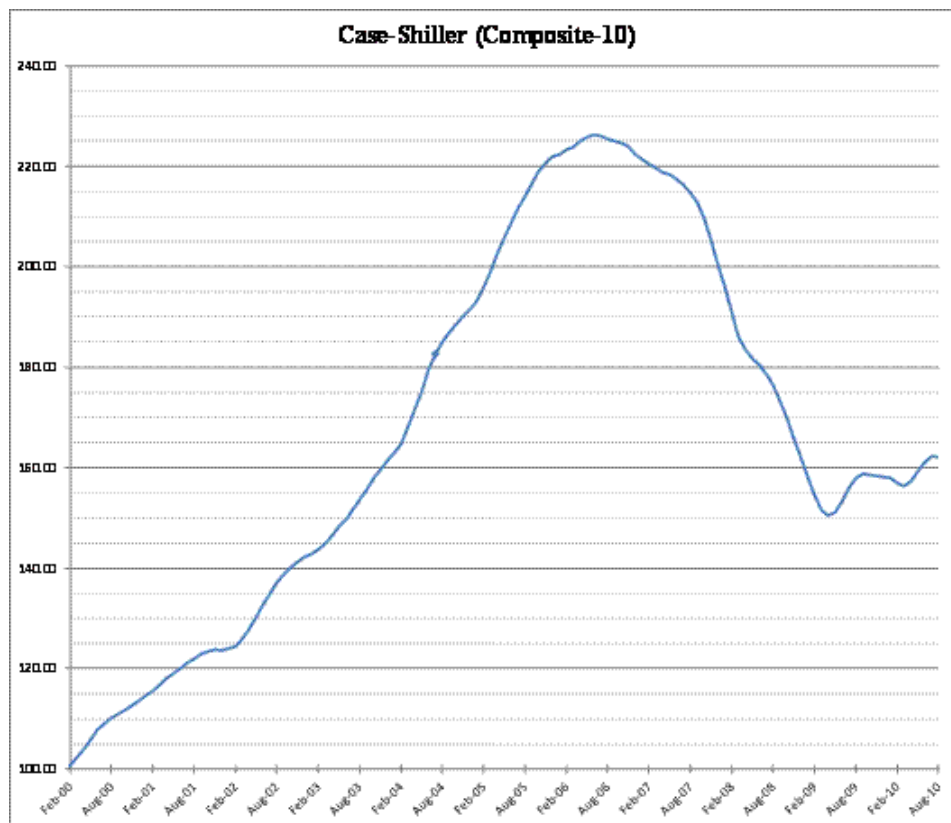
Financial Regulatory Reform On July 21, 2010, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" was signed into law. This legislation is a sweeping overhaul of the financial regulatory system.

The legislation provides for new regulation on financial institutions, creates new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau, and contains many consumer related provisions including provisions addressing mortgage reform. In the area of mortgage origination, it appears there is an effective elimination of stated income loans and a requirement to apply a net tangible benefit test for all refinancing transactions. There are also numerous revised servicing requirements for mortgage loans.

The legislation will have a significant impact on the operations of many financial institutions in the U.S. As the legislation calls for extensive regulations to be promulgated to interpret and implement the legislation, it is not possible to precisely determine the impact to operations and financial results at this time. The Company will continue to assess the effect of the legislation on the Company's business as the associated regulations are adopted.

Effects of Recent Market Activity

As a result of the Company's inability to sell or securitize non-conforming loans during the second half of 2007, the Company discontinued funding loans and discontinued substantially all of its mortgage (non-conforming single-family loans and commercial loans, which consist primarily of multifamily loans) and warehouse lending operations. Market conditions deteriorated in 2008 and continued to be depressed for most of 2009 before recovering slightly towards the end of 2009 and early 2010. As a result, the Company's investment in securitized non-conforming loans (residual interests) has been affected by the increase in estimated defaults and severities, evidenced by significant home price depreciation. The decline in single-family home prices can be seen in the chart below.



As depicted in the chart above, average home prices peaked in June 2006 at 226.29 and continued their dramatic decline through much of the first half of 2009, while increasing slightly over the remaining half of the year. The Standard & Poor's Case-Shiller 10-City Composite Home Price Index (the Index) for August 2010 was 162.13 (with the base of 100.00 for January 2000) and hasn't been this low since December 2003 when the Index was 161.27. Beginning in the third quarter of 2007, the Company began to believe that there was a correlation between the borrowers' perceived equity in their homes and defaults. The original loan-to-value (defined as loan amount as a percentage of collateral value, "LTV") and original combined loan-to-value (defined as first lien plus total subordinate liens to collateral value, "CLTV") ratios of single-family mortgages remaining in the Company's securitized mortgage collateral as of September 30, 2010 was 72% and 80%, respectively. The current LTV and CLTV ratios likely increased from origination date as a result of the deterioration in the real estate market. We believe that home prices that have declined below the borrower's original purchase price have a higher risk of default within our portfolio. Based on the Index, home prices have declined 28% through August 2010 from the 2006 peak. Further, we believe the home prices in general within California and Florida, the states with the highest concentration of our mortgages, have declined even further than the Index. We have considered the deterioration in home prices and its impact on our loss severities, which are a primary assumption used in the valuation of securitized mortgage collateral and borrowings.

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Critical Accounting Policies

We define critical accounting policies as those that are important to the portrayal of our financial condition and results of operations. Our critical accounting policies require management to make difficult and complex judgments that rely on estimates about the effect of matters that are inherently uncertain due to the effect of changing market conditions and/or consumer behavior. In determining which accounting policies meet this definition, we considered our policies with respect to the valuation of our assets and liabilities and estimates and assumptions used in determining those valuations. We believe the most critical accounting issues that require the most complex and difficult judgments and that are particularly susceptible to significant change to our financial condition and results of operations include the following:

Please refer to IMH's report on Form 10-K on pages 33 through 39 of Management's Discussion and Analysis of Results of Operations for the year ended December 31, 2009 for a detailed discussion of our significant accounting policies. Such policies have not changed during 2010 except those outlined below.

Variable Interest Entities and Transfers of Financial Assets and Liabilities

Historically, the Company securitized mortgages in the form of collateralized mortgage obligations (CMO), which were consolidated and accounted for as secured borrowings for financial statement purposes. The Company also securitized mortgages in the form of real estate mortgage investment conduits (REMICs), which were either consolidated or unconsolidated depending on the design of the securitization structure. CMO and certain REMIC securitizations were designed so that the transferee (securitization trust) was not a qualifying special purpose entity (QSPE), and therefore the Company consolidated the variable interest entity (VIE) as it was the primary beneficiary of the sole residual interest in each securitization trust. Generally, this was achieved by including terms in the securitization agreements that gave the Company the ability to unilaterally cause the securitization trust to return specific mortgages, other than through a clean-up call. Amounts consolidated are included in trust assets and liabilities as securitized mortgage collateral, real estate owned, derivative assets, securitized mortgage borrowings and derivative liabilities in the accompanying consolidated balance sheets.

Our estimate of the fair value of our net retained residual interests in unconsolidated securitizations, which are included in investment securities available-for-sale in the consolidated balance sheets, requires us to exercise significant judgment as to the timing and amount of future cash flows from the residual interests. We are exposed to credit risk from the underlying mortgage loans in unconsolidated securitizations to the extent we retain subordinated interests. Changes in expected cash flows resulting from changes in expected net credit losses will impact the value of our subordinated retained interests and those changes are recorded as a component of change in fair value of net trust assets.

In contrast, for securitizations that are structured as secured borrowings, we recognize interest income over the life of the securitized mortgage collateral and interest expense incurred for the securitized mortgage borrowings. We refer to these transactions as consolidated securitizations. The mortgage loans collateralizing the debt securities for these financings are included in securitized mortgage collateral and the debt securities payable to investors in these securitizations are included in securitized mortgage borrowings in our consolidated balance sheet.

Whether a securitization is consolidated or unconsolidated, investors in the securities issued by the securitization trust have no recourse to our non-securitized assets or to us and have no ability to require us to provide additional assets, but rather have recourse only to the assets transferred to the trust. Whereas the accounting differences are significant, the underlying economic impact to us, over time, will be the same regardless of whether the securitization trust is consolidated or unconsolidated.

Effective January 1, 2010, former QSPEs are evaluated for consolidation based on the provisions of FASB ASC 810-10-25, which eliminates the concept of a QSPE and changes the approach to determining a securitization trust's primary beneficiary. Refer to Note 1.— *Summary of Business, Financial Statement Presentation, Market Conditions and Liquidity* in the notes to the consolidated financial statements for a discussion of the impact of this new standard on the Company's consolidated balance sheet at January 1, 2010.

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Income Taxes

While the Company has generated significant net operating loss carryforwards in recent periods, we do not expect to generate sufficient taxable income in future periods to be able to realize these tax benefits. Therefore, we have recorded a full valuation allowance against the net deferred tax assets as we believe that as of September 30, 2010 it is more likely than not that the net deferred tax assets will not be recoverable.

Selected Financial Results for the Three Months Ended September 30, 2010

Continuing Operations

- Earnings from continuing operations of \$2.3 million for the third quarter of 2010, compared to \$4.8 million for the comparable 2009 period.
- Net interest income of \$1.7 million for the third quarter of 2010, primarily from our long-term mortgage portfolio, compared to \$1.9 million for the comparable 2009 period.
- Non-interest (loss) income - net trust assets of \$(574) thousand for the third quarter of 2010, compared to \$3.2 million for the comparable 2009 period.
- Mortgage and real estate services fees of \$15.5 million for the third quarter of 2010, compared to \$13.5 million for the comparable 2009 period.
- Personnel expense of \$10.7 million for the third quarter of 2010, compared to \$9.4 million for the comparable 2009 period.

Discontinued Operations

- Loss from discontinued operations of \$1.3 million for the third quarter of 2010, compared to a loss of \$1.8 million for the comparable 2009 period.
- Repurchase reserve was \$8.7 million at September 30, 2010, compared to \$11.0 million at December 31, 2009.

Selected Financial Results for the Nine Months Ended September 30, 2010

- Earnings from continuing operations of \$8.3 million for the nine months ended September 30, 2010, compared to \$14.1 million for the comparable 2009 period.
- Net interest income of \$4.0 million for the nine months ended September 30, 2010, primarily from our long-term mortgage portfolio, compared to \$8.5 million for the comparable 2009 period.
- Non-interest income—net trust assets of \$6.4 million for the nine months ended September 30, 2010, compared to \$16.1 million for the comparable 2009 period.

- Mortgage and real estate services fees of \$42.5 million for the nine months ended September 30, 2010, compared to \$32.3 million for the comparable 2009 period.
- Personnel expense of \$31.1 million for the nine months ended September 30, 2010, compared to \$26.1 million for the comparable 2009 period.

Discontinued Operations

- Earnings from discontinued operations of \$1.9 million for the nine months ended September 30, 2010, compared to a loss of \$8.4 million for the comparable 2009 period.

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Financial Condition and Results of Operations

Financial Condition

Condensed Balance Sheet Data

| | September 30, 2010 | December 31, 2009 | Increase (Decrease) | % Change |
|---|-----------------------|----------------------|------------------------|-------------|
| Investment securities available-for-sale | \$ 1,254 | \$ 813 | \$ 441 | 54% |
| Securitized mortgage collateral | 6,070,577 | 5,666,122 | 404,455 | 7 |
| Derivative assets | 39 | 146 | (107) | (73) |
| Real estate owned | 106,042 | 142,364 | (36,322) | (26) |
| Total trust assets | 6,177,912 | 5,809,445 | 368,467 | 6 |
| Assets of discontinued operations | 672 | 4,480 | (3,808) | (85) |
| Other assets | 42,033 | 58,987 | (16,954) | (29) |
| Total assets | \$ 6,220,617 | \$ 5,872,912 | \$ 347,705 | 6% |
| Securitized mortgage borrowings | \$ 6,061,000 | \$ 5,659,865 | \$ 401,135 | 7% |
| Derivative liabilities | 89,028 | 126,603 | (37,575) | (30) |
| Total trust liabilities | 6,150,028 | 5,786,468 | 363,560 | 6 |
| Liabilities of discontinued operations | 14,125 | 19,152 | (5,027) | (26) |
| Other liabilities | 30,231 | 51,859 | (21,628) | (42) |
| Total liabilities | 6,194,384 | 5,857,479 | 336,905 | 6 |
| Total stockholders' equity | 26,233 | 15,433 | 10,800 | 70 |
| Total liabilities and stockholders' equity | \$ 6,220,617 | \$ 5,872,912 | \$ 347,705 | 6% |

Total assets and total liabilities were \$6.2 billion at September 30, 2010 as compared to \$5.9 billion at December 31, 2009. The increase in total assets and liabilities are primarily attributable to increases in the Company's trust assets and trust liabilities as summarized below.

The Company updates its collateral assumptions quarterly based on recent delinquency, default, prepayment and loss experience. Additionally, the Company updates the forward interest rates and investor yield (discount rate) assumptions based on information derived from market participants. At March 31, 2010, the Company decreased the investor yield requirements for senior bonds of the securitized mortgage borrowings as yields tightened significantly compared to prior periods. The Company continues to see a corresponding increase in the prices for senior bonds from our pricing services. The decrease in investor yield assumptions on securitized mortgage collateral and securitized mortgage borrowings resulted in an increase in the value of these trust assets and liabilities. However, this change in assumption did not have any effect on the consolidated statement of operations or equity of the Company as the increase in the value of collateral directly offset the increase in the value of the borrowings. The Company did not make any changes to the discount rate assumptions for residual interests during the first nine months of 2010.

- Securitized mortgage collateral increased \$404.5 million during the nine months ended September 30, 2010. The increase in securitized mortgage collateral from \$5.7 billion at December 31, 2009 to \$6.1 billion at September 30, 2010 was primarily due to decreased loss assumptions for single-family collateral, reduction in investor yield requirements as discussed below, and the net consolidation of trust assets, partially offset by reductions in principal balances from defaults and principal payments during the period. For the nine months ended September 30, 2010, the balance increased due to increases in fair value of \$981.2 million and net consolidation of trust assets related to the adoption of ASU 2009-17 of \$116.9 million, offset by reductions in principal balances (resulting from transfers to REO and principal paydowns) of \$693.6 million.
- REO within the Company's securitization trusts decreased \$36.3 million to \$106.0 million at September 30, 2010. Decreases in REO were due to liquidations of \$159.7 million. Offsetting the decrease from liquidations were increases in REO from foreclosures of \$129.9 million, \$3.0 million in the net consolidation of trust assets related to the adoption of ASU 2009-17, and \$9.8 million in additional impairment write-downs.

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- Securitized mortgage borrowings increased \$401.1 million to \$6.1 billion at September 30, 2010. The increase in securitized mortgage borrowings was primarily due to decreased loss assumptions for single-family collateral, reduction in investor yield requirements as discussed below, and the net consolidation of trust liabilities, offset by reductions in principal balances during the period. For the nine months ended

September 30, 2010, the balance increased due to increases in fair value of \$1.2 billion, net consolidation of trust liabilities related to the adoption of ASU 2009-17 of \$110.6 million, offset by reductions in outstanding balances of \$942.9 million.

- Derivative liabilities, net decreased \$37.6 million to \$89.0 million at September 30, 2010. The decrease is the result of \$88.1 million in derivative cash payments from the securitization trusts, offset by a \$41.6 million increase in fair value resulting from decreases in the forward LIBOR curve and the net consolidation of off balance sheet trusts related to the adoption of ASU 2009-17 of \$9.0 million.

Since our consolidated and unconsolidated securitization trusts are nonrecourse to the Company, our economic risk is limited to our residual interests in these securitization trusts. Therefore, in the following table we have netted trust assets and trust liabilities to present these residual interests more simply. Our residual interests in securitizations are segregated between our single-family (SF) residential and multifamily (MF) residential portfolios and are represented by the difference between trust assets and trust liabilities. The following tables present the estimated fair value of our residual interests, including investment securities available for sale, by securitization vintage year and other related assumptions used to derive these values at September 30, 2010:

| Origination Year | | Estimated Fair Value of Residual Interests by Vintage Year | | |
|----------------------------------|-----|--|------------------|------------------|
| | | SF | MF | Total |
| 2002-2003 | (1) | \$ 14,185 | \$ 3,897 | \$ 18,082 |
| 2004 | | 2,245 | 7,395 | 9,640 |
| 2005 | (2) | — | 126 | 126 |
| 2006 | (2) | — | 36 | 36 |
| 2007 | (2) | — | — | — |
| Total | | \$ 16,430 | \$ 11,454 | \$ 27,884 |
| Weighted average prepayment rate | | 7% | 6% | 7% |
| Weighted average discount rate | | 30% | 20% | 26% |

- (1) 2002-2003 vintage year includes CMO 2007-A, since the majority of the mortgages collateralized in this securitization were originated during this period.
- (2) The estimated fair values of residual interests in vintage years 2005 through 2007 is reflective of higher estimated future losses and investor yield requirements compared to earlier vintage years.

The Company utilizes a number of assumptions to value securitized mortgage collateral, securitized mortgage borrowings and residual interests. These assumptions include estimated collateral default rates and loss severities (credit losses), collateral prepayment rates, forward interest rates and investor yields (discount rates). The Company uses the same collateral assumptions for securitized mortgage collateral and securitized mortgage borrowings as the collateral assumptions determine collateral cash flows which are used to pay interest and principal for securitized mortgage borrowings and excess spread, if any, to the residual interests. However, the Company uses different investor yield (discount rate) assumptions for securitized mortgage collateral and securitized mortgage borrowings and the discount rate used for residual interests based on underlying collateral characteristics, vintage year, assumed risk and market participant assumptions. The table below reflects the estimated future credit losses and investor yield requirements for trust assets by product (SF and MF) and securitization vintage:

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| | Estimated Future Losses (1) | | Investor Yield Requirement (2) | |
|-----------|-----------------------------|-----|--------------------------------|-----|
| | SF | MF | SF | MF |
| 2002-2003 | 5% | 8% | 12% | 11% |
| 2004 | 15% | 1% | 11% | 9% |
| 2005 | 30% | 13% | 13% | 11% |
| 2006 | 39% | 8% | 20% | 14% |
| 2007 | 33% | 7% | 21% | 8% |

- (1) Estimated future losses derived by dividing future projected losses by unpaid principal balances at September 30, 2010.
- (2) Investor yield requirements represent the Company's estimate of the yield third-party market participants would require to price our trust assets and liabilities given our prepayment, credit loss and forward interest rate assumptions.

As illustrated in S&Ps Case Shiller 10-City Composite Home Price Index, from 2002 through 2006, home price appreciation escalated to historic levels. During 2005 through 2007, the company originated or acquired mortgages supported by these elevated real estate values. Beginning in 2007, deterioration in the economy resulting in high unemployment and a dramatic drop in home prices resulted in significant negative equity for borrowers. These factors have led to significant increases in loss severities resulting from deterioration in the credit quality of borrowers, as well as strategic defaults, whereby borrowers with the ability to pay are defaulting on their mortgages based on the belief that home prices will not recover in a reasonable amount of time. Home prices have deteriorated back to December 2003 levels which has significantly reduced or eliminated equity for loans originated after 2003. Future loss estimates are significantly higher for mortgage loans included in securitization vintages after 2004 which reflect severe home price deterioration and defaults experienced with mortgages originated during these periods.

Cash flows from the Company's long-term mortgage portfolio are affected by the following market and operational risks:

- liquidity risk;
- interest rate risk;
- credit risk; and
- prepayment risk.

Liquidity Risk. Refer to “Liquidity and Capital Resources.”

Interest Rate Risk. The Company’s earnings from the long-term mortgage portfolio depend largely on our interest rate spread, represented by the relationship between the yield on our interest-earning assets (primarily investment securities available-for-sale and securitized mortgage collateral) and the cost of our interest-bearing liabilities (primarily securitized mortgage borrowings, long-term debt and note payable). Our interest rate spread is impacted by several factors, including general economic factors, forward interest rates and the credit quality of mortgage loans in the long-term mortgage portfolio.

The residual interests in our long-term mortgage portfolio are sensitive to changes in interest rates on securitized mortgage collateral and the related securitized mortgage borrowings. Changes in interest rates can significantly affect the cash flows and fair values of the Company’s assets and liabilities, as well as our earnings and stockholders’ equity.

The Company uses derivative instruments to manage some of its interest rate risk. However, the Company does not attempt to completely hedge interest rate risk. To help mitigate some of the exposure to the effect of changing interest rates on cash flows on securitized mortgage borrowings, the Company utilized derivative instruments primarily in the form of interest rate swap agreements (swaps) and, to a lesser extent, interest rate cap agreements (caps) and interest rate floor agreements (floors). These derivative instruments are recorded at fair value in the consolidated balance sheets. For non-exchange traded contracts, fair value is based on the amounts that would be required to settle the positions with the related counterparties as of the valuation date. Valuations of derivative assets and liabilities are based on observable market inputs, if available. To the extent observable market inputs are not available, fair values measurements include the Company’s judgments about future cash flows, forward interest rates and certain other factors, including counterparty risk. Additionally, these values also take into account the Company’s own credit standing, to the extent applicable; thus, the valuation of the derivative instrument includes the estimated value of the net credit differential between the counterparties to the derivative contract.

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At September 30, 2010, derivative liabilities, net were \$89.0 million and reflect the securitization trust’s liability to pay third-party counterparties based on the estimated value to settle the derivative instruments. Cash payments on these derivative instruments are based on notional amounts that are decreasing over time. Excluding the effects of other factors such as portfolio delinquency and loss severities within the securitization trusts, as the notional amount of these derivative instruments decrease over time, payments to counterparties in the current interest rate environment are reduced, thereby potentially increasing cash flows on our residual interests in securitizations. Conversely, increases in interest rates from current levels could potentially reduce overall cash flows on our residual interests in securitizations. Since our consolidated and unconsolidated securitization trusts are nonrecourse to the Company, our economic risk is limited to our residual interests in these securitization trusts.

The Company is also subject to interest rate risk on its long-term debt (consisting of trust preferred securities and junior subordinated notes) and notes payable. These interest bearing liabilities include adjustable rate periods based on one-month LIBOR (note payable) and three-month LIBOR (trust preferred securities and junior subordinated notes). The Company does not currently hedge its exposure to the effect of changing interest rates related to these interest-bearing liabilities. Significant fluctuations in interest rates could have a material adverse effect on the Company’s business, financial condition, results of operations or liquidity.

Credit risk. We manage credit risk by actively managing delinquencies and defaults through our servicers. Starting with the second half of 2007 we have not retained any additional Alt-A mortgages in our long-term mortgage portfolio. Our securitized mortgage collateral primarily consists of Alt-A mortgages which are generally within typical Fannie Mae and Freddie Mac guidelines but have loan characteristics, which may include higher loan balances, higher loan-to-value ratios or lower documentation requirements (including stated-income loans), that make them non-conforming under those guidelines.

Using historical losses, current portfolio statistics and market conditions and available market data, the Company has estimated future loan losses, which are included in the fair value adjustment to our securitized mortgage collateral. While the credit performance for the loans has been clearly far worse than the Company’s initial expectations when the loans were originated, the ultimate level of realized losses will largely be influenced by events that will likely unfold over the next several years, including the severity of housing price declines and overall strength of the economy. If market conditions continue to deteriorate in excess of our expectations, the Company may need to recognize additional fair value reductions to our securitized mortgage collateral, which may also affect the value of the related securitized mortgage borrowings and residual interests.

We monitor our servicers to attempt to ensure that they perform loss mitigation, foreclosure and collection functions according to their servicing practices and each securitization trust’s pooling and servicing agreement. We have met with the management of our servicers to assess our borrowers’ current ability to pay their mortgages and to make arrangements with selected delinquent borrowers which will result in the best interest of the trust and borrower, in an effort to minimize the number of mortgages which become seriously delinquent. When resolving delinquent mortgages, servicers are required to take timely action. The servicer is required to determine payment collection under various circumstances, which will result in the maximum financial benefit. This is accomplished by either working with the borrower to bring the mortgage current by modifying the loan with terms that will maximize the recovery or by foreclosing and liquidating the property. At a foreclosure sale, the trusts consolidated on our balance sheet generally acquire title to the property.

We use the Mortgage Bankers Association (MBA) method to define delinquency as a contractually required payment being 30 days or more past due. We measure delinquencies from the date of the last payment due date in which a payment was received. Delinquencies for loans 60 days late or greater, foreclosures and delinquent bankruptcies were \$2.5 billion or 21.7% as of September 30, 2010.

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The following table summarizes the unpaid principal balances of loans in our mortgage portfolio, included in securitized mortgage collateral, loans held-for-investment and loans held-for-sale for continuing and discontinued operations combined, that were 60 or more days delinquent (utilizing the MBA method) as of the periods indicated:

| September 30, 2010 | Total Collateral % | December 31, 2009 | Total Collateral % |
|-----------------------|--------------------------|----------------------|--------------------------|
|-----------------------|--------------------------|----------------------|--------------------------|

| Loans held for sale and investment (1) | | | | | |
|---|-----------|-------------------|--------------|----------------------|--------------|
| 60 - 89 days delinquent | \$ | — | 0.0% | \$ 66 | 0.0% |
| 90 or more days delinquent | | 1,139 | 0.0% | 6,928 | 0.1% |
| Foreclosures (2) | | 1,043 | 0.0% | 7,397 | 0.1% |
| Total 60+ days delinquent loans held-for-sale and investment | | 2,182 | 0.0% | 14,391 | 0.1% |
| Securitized mortgage collateral | | | | | |
| 60 - 89 days delinquent | \$ | 252,739 | 2.2% | \$ 324,032 | 2.6% |
| 90 or more days delinquent | | 865,534 | 7.5% | 1,043,718 | 8.4% |
| Foreclosures (2) | | 1,053,384 | 9.1% | 1,449,538 | 11.6% |
| Delinquent bankruptcies (3) | | 342,125 | 2.9% | 302,314 | 2.4% |
| Total 60+ days delinquent long-term mortgage portfolio | | 2,513,782 | 21.6% | 3,119,602 | 25.0% |
| Total 60 or more days delinquent | \$ | 2,515,964 | 21.7% | \$ 3,133,993 | 25.1% |
| Total collateral | \$ | 11,616,852 | | \$ 12,492,493 | |

(1) Loans held-for-sale are substantially included in discontinued operations in the consolidated balance sheets.

(2) Represents properties in the process of foreclosure.

(3) Represents bankruptcies that are 30 days or more delinquent.

The following table summarizes securitized mortgage collateral, loans held-for-investment, loans held-for-sale and real estate owned, that were non-performing for continuing and discontinued operations combined as of the dates indicated (excludes 60-89 days delinquent):

| | September 30, 2010 | Total Collateral % | December 31, 2009 | Total Collateral % |
|--|-----------------------|--------------------------|----------------------|--------------------------|
| 90 or more days delinquent, foreclosures and delinquent bankruptcies | \$ 2,263,225 | 19.5% | \$ 2,809,895 | 22.5% |
| Real estate owned | 106,114 | 0.9% | 142,676 | 1.1% |
| Total non-performing assets | \$ 2,369,339 | 20.4% | \$ 2,952,571 | 23.6% |

Non-performing assets consist of non-performing loans (mortgages that are 90 days or more delinquent, including loans in foreclosure and delinquent bankruptcies) plus REO. It is our policy to place a mortgage on non-accrual status when it becomes 90 days delinquent and to reverse from revenue any accrued interest, except for interest income on securitized mortgage collateral when the scheduled payment is received from the servicer. The servicers are required to advance principal and interest on loans within the securitization trusts to the extent the advances are considered recoverable. As of September 30, 2010, non-performing assets (unpaid principal balance of loans 90 or more days delinquent, foreclosures and delinquent bankruptcies plus REO) as a percentage of the total collateral was 20%. At December 31, 2009, non-performing assets to total collateral was 24%. As of September 30, 2010, the estimated fair value of non-performing assets (representing the fair value of loans 90 or more days delinquent, foreclosures and delinquent bankruptcies plus REO) as a percentage of the total assets was 12%. At December 31, 2009, the estimated fair value of non-performing assets to total assets was 16%.

REO, which consists of residential real estate acquired in satisfaction of loans, is carried at the lower of cost or net realizable value less estimated selling costs. Adjustments to the loan carrying value required at the time of foreclosure are included in the change in the fair value of net trust assets. Changes in the Company's estimates of net realizable value subsequent to the time of foreclosure and through the time of ultimate disposition are recorded as gains or losses from real estate owned in the consolidated statements of operations. REO, for continuing and discontinued operations, at September 30, 2010 decreased \$36.3 million or 26% from December 31, 2009 as a result of liquidations and a decrease in foreclosures.

We realized gains on the sale of real estate owned in the amount \$111 thousand and \$3.5 million for the three and nine months ended September 30, 2010, respectively, compared to losses of \$18.6 million and \$100.2 million, respectively for the comparable 2009 periods. Additionally, during the three and nine month ended September 30, 2010, the Company recorded write-downs of the net realizable value of the REO in the amount of \$10.3 million and \$9.8 million, respectively, compared to write-downs of \$24.5 million and \$117.9 million, respectively for the comparable 2009 periods. These write-downs of the net realizable value reflect declines in value of the REO subsequent to foreclosure date.

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The following table presents the balances of REO for continuing operations:

| | September 30, 2010 | December 31, 2009 |
|-----------------------|-----------------------|----------------------|
| REO | \$ 137,517 | \$ 176,800 |
| Impairment (1) | (31,403) | (34,080) |
| Ending balance | \$ 106,114 | \$ 142,720 |
| REO inside trusts | \$ 106,042 | \$ 142,364 |
| REO outside trusts | 72 | 356 |
| Total | \$ 106,114 | \$ 142,720 |

(1) Impairment represents the cumulative write-downs of net realizable value subsequent to foreclosure.

In calculating the cash flows to assess the fair value of the securitized mortgage collateral, the Company estimates the future losses embedded in our loan portfolio. In evaluating the adequacy of these losses, management takes many factors into consideration. For instance, a detailed analysis of historical loan performance data is accumulated and reviewed. This data is analyzed for loss performance and prepayment performance by product type, origination

year and securitization issuance. The data is also broken down by collection status. Our estimate of losses for these loans is developed by estimating both the rate of default of the loans and the amount of loss severity in the event of default. The rate of default is assigned to the loans based on their attributes (e.g., original loan-to-value, borrower credit score, documentation type, geographic location, etc.) and collection status. The rate of default is based on analysis of migration of loans from each aging category. The loss severity is determined by estimating the net proceeds from the ultimate sale of the foreclosed property. The results of that analysis are then applied to the current mortgage portfolio and an estimate is created. We believe that pooling of mortgages with similar characteristics is an appropriate methodology in which to evaluate the future loan losses.

Management recognizes that there are qualitative factors that must be taken into consideration when evaluating and measuring losses in the loan portfolios. These items include, but are not limited to, economic indicators that may affect the borrower's ability to pay, changes in value of collateral, political factors, employment and market conditions, competitor's performance, market perception, historical losses, and industry statistics. The assessment for losses, is based on delinquency trends and prior loss experience and management's judgment and assumptions regarding various matters, including general economic conditions and loan portfolio composition. Management continually evaluates these assumptions and various relevant factors affecting credit quality and inherent losses.

Prepayment Risk. The Company historically used prepayment penalties as a method of partially mitigating prepayment risk for those borrowers that have the ability to refinance. The recent economic downturn, lack of available credit and declines in property values have limited borrowers' ability to refinance. These factors have significantly reduced prepayment risk within our long-term mortgage portfolio. With the seasoning of the long-term mortgage portfolio, a significant portion of prepayment penalties terms have expired, thereby further reducing prepayment penalty income.

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Results of Operations

For the Three and Nine Months Ended September 30, 2010 compared to the Three and Nine Months Ended September 30, 2009

Condensed Statements of Operations Data

| | For the Three Months Ended September 30, | | | |
|---|---|-------------------|--------------------------------|---------------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Interest income | \$ 230,927 | \$ 341,323 | \$ (110,396) | (32)% |
| Interest expense | 229,256 | 339,417 | (110,161) | (32) |
| Net interest income | 1,671 | 1,906 | (235) | (12) |
| Total non-interest income | 16,154 | 16,913 | (759) | (4) |
| Total non-interest expense | 15,552 | 14,016 | 1,536 | 11 |
| Income tax expense | 14 | — | 14 | n/a |
| Earnings from continuing operations | 2,259 | 4,803 | (2,544) | (53) |
| Loss from discontinued operations, net | (1,285) | (1,776) | 491 | 28 |
| Earnings available to common stockholders before redemption of preferred stock (1) | <u>\$ 974</u> | <u>\$ 3,027</u> | <u>\$ (2,053)</u> | <u>(68)%</u> |
| Earnings per share available to common stockholders before redemption of preferred stock (1) - basic | <u>\$ 0.13</u> | <u>\$ 0.40</u> | <u>\$ (0.27)</u> | <u>(68)%</u> |
| Earnings per share available to common stockholders before redemption of preferred stock (1) - diluted | <u>\$ 0.12</u> | <u>\$ 0.38</u> | <u>\$ (0.26)</u> | <u>(69)%</u> |
| | For the Nine Months Ended September 30, | | | |
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Interest income | \$ 759,016 | \$ 1,508,230 | \$ (749,214) | (50)% |
| Interest expense | 755,020 | 1,499,729 | (744,709) | (50) |
| Net interest income | 3,996 | 8,501 | (4,505) | (53) |
| Total non-interest income | 49,830 | 48,729 | 1,101 | 2 |
| Total non-interest expense | 45,410 | 41,103 | 4,307 | 10 |
| Income tax expense | 143 | 2,018 | (1,875) | (93) |
| Earnings from continuing operations | 8,273 | 14,109 | (5,836) | (41) |
| Earnings (loss) from discontinued operations, net | 1,905 | (8,366) | 10,271 | 123 |
| Net Earnings | 10,178 | 5,743 | 4,435 | 77 |
| Cash dividends on preferred stock | — | (7,443) | 7,443 | 100 |
| Earnings (loss) available to common stockholders before redemption of preferred stock (1) | <u>\$ 10,178</u> | <u>\$ (1,700)</u> | <u>\$ 11,878</u> | <u>699%</u> |
| Earnings (loss) per share available to common stockholders before redemption of preferred stock (1) - basic | <u>\$ 1.32</u> | <u>\$ (0.22)</u> | <u>\$ 1.54</u> | <u>690%</u> |
| Earnings (loss) per share available to common stockholders before redemption of preferred stock (1) - diluted | <u>\$ 1.22</u> | <u>\$ (0.22)</u> | <u>\$ 1.45</u> | <u>648%</u> |

(1) As discussed in Note 4 to the consolidated financial statements, the difference between the carrying value of the tendered preferred stock (\$106.1 million) and the amount paid for the shares (\$1.3 million) was recognized as a decrease in retained deficit in 2009. Including the redemption, total basic earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$14.16 and \$13.54, respectively. Including the redemption, total diluted earnings per share from continuing operations available to common stockholders for the three and nine month period ended September 30, 2009, were \$13.48 and \$13.54, respectively. However, because of

the special nature of the preferred stock redemption (which the Company considers an infrequently occurring item), management believes that earnings per common share excluding such transaction are more meaningful from an operations standpoint.

Net Interest Income

We earn net interest income primarily from mortgage assets which include securitized mortgage collateral, loans held-for-sale and investment securities available-for-sale, or collectively, "mortgage assets," and, to a lesser extent, interest income earned on cash and cash equivalents. Interest expense is primarily interest paid on borrowings secured by mortgage assets, which include securitized mortgage borrowings and to a lesser extent, interest expense paid on long-term debt and note payable. Interest income and interest expense during the period primarily represents the effective yield, based on the fair value of the trust assets and liabilities.

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The following tables summarize average balance, interest and weighted average yield on mortgage assets and borrowings, included within continuing operations, for the periods indicated. Cash receipts and payments on derivative instruments hedging interest rate risk related to our securitized mortgage borrowings are not included in the results below. These cash receipts and payments are included as a component of the change in fair value of net trust assets.

| | For the three months ended September 30, | | | | | |
|--|--|-------------------|--------|---------------------|-------------------|--------|
| | 2010 | | | 2009 | | |
| | Average Balance | Interest | Yield | Average Balance | Interest | Yield |
| ASSETS | | | | | | |
| Investment securities available-for-sale | \$ 1,262 | \$ 90 | 28.53% | \$ 1,191 | \$ 154 | 51.72% |
| Securitized mortgage collateral | 6,148,164 | 230,837 | 15.02% | 5,919,620 | 341,169 | 23.05% |
| Total interest-earning assets | <u>\$ 6,149,426</u> | <u>\$ 230,927</u> | 15.02% | <u>\$ 5,920,811</u> | <u>\$ 341,323</u> | 23.06% |
| LIABILITIES | | | | | | |
| Securitized mortgage borrowings | \$ 6,130,796 | \$ 228,077 | 14.88% | \$ 5,912,681 | \$ 338,563 | 22.90% |
| Long-term debt | 11,089 | 1,071 | 38.63% | 9,298 | 854 | 36.74% |
| Note payable | 10,322 | 108 | 4.19% | — | — | — |
| Total interest-bearing liabilities | <u>\$ 6,152,207</u> | <u>\$ 229,256</u> | 14.91% | <u>\$ 5,921,979</u> | <u>\$ 339,417</u> | 22.93% |
| Net Interest Spread (1) | | \$ 1,671 | 0.11% | | \$ 1,906 | 0.13% |
| Net Interest Margin (2) | | | 0.11% | | | 0.13% |

- (1) Net interest spread is calculated by subtracting the weighted average yield on interest-bearing liabilities from the weighted average yield on interest-earning assets.
- (2) Net interest margin is calculated by dividing net interest spread by total average interest-earning assets.

Net interest income spread decreased \$200 thousand for the three months ended September 30, 2010 to \$1.7 million from \$1.9 million for the comparable 2009 period. The decrease in net interest spread was primarily attributable to overall declines in yields between periods and the resulting decrease in net interest income on securitized mortgage collateral and securitized mortgage borrowings, as well as an increase in interest expense incurred on the note payable of \$108 thousand for the quarter ended September 30, 2010 as compared to none for the comparable 2009 period. As a result, net interest margin decreased from 0.13% for the three months ended September 30, 2009 to 0.11% for the three months ended September 30, 2010.

During the three months ended September 30, 2010, the yield on interest-earning assets decreased to 15.02% from 23.06% in the comparable 2009 period. The yield on interest-bearing liabilities decreased to 14.91% for the three months ended September 30, 2010 from 22.93% for the comparable 2009 period. In connection with the fair value accounting for investment securities available-for-sale and securitized mortgage collateral and borrowings, interest income and interest expense is recognized using effective yields based on estimated fair values for these instruments. The decrease in yield for securitized mortgage collateral and securitized mortgage borrowings is primarily related to increased prices on mortgage-backed bonds which resulted in a decrease in yield. Bond prices received from pricing services and other market participants have increased over the past few quarters as investor's demand for mortgage-backed securities has increased. This has resulted in an increase in fair value for both securitized mortgage collateral and securitized mortgage borrowings. These increases in fair value have decreased the effective yields used for purposes of recognizing interest income and interest expense on these instruments.

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| | For the nine months ended September 30, | | | | | |
|--|---|-------------------|--------|---------------------|---------------------|--------|
| | 2010 | | | 2009 | | |
| | Average Balance | Interest | Yield | Average Balance | Interest | Yield |
| ASSETS | | | | | | |
| Investment securities available-for-sale | \$ 927 | \$ 203 | 29.20% | \$ 1,443 | \$ 387 | 35.76% |
| Securitized mortgage collateral | 6,119,520 | 758,813 | 16.53% | 6,437,085 | 1,507,843 | 31.23% |
| Total interest-earning assets | <u>\$ 6,120,447</u> | <u>\$ 759,016</u> | 16.54% | <u>\$ 6,438,528</u> | <u>\$ 1,508,230</u> | 31.23% |
| LIABILITIES | | | | | | |
| Securitized mortgage borrowings | \$ 6,095,991 | \$ 751,022 | 16.43% | \$ 6,499,331 | \$ 1,497,476 | 30.72% |
| Long-term debt | 10,671 | 3,433 | 42.90% | 12,401 | 2,253 | 24.22% |
| Note payable | 17,234 | 565 | 4.37% | — | — | — |

| | | | | | | |
|------------------------------------|--------------|------------|--------|--------------|--------------|--------|
| Total interest-bearing liabilities | \$ 6,123,896 | \$ 755,020 | 16.44% | \$ 6,511,732 | \$ 1,499,729 | 30.71% |
| Net Interest Spread (1) | | \$ 3,996 | 0.10% | | \$ 8,501 | 0.52% |
| Net Interest Margin (2) | | | 0.09% | | | 0.18% |

- (1) Net interest spread is calculated by subtracting the weighted average yield on interest-bearing liabilities from the weighted average yield on interest-earning assets.
- (2) Net interest margin is calculated by dividing net interest spread by total average interest-earning assets.

Net interest income spread decreased \$4.5 million for the nine months ended September 30, 2010 to \$4.0 million from \$8.5 million for the comparable 2009 period. The decrease in net interest spread was primarily attributable to overall declines in yields and balances between periods and the resulting decrease in net interest income on securitized mortgage collateral and securitized mortgage borrowings, as well as an increase in interest expense incurred on the note payable of \$565 thousand for the nine months ended September 30, 2010 as compared to none for the comparable 2009 period. As a result, net interest margin decreased from 0.18% for the nine months ended September 30, 2009 to 0.09% for the nine months ended September 30, 2010.

During the nine months ended September 30, 2010, the yield on interest-earning assets decreased to 16.54% from 31.23% in the comparable 2009 period. The yield on interest-bearing liabilities decreased to 16.44% for the nine months ended September 30, 2010 from 30.71% for the comparable 2009 period. In connection with the fair value accounting for investment securities available-for-sale and securitized mortgage collateral and borrowings, interest income and interest expense is recognized using effective yields based on estimated fair values for these instruments. The decrease in yield for securitized mortgage collateral and securitized mortgage borrowings is primarily related to the adoption of FAS ASC 820-10-65-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," during the second quarter of 2009. The fair value of the securitized mortgage collateral and securitized mortgage borrowings increased and the yields decreased as a result of the adoption which clarified the use of quoted prices in determining fair value in markets that are inactive, thus moderating the need to use distressed prices in valuing financial assets and liabilities in illiquid markets as the Company had used in prior periods. Furthermore, bond prices received from pricing services and other market participants have increased over the past few quarters as investor's demand for mortgage-backed securities has increased. This has resulted in an increase in fair value for both securitized mortgage collateral and securitized mortgage borrowings. These increases in fair value have decreased the effective yields used for purposes of recognizing interest income and interest expense on these instruments.

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Non-Interest Income

Changes in Non-Interest Income

| | For the Three Months Ended September 30, | | | |
|---|--|------------------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Change in fair value of net trust assets, excluding REO | \$ 9,573 | \$ 46,325 | \$ (36,752) | (79)% |
| Losses from REO | (10,147) | (43,160) | 33,013 | 76 |
| Non-interest income (loss) - net trust assets | (574) | 3,165 | (3,739) | (118) |
| Change in fair value of long-term debt | 1,168 | 341 | 827 | 243 |
| Mortgage and real estate services fees | 15,521 | 13,514 | 2,007 | 15 |
| Other | 39 | (107) | 146 | 136 |
| Total non-interest income | \$ 16,154 | \$ 16,913 | \$ (759) | (4)% |

Non-interest income—net trust assets. Since our consolidated and unconsolidated securitization trusts are nonrecourse to the Company, our economic risk is limited to our residual interests in these securitization trusts. To better understand the economics on our residual interests in securitizations, it is necessary to consider the net effect of changes in fair value of net trust assets and losses from real estate owned. All estimated future losses are included in the estimate of the fair value of securitized mortgage collateral and REO. Losses on REO are reported separately in the consolidated statement of operations as REO is a nonfinancial asset which is the only component of trust assets and liabilities that is not recorded at fair value. Therefore, REO value at the time of sale or losses from further write-downs are recorded separately in the Company's consolidated statement of operations. The net effect of changes in value related to our investment in all trust assets and liabilities is shown as non-interest income—net trust assets, which includes losses from REO. Non-interest income (loss) related to our net trust assets (residual interests in securitizations) was a loss of \$574 thousand for the three months ended September 30, 2010, compared to a gain of \$3.2 million in the comparable 2009 period. The \$574 thousand loss on net trust assets was primarily attributable to losses from REO during the three months ended September 30, 2010. The individual components of the non-interest income from net trust assets are discussed below:

Change in fair value of net trust assets, excluding REO. For the quarter ended September 30, 2010, the Company recognized a \$9.6 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains resulting from the reduction in the fair market value of securitized mortgage borrowings of \$66.2, offset by losses resulting from the decreases in the fair value of investment securities-for-sale and of securitized mortgage collateral of \$66 thousand and \$44.3 million, respectively, as well as an increase in the fair value of net derivative liabilities of \$12.3 million.

For the quarter ended September 30, 2009, the Company recognized a \$46.3 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains from the increase in fair value of investment securities-for-sale and reduction in the fair value of securitized mortgage borrowings of \$1.2 million and \$153.0 million, respectively. Offsetting these gains were losses resulting from decreases in the fair value of securitized mortgage collateral and increases in the fair value of derivative liabilities, net of \$79.4 million and \$28.4 million, respectively.

Losses from REO. Losses from REO were \$10.1 million for the three months ended September 30, 2010. This loss was comprised of \$10.2 million in additional impairment write-downs during the period partially offset by \$111 thousand in gain on sale of REO. During the three months ended September 30, 2010, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period as compared to previously reserved. The gain is attributable to mortgage insurance recovery collected in the period as a result of our increased loss mitigation efforts of our portfolio.

Losses from real estate owned were \$43.2 million for the three months ended September 30, 2009. This loss was comprised of an \$18.7 million loss on sale of real estate owned, coupled with \$24.5 million in additional impairment write-downs during the period. During the quarter, loss severities resulting from liquidations in areas where we have high concentration of foreclosed properties (such as California and Florida) have continued to increase over previous periods as a result of continued deterioration in the U.S. economy and real estate markets. These continued declines in housing prices have resulted in liquidations of foreclosed assets at prices below expected levels as well as additional impairment write-downs of REO since foreclosure.

Change in the fair value of long-term debt. Change in the fair value of long-term debt was a gain of \$1.2 million for the three months ended September 30, 2010, compared to a gain of \$341 thousand for the comparable 2009 period. Long-term debt (consisting of trust preferred securities and junior subordinated notes) is measured based upon an analysis prepared by the Company, which considers the Company's own credit risk, including consideration of settlements with trust preferred debt holders and discounted cash flow analysis.

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Mortgage and real estate services fees. Revenues generated from these businesses are primarily from the Company's long-term mortgage portfolio. For the three months ended September 30, 2010, mortgage and real estate services fees, which primarily include loan modification fees and monitoring and surveillance services fees, were \$15.5 million compared to \$13.5 million in monitoring fees in the comparable 2009 period. The mortgage and real estate services fees of \$15.5 million for the three months ended September 30, 2010, was primarily comprised of \$7.3 million in monitoring, surveillance and recovery fees, \$4.5 million in title and escrow fees, \$1.9 million in servicing income, and \$1.8 million in loan modification fees. The \$2.0 million increase in mortgage and real estate services fees was comprised of increases in title and escrow fees and monitoring, surveillance and recovery fees of \$3.6 million and \$3.1 million, respectively. Offsetting these increases were reductions in loan modification fees and servicing income of \$4.6 million and \$0.1 million, respectively.

| | For the Nine Months Ended September 30, | | | |
|---|---|------------------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Change in fair value of net trust assets, excluding REO | \$ 12,701 | \$ 234,167 | \$ (221,466) | (95)% |
| Losses from REO | (6,290) | (218,083) | 211,793 | 97 |
| Non-interest income - net trust assets | 6,411 | 16,084 | (9,673) | (60) |
| Change in fair value of long-term debt | 952 | 682 | 270 | 40 |
| Mortgage and real estate services fees | 42,523 | 32,296 | 10,227 | 32 |
| Other | (56) | (333) | 277 | 83 |
| Total non-interest income | <u>\$ 49,830</u> | <u>\$ 48,729</u> | <u>\$ 1,101</u> | 2% |

Non-interest income—net trust assets. Since our consolidated and unconsolidated securitization trusts are nonrecourse to the Company, our economic risk is limited to our residual interests in these securitization trusts. To better understand the economics on our residual interests in securitizations, it is necessary to consider the net effect of changes in fair value of net trust assets and losses from real estate owned. All estimated future losses are included in the estimate of the fair value of securitized mortgage collateral and REO. Losses on REO are reported separately in the consolidated statement of operations as REO is a nonfinancial asset which is the only component of trust assets and liabilities that is not recorded at fair value. Therefore, REO value at the time of sale or losses from further write-downs are recorded separately in the Company's consolidated statement of operations. The net effect of changes in value related to our investment in all trust assets and liabilities is shown as non-interest income—net trust assets, which includes losses from REO. Non-interest income related to our net trust assets (residual interests in securitizations) was \$6.4 million for the nine months ended September 30, 2010, compared to \$16.1 million in the comparable 2009 period. The \$6.4 million in non-interest income - net trust assets was primarily attributable to increased expected net interest spread as a result of a downward shift in the forward LIBOR curve during the nine months ended September 30, 2010. The \$16.1 million gain on net trust assets was primarily attributable to the adoption of FAS ASC 820-10-65-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," during the second quarter of 2009, which resulted in an increase to the fair value of net trust assets before REO losses. The individual components of the non-interest income from net trust assets are discussed below:

Change in fair value of net trust assets, excluding REO. For the nine months ended September 30, 2010, the Company recognized a \$12.7 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains resulting from the increase in fair value of investment securities-for-sale and securitized mortgage collateral of \$653 thousand and \$606.5 million, respectively. Offsetting these gains were losses resulting from increases in the fair value of securitized mortgage borrowings and net derivative liabilities of \$552.9 million and \$41.6 million, respectively.

For the nine months ended September 30, 2009, the Company recognized a \$234.2 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains resulting from the increase in fair value of investment securities-for-sale and reduction in the fair value of securitized mortgage borrowings of \$2.9 million and \$313.8 million, respectively. Offsetting these gains were losses from the reduction in the fair value of securitized mortgage collateral and increase in the fair value of net derivative liabilities of \$33.8 million and \$48.7 million, respectively.

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Losses from REO. Losses from REO were \$6.3 million for the nine months ended September 30, 2010. This loss was comprised of \$9.8 million in additional impairment write-downs during the period partially offset by \$3.5 million in gain on sale of REO. During the nine months ended September 30, 2010, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period as compared to previously reserved. The gain is attributable to mortgage insurance recovery collected in the period as a result of our increased loss mitigation efforts of our portfolio.

Losses from real estate owned were \$218.1 million for the nine months ended September 30, 2009. This loss was comprised of a \$100.2 million loss on sale of real estate owned, coupled with \$117.9 million in additional impairment write-downs during the period. During the first nine months of 2009, loss

severities resulting from liquidations in areas where we have high concentration of foreclosed properties (such as California and Florida) have continued to increase significantly over previous periods as a result of continued deterioration in the U.S. economy and real estate markets. These continued declines in housing prices have resulted in liquidations of foreclosed assets at prices below expected levels as well as additional impairment write-downs of REO since foreclosure.

Change in the fair value of long-term debt. Change in the fair value of long-term debt was a gain of \$952 thousand for the nine months ended September 30, 2010, compared to a gain of \$682 thousand for the comparable 2009 period. Long-term debt (consisting of trust preferred securities and junior subordinated notes) is measured based upon an analysis prepared by the Company, which considers the Company's own credit risk, including consideration of settlements with trust preferred debt holders and discounted cash flow analysis.

Mortgage and real estate services fees. Revenues generated from these businesses are primarily from the Company's long-term mortgage portfolio. For the nine months ended September 30, 2010, mortgage and real estate services fees, which primarily include loan modification fees and monitoring and surveillance services fees, were \$42.5 million compared to \$32.3 million in monitoring fees in the comparable 2009 period. The mortgage and real estate services fees of \$42.5 million for the nine months ended September 30, 2010, was primarily comprised of \$20.1 million in monitoring, surveillance and recovery fees, \$10.5 million in title and escrow fees, \$7.7 million in loan modification fees, and \$4.2 million in servicing income. The \$10.2 million increase in mortgage and real estate services fees was comprised of increases in monitoring, surveillance and recovery fees and title and escrow fees of \$9.1 million and \$8.1 million, respectively. Offsetting these increases were reductions in loan modification fees and servicing income of \$5.7 million and \$1.3 million, respectively.

Non-Interest Expense

Changes in Non-Interest Expense

| | For the Three Months Ended September 30, | | | |
|----------------------------|--|-----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| General and administrative | \$ 4,869 | \$ 4,603 | \$ 266 | 6% |
| Personnel expense | 10,683 | 9,413 | 1,270 | 13 |
| Total operating expense | \$ 15,552 | \$ 14,016 | \$ 1,536 | 11% |

Total non-interest expense was \$15.6 million for the three months ended September 30, 2010, compared to \$14.0 million for the comparable period of 2009. The \$1.5 million increase in non-interest expense was primarily attributable to a \$1.3 million increase in personnel and related costs associated with the initiation of the new mortgage and real estate fee-based business activities, which was partially offset by a decrease in personnel costs associated with the long-term mortgage portfolio.

| | For the Nine Months Ended September 30, | | | |
|----------------------------|---|-----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| General and administrative | \$ 14,278 | \$ 15,053 | \$ (775) | (5)% |
| Personnel expense | 31,132 | 26,050 | 5,082 | 20 |
| Total operating expense | \$ 45,410 | \$ 41,103 | \$ 4,307 | 10% |

Total non-interest expense was \$45.4 million for the nine months ended September 30, 2010, compared to \$41.1 million for the comparable period of 2009. The \$4.3 million increase in non-interest expense was primarily attributable to a \$5.1 million increase in personnel expense over the previous period as a result of increases in personnel and related costs associated with the initiation of our new mortgage and real estate fee-based business activities, which was partially offset by a decrease in personnel costs associated with the long-term mortgage portfolio.

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Results of Operations by Business Segment

Mortgage and Real Estate Services

During 2009, the Company initiated various mortgage and real estate fee-based business activities, including loan modifications, real estate disposition, monitoring and surveillance services, real estate brokerage, mortgage lending and title and escrow services. Although the Company intends to generate more fees by providing these services to third parties in the marketplace, the revenues from these businesses have primarily been generated from the Company's long-term mortgage portfolio. Despite our efforts to expand these services, we have encountered challenges in selling these services to third-parties.

Condensed Statements of Operations Data

| | For the Three Months Ended September 30, | | | |
|--|--|----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income | \$ 5 | \$ 12 | \$ (7) | (58)% |
| Mortgage and real estate services fees | 15,521 | 13,514 | 2,007 | 15 |
| Other non-interest income | 18 | (127) | 145 | 114 |
| Total non-interest income | 15,539 | 13,387 | 2,152 | 16 |
| Personnel expense | 9,072 | 6,996 | 2,076 | 30 |
| Non-interest expense and income taxes | 2,130 | 1,598 | 532 | 33 |
| Net earnings | \$ 4,342 | \$ 4,805 | \$ (463) | (10)% |

For the three months ended September 30, 2010, mortgage and real estate services fees, which primarily include loan modification fees and monitoring and surveillance services fees, were \$15.5 million compared to \$13.5 million in monitoring fees in the comparable 2009 period. The \$2.0 million increase in mortgage and real estate services fees was comprised of increases in title and escrow fees and monitoring, surveillance and recovery fees of \$3.6 million and \$3.1 million, respectively. Offsetting these increases were reduction in loan modification fees and servicing income of \$4.6 million and \$0.1 million, respectively.

For the three months ended September 30, 2010, personnel expense increased \$2.1 million to \$9.1 million as a result of increases in personnel and related costs associated with the growth of our mortgage and real estate fee-based business activities.

| | For the Nine Months Ended September 30, | | | |
|--|---|-----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income | \$ 16 | \$ 5 | \$ 11 | 220% |
| Mortgage and real estate services fees | 42,523 | 32,296 | 10,227 | 32 |
| Other non-interest income | 20 | (312) | 332 | 106 |
| Total non-interest income | 42,543 | 31,984 | 10,559 | 33 |
| Personnel expense | 25,512 | 15,598 | 9,914 | 64 |
| Non-interest expense and income taxes | 6,459 | 4,561 | 1,898 | 42 |
| Net earnings | \$ 10,588 | \$ 11,830 | \$ (1,242) | (10)% |

For the nine months ended September 30, 2010, mortgage and real estate services fees, which primarily include loan modification fees and monitoring and surveillance services fees, were \$42.5 million compared to \$32.3 million in monitoring fees in the comparable 2009 period. The \$10.2 million increase in mortgage and real estate services fees was comprised of increases in monitoring, surveillance and recovery fees and title and escrow fees of \$9.1 million and \$8.1 million, respectively. Offsetting these increases were reduction in loan modification fees and servicing income of \$5.7 million and \$1.3 million, respectively.

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For the nine months ended September 30, 2010, personnel expense increased \$9.9 million to \$25.5 million as a result of increases in personnel and related costs associated with the growth of our mortgage and real estate fee-based business activities.

For the nine months ended September 30, 2010, non-interest expense and income taxes increased \$1.9 million to \$6.5 million. The increase is related to higher business promotion and occupancy expenses associated with the mortgage and real estate fee-based business activities.

Long-term Portfolio

Condensed Statements of Operations Data

| | For the Three Months Ended September 30, | | | |
|---|--|----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income | \$ 1,666 | \$ 1,894 | \$ (228) | (12)% |
| Change in fair value of net trust assets, excluding REO | 9,573 | 46,325 | (36,752) | (79) |
| Losses from REO | (10,147) | (43,160) | 33,013 | 76 |
| Non-interest (loss) income- net trust assets | (574) | 3,165 | (3,739) | (118) |
| Change in fair value of long-term debt | 1,168 | 341 | 827 | 243 |
| Other non-interest income | 21 | 20 | 1 | 5 |
| Total non-interest income | 615 | 3,526 | (2,911) | (83) |
| Personnel expense | 1,611 | 2,417 | (806) | (33) |
| Non-interest expense and income taxes | 2,753 | 3,005 | (252) | (8) |
| Net loss | \$ (2,083) | \$ (2) | \$ (2,081) | (104,050)% |

Net loss for the long-term portfolio was \$2.1 million for the three months ended September 30, 2010, compared to \$2 thousand for the comparable period of 2009. The increase in net loss is primarily attributable to a \$3.7 million decrease in non-interest income-net trust assets, partially offset by an \$827 thousand increase in the change in fair value of long-term debt and \$806 thousand reduction in personnel expense.

For the quarter ended September 30, 2010, the Company recognized a \$9.6 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains resulting from the reduction in the fair market value of securitized mortgage borrowings of \$66.2, offset by losses resulting from the decreases in the fair value of investment securities-for-sale and of securitized mortgage collateral of \$66 thousand and \$44.3 million, respectively, as well as an increase in the fair value of net derivative liabilities of \$12.3 million. Losses from REO were \$10.1 million for the three months ended September 30, 2010. This loss was comprised of \$10.2 million in additional impairment write-downs during the period partially offset by \$111 thousand in gain on sale of REO. During the three months ended September 30, 2010, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period as compared to previously reserved. The gain is attributable to mortgage insurance recovery collected in the period as a result of our increased loss mitigation efforts of our portfolio.

Personnel expense decreased \$806 thousand during the three months ended September 30, 2010 as a result of reduced personnel associated with the long-term portfolio segment of the Company.

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| | For the Nine Months Ended September 30, | | | |
|---|---|-----------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income | \$ 3,980 | \$ 8,496 | \$ (4,516) | (53)% |
| Change in fair value of net trust assets, excluding REO | 12,701 | 234,167 | (221,466) | (95) |
| Losses from REO | (6,290) | (218,083) | 211,793 | 97 |
| Non-interest income- net trust assets | 6,411 | 16,084 | (9,673) | (60) |
| Change in fair value of long-term debt | 952 | 682 | 270 | 40 |
| Other non-interest income | (76) | (21) | (55) | (262) |
| Total non-interest income | 7,287 | 16,745 | (9,458) | (56) |
| Personnel expense | 5,620 | 10,452 | (4,832) | (46) |
| Non-interest expense and income taxes | 7,962 | 12,510 | (4,548) | (36) |
| Net (loss) earnings | \$ (2,315) | \$ 2,279 | \$ (4,594) | (202)% |

Net (loss) earnings for the long-term portfolio was a loss of \$2.3 million for the nine months ended September 30, 2010, compared to earnings of \$2.3 million for the comparable period of 2009. This decrease in net earnings is primarily attributable to a \$9.7 million decrease in non-interest income-net trust assets and a \$4.5 million decrease in net interest income, offset by a \$4.8 million reduction in personnel expense and a \$4.5 million reduction in non-interest expense and income taxes.

The decrease in the fair value of net trust assets was primarily the result of the adoption of FASB ASC 820-10-65-4 during the second quarter of 2009. This clarified the use of quoted prices in determining fair values in markets that are inactive, thus moderating the need to use distressed prices in valuing financial assets and liabilities in illiquid markets as the Company used in prior periods. The Company recorded a significant increase in the fair value of net trust assets as a result of the adoption of ASC 820-10-65-4 during June of 2009. For the nine months ended September 30, 2010, the Company recognized a \$12.7 million gain from the change in fair value of net trust assets, excluding REO. The net gain recognized during the period was comprised of gains resulting from the increase in fair value of investment securities-for-sale and securitized mortgage collateral of \$653 thousand and \$606.5 million, respectively. Offsetting these gains were losses resulting from increases in the fair value of securitized mortgage borrowings and net derivative liabilities of \$552.9 million and \$41.6 million, respectively. Losses from REO were \$6.3 million for the nine months ended September 30, 2010. This loss was comprised of \$9.8 million in additional impairment write-downs during the period partially offset by \$3.5 million in gain on sale of REO. During the nine months ended September 30, 2010, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period as compared to previously reserved. The gain is attributable to mortgage insurance recovery collected in the period as a result of our increased loss mitigation efforts of our portfolio.

Personnel expense decreased \$4.8 million during the nine months ended September 30, 2010 as a result of reduced personnel associated with the long-term portfolio segment of the Company.

Non-interest expense and income taxes decreased \$4.5 million. The decrease is attributable to a \$2.0 million reduction in income tax expense, \$1.2 million reduction in legal and professional fees as well as a \$1.3 million decrease in general and administrative expenses. The reduction in income tax expense is the result of the amount of the deferred charge amortized and/or impaired in 2009 resulting from credit losses.

Discontinued Operations

Condensed Statements of Operations Data

| | For the Three Months Ended September 30, | | | |
|---------------------------------------|--|------------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income | \$ 4 | \$ 834 | \$ (830) | (100)% |
| Loss on sale of loans | (66) | (756) | 690 | 91 |
| Provision for repurchases | (1,787) | (1,107) | (680) | (61) |
| Other non-interest income | 180 | (285) | 465 | 163 |
| Total non-interest income | (1,673) | (2,148) | 475 | 22 |
| Non-interest expense and income taxes | (384) | 462 | (846) | (183) |
| Net loss | \$ (1,285) | \$ (1,776) | \$ 491 | 28% |

Net loss from discontinued operations was \$1.3 million for the three months ended September 30, 2010, compared to a loss of \$1.8 million for the comparable period in 2009. Net interest income decreased \$830 thousand to \$4 thousand due to the reduction in loans held-for-sale as a result of the Settlement Agreement reached in October 2009.

Loss on sale of loans decreased \$690 thousand during the quarter to a loss of \$66 thousand as compared to a loss of \$756 thousand in the comparable period in 2009. The decrease in loss on sale of loans was the result of reduced sale activity between periods.

Provision for repurchases increased \$680 thousand to a provision of \$1.8 million for the three months ended September 30, 2010, compared to a provision of \$1.1 million for the same period in 2009. The \$680 thousand increase is the result of increases in estimated repurchase obligations during 2010. During the third quarter, consistent with other mortgage lenders, we received repurchase requests from Fannie Mae for loans funded primarily in 2007 resulting in an increase in our repurchase reserve to \$8.7 million at September 30, 2010.

The \$465 thousand increase in other non-interest income is primarily the result of gains of \$215 thousand on sales of REO properties not in trusts during the three months ended September 30, 2010 as compared to loss on sale of REO properties and write-downs of REO totaling \$285 thousand for the comparable period in 2009.

Non-interest expense and income taxes decreased \$846 thousand. The decrease is primarily attributable to a \$665 thousand recovery in legal and professional expenses.

Condensed Statements of Operations Data

| | For the Nine Months Ended September 30, | | | |
|--|---|------------|------------------------|-------------|
| | 2010 | 2009 | Increase (Decrease) | % Change |
| Net interest income (expense) | \$ 48 | \$ (244) | \$ 292 | 120% |
| Gain (loss) on sale of loans | 18 | (8,767) | 8,785 | 100 |
| (Provision) recoveries for repurchases | (2,151) | 68 | (2,219) | (3263) |
| Other non-interest income | 2,593 | (2,229) | 4,822 | 216 |
| Total non-interest income | 460 | (10,928) | 11,388 | 104 |
| Lease impairment adjustment | (357) | (2,418) | 2,061 | 85 |
| Non-interest expense and income taxes | (1,040) | (388) | (652) | (168) |
| Net earnings (loss) | \$ 1,905 | \$ (8,366) | \$ 10,271 | 123% |

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Net earnings from discontinued operations was \$1.9 million for the nine months ended September 30, 2010, compared to a loss of \$8.4 million for the comparable period in 2009. Net interest income increased \$292 thousand to \$48 thousand as a result of reductions in overall interest expense from the previous reverse repurchase facility that was settled as a result of the Settlement Agreement reached in October 2009.

Gain (loss) on sale of loans increased \$8.8 million to a gain of \$18 thousand for the nine months ended September 30, 2010 as compared to a loss of \$8.8 million in the comparable period in 2009. The decrease in loss on sale of loans was the result of reductions in LOCOM adjustments against loans held-for-sale between periods resulting from the Settlement Agreement in October 2009 with its reverse repurchase facility lender which removed the exposure associated with the loans held for sale that secured the line.

(Provision) recoveries for repurchases decreased \$2.2 million to a provision of \$2.2 million for the nine months ended September 30, 2010, compared to a recovery of \$68 thousand for the same period in 2009. The \$2.2 million decrease is the result of settlements reached with whole-loan investors during 2009, coupled with increases in estimated repurchase obligations during 2010. During the third quarter, consistent with other mortgage lenders, we received repurchase requests from Fannie Mae for loans funded primarily in 2007 resulting in an increase in our repurchase reserve to \$8.7 million at September 30, 2010.

The \$4.8 million increase in other non-interest income is primarily the result of gains of \$1.9 million on sales of REO properties not in trusts and recovery of REO write-downs during the nine months ended September 30, 2010 as compared to loss on sale of REO and write-downs of REO totaling \$2.2 million for the comparable period in 2009.

The \$2.1 million increase in lease impairment adjustment during the nine months ended September 30, 2010 over the comparable period was primarily attributable to a \$2.4 million gain in the second quarter of 2009 resulting from reduction in the lease liabilities as a result of changes in our expected minimum future lease payments.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide the information required by this Item.

ITEM 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As required by Rules 13a-15 and 15d-15 under the Exchange Act, in connection with the filing of this Quarterly Report on Form 10-Q, our management, under the supervision and with the participation of our CEO and CFO, conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e). Based on that evaluation, the Company's chief executive officer and chief financial officer concluded that, as of that date, the Company's disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the Company's quarter ended September 30, 2010, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION**ITEM 1: LEGAL PROCEEDINGS**

The Company is party to litigation and claims which arise in the ordinary course of business.

Please refer to IMH's reports on Form 10-K for the year ended December 31, 2009 and Forms 10-Q for the quarters ended June 30, 2010 and March 31, 2010 for a description of litigation and claims.

ITEM 1A: RISK FACTORS

Our Annual Report on Form 10-K for the year ended December 31, 2009 and our quarterly reports on Form 10-Q for the period ended March 31, 2010, include a detailed discussion of our risk factors. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

Representations and warranties made by us in our loan sales and securitizations may subject us to liability.

In connection with our loan sales to third parties and our prior securitizations, we transferred mortgages acquired and originated by us to the third parties or into a trust in exchange for cash and, in the case of a securitized mortgage, residual certificates issued by the trust. The trustee, purchaser, bondholder, or other entities involved in the issuance of the securities (which may include bond insurers) may have recourse to us with respect to the breach of the representations, and warranties made by us at the time such mortgages are transferred or when the securities are sold. Those representations and warranties may include, but are not limited to, issues such as the validity of the lien, the absence of liens or delinquent taxes, the validity of the appraisal obtained in conjunction with the loan, the truthfulness of information used in the loan approval process, the loans compliance with all local, state and federal laws, the delivery of all documents required to perfect title to the lien, the loan meeting all underwriting criteria and the selection process used to include the loans in any particular transaction. Also, we previously engaged in bulk whole loan sales pursuant to agreements that generally provide for recourse by the purchaser against us in the event of a breach of one of our representations or warranties, any fraud or misrepresentation during the mortgage origination process, or upon early default on such mortgage. We attempted to limit the potential remedies of such purchasers to the potential remedies we received from those from whom we acquired or originated the mortgages. However, in some cases, the remedies available to a purchaser of mortgages from us may be broader or extend longer than those available to us against others whom we have sold mortgage loans to us and should a purchaser enforce its remedies against us, we are not always able to enforce whatever remedies we have against others. Furthermore, if we discover, prior to the sale or transfer of a loan, that there is any fraud or misrepresentation with respect to the mortgage and the originator fails to repurchase the mortgage, then we may not be able to sell the mortgage or we may have to sell the mortgage at a discount.

There has been recent litigation in the mortgage industry related to securitizations.

As defaults, delinquencies, foreclosures, and losses in the real estate market continue, there have been recent lawsuits by various investors, insurers, underwriters and others against various participants in securitizations, such as sponsors, depositors, underwriters, and loan sellers. Some lawsuits have alleged that the mortgage loans had origination defects, that there were misrepresentations made about the mortgage loans and the parties failed to properly disclose the quality of the mortgage loans or repurchase defective loans or that there were other misrepresentations, lack of representations, or errors in securitization documents. There have been other claims contending errors or misrepresentations in the securitization documents or process itself. Historically, we both securitized and sold mortgage loans to third parties that may have been deposited or included in pools for securitizations. We have recently discovered discrepancies in our securitization documents and are working with the parties involved, including holders of the securities, on the issue. To the extent that we are not successful in correcting the discrepancies or even if we are successful and make revisions to correct the discrepancies, we may be subject to liability. Recently the trustee of three of our securitizations has filed actions in the Superior Court of the State of California, County of Orange, seeking instructions on how to resolve the ambiguities, inconsistencies in and/or omissions by modifying or reforming the securitizations documents to be consistent. Although the petitions do not seek any affirmative recovery from us, the outcome of that litigation may have an effect on us. In connection with these potential claims, we may be asked to repurchase these mortgage loans, provide indemnification against such claims or we may become subject to litigation related to the securitizations. As a result, we may incur significant legal and other expenses in defending against claims and litigation and we may be required to pay settlement costs, damages, penalties or other charges which could adversely affect our financial results.

Our performance may be adversely affected by the performance of parties who service or sub-service our mortgage loans.

We sell or contract with third-parties for the servicing of all our mortgage loans. Our operations, performance and liabilities are subject to risks associated with inadequate or untimely servicing. Poor performance by a servicer may result in greater than expected delinquencies and losses on our mortgage loans or in our resulting exposure to investors, bond holders, bond insurers or others as we are responsible for the performance of our loan servicers. If we, or our servicers, commit a material breach of our obligations as a servicer or master servicer, we may be subject to termination if the breach is not cured within a specified period of time following notice, causing us to lose master servicing income. In addition, we may be required to indemnify the securitization trustee against losses from any failure by us, as master servicer or on behalf of the servicer, to perform the servicing obligations properly. Recent announcements of deficiencies in foreclosure documentation by several large servicers have raised various concerns relating to foreclosure practices. We are working with all of our servicers to identify deficient foreclosure practices. A number of our servicers, including several of our largest ones, have temporarily suspended foreclosure proceedings in some or all states in which they do business while they conduct their evaluations. We are also evaluating the impact of these foreclosure practices on our REO properties and the servicers have suspended certain REO sales and eviction proceedings for REO properties pending the completion of the evaluation. Issues have also been identified with respect to practices of certain legal counsel involved in the foreclosure process and in the use of the mortgage electronic registration system as a foreclosing party or as a listed beneficiary of a mortgage. We expect that these issues and the related foreclosure suspensions could prolong the foreclosure process nationwide and may delay sales of our REO properties and

hence affect the performance of our securities. Continued foreclosure delays and other disruptions in the real estate market may result in a material adverse impact to our financial results.

Also, 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 mortgage loans subject to a securitization, greater delinquencies would adversely affect the value of our residual interest, if any, we hold in connection with that securitization.

In a securitization, relevant agreements permit us to be terminated as servicer or master servicer under specific conditions described in these agreements. If, as a result of a servicer or sub-servicer's failure to perform adequately, we were terminated as master servicer of a securitization, the value of any master servicing rights held by us could be adversely affected.

ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3: DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4: RESERVED

None.

ITEM 5: OTHER INFORMATION

None

ITEM 6: EXHIBITS

(a) Exhibits:

- 31.1 Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1* Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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SIGNATURES

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

IMPAC MORTGAGE HOLDINGS, INC.

/s/ TODD R. TAYLOR

Todd R. Taylor

Chief Financial Officer

(authorized officer of registrant and principal financial officer)

November 15, 2010

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CERTIFICATION

I, Joseph R. Tomkinson, certify that:

1. I have reviewed this report on Form 10-Q of Impac Mortgage Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JOSEPH R. TOMKINSON

Joseph R. Tomkinson
Chief Executive Officer
November 15, 2010

CERTIFICATION

I, Todd R. Taylor, certify that:

1. I have reviewed this report on Form 10-Q of Impac Mortgage Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ TODD R. TAYLOR

Todd R. Taylor

Chief Financial Officer

November 15, 2010

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the report of Impac Mortgage Holdings, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned, in the capacities and on the dates indicated below, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JOSEPH R. TOMKINSON

Joseph R. Tomkinson
Chief Executive Officer
November 15, 2010

/s/ TODD R. TAYLOR

Todd R. Taylor
Chief Financial Officer
November 15, 2010
