

IMPAC MORTGAGE HOLDINGS INC  
Form 10-Q  
May 15, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2012**

**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)

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**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  No

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  No

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

Accelerated filer

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

Smaller reporting company

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

There were 7,845,146 shares of common stock outstanding as of May 11, 2012.

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**IMPAC MORTGAGE HOLDINGS, INC.**

**FORM 10-Q QUARTERLY REPORT**

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(in thousands, except share data)

|   | March 31,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|---|----------------------------------|----------------------|
| <b>ASSETS</b>   |                                  |                      |
| Cash and cash equivalents   | \$ 7,302                         | \$ 7,653             |
| Restricted cash   | 1,404                            | 5,019                |
| Trust assets  |                                  |                      |
| Investment securities available-for-sale  | 189                              | 688                  |
| Securitized mortgage collateral   | 5,573,365                        | 5,449,001            |
| Derivative assets   | 38                               | 37                   |
| Real estate owned   | 50,064                           | 56,467               |
| Total trust assets  | 5,623,656                        | 5,506,193            |
| Mortgage loans held-for-sale  | 58,916                           | 61,718               |
| Assets of discontinued operations   | 316                              | 264                  |
| Other assets  | 32,398                           | 31,193               |
| Total assets  | \$ 5,723,992                     | \$ 5,612,040         |
| <b>LIABILITIES</b>  |                                  |                      |
| Trust liabilities   |                                  |                      |
| Securitized mortgage borrowings   | \$ 5,579,512                     | \$ 5,454,901         |
| Derivative liabilities  | 21,685                           | 24,786               |
| Total trust liabilities   | 5,601,197                        | 5,479,687            |
| Warehouse borrowings  | 55,415                           | 58,691               |
| Long-term debt  | 12,163                           | 11,561               |
| Notes payable   | 6,797                            | 5,182                |
| Liabilities of discontinued operations  | 9,966                            | 9,932                |
| Other liabilities   | 11,895                           | 15,890               |
| Total liabilities   | 5,697,433                        | 5,580,943            |
| Commitments and contingencies   |                                  |                      |
| <b>STOCKHOLDERS EQUITY</b>  |                                  |                      |
| Series A junior participating preferred stock, \$0.01 par value; 2,500,000 shares authorized; none issued or outstanding  |                                  |                      |
| Series B 9.375% redeemable preferred stock, \$0.01 par value; liquidation value \$16,904; 2,000,000 shares authorized, 665,592 noncumulative shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively | 7                                | 7                    |

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Series C 9.125% redeemable preferred stock, \$0.01 par value; liquidation value \$35,389; 5,500,000 shares authorized; 1,405,086 noncumulative shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively

|   |              |              |
|---|--------------|--------------|
|   | 14           | 14           |
| Common stock, \$0.01 par value; 200,000,000 shares authorized; 7,835,746 and 7,814,946 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively | 78           | 78           |
| Additional paid-in capital  | 1,076,799    | 1,076,723    |
| Net accumulated deficit:  |              |              |
| Cumulative dividends declared   | (822,520)    | (822,520)    |
| Retained deficit  | (229,124)    | (224,334)    |
| Net accumulated deficit   | (1,051,644)  | (1,046,854)  |
| Total Impac Mortgage Holdings, Inc. stockholders' equity  | 25,254       | 29,968       |
| Noncontrolling interests  | 1,305        | 1,129        |
| Total equity  | 26,559       | 31,097       |
| Total liabilities and stockholders' equity  | \$ 5,723,992 | \$ 5,612,040 |

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<br>Ended March 31, |            |
|--|---|------------|
|  | 2012                                    | 2011       |
| <b>INTEREST INCOME</b>                                       | \$ 142,792                              | \$ 218,082 |
| <b>INTEREST EXPENSE</b>                                      | 141,738                                 | 216,547    |
| Net interest income  | 1,054                                   | 1,535      |
| <b>NON-INTEREST INCOME:</b>                                  |   |            |
| Change in fair value of net trust assets, excluding REO      | 6,400                                   | 4,896      |
| Losses from REO  | (9,427)                                 | (4,249)    |
| Non-interest (loss) income - net trust assets                | (3,027)                                 | 647        |
| Mortgage and real estate services fees                       | 14,036                                  | 12,240     |
| Other  | (615)                                   | (17)       |
| Total non-interest income                                    | 10,394                                  | 12,870     |
| <b>NON-INTEREST EXPENSE:</b>                                 |   |            |
| Personnel expense  | 10,485                                  | 10,766     |
| General, administrative and other                            | 4,219                                   | 4,579      |
| Total non-interest expense                                   | 14,704                                  | 15,345     |
| Loss from continuing operations before income taxes          | (3,256)                                 | (940)      |
| Income tax expense from continuing operations                | 30                                      | 12         |
| Loss from continuing operations                              | (3,286)                                 | (952)      |
| Loss from discontinued operations, net of tax                | (1,268)                                 | (350)      |
| Net loss   | (4,554)                                 | (1,302)    |
| Net (earnings) loss attributable to noncontrolling interests | (236)                                   | 315        |
| Net loss attributable to IMH                                 | \$ (4,790)                              | \$ (987)   |
| Loss per common share - basic and diluted:                   |   |            |
| Loss from continuing operations attributable to IMH          | \$ (0.45)                               | \$ (0.08)  |
| Loss from discontinued operations                            | (0.16)                                  | (0.04)     |
| Net loss per share available to common stockholders          | \$ (0.61)                               | \$ (0.12)  |

See accompanying notes to consolidated financial statements

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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

|  | For the Three Months<br>Ended March 31, |            |
|--|---|------------|
|  | 2012                                    | 2011       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                   |   |            |
| Net loss   | \$ (4,554)                              | \$ (1,302) |
| Losses from REO  | 9,427                                   | 4,249      |
| Extinguishment of debt   | 423                                     |            |
| Change in fair value of mortgage servicing rights                              | (257)                                   | 99         |
| Gain on sale of loans  | (8,650)                                 | (90)       |
| Change in fair value of mortgage loans held-for-sale                           | 533                                     | (625)      |
| Provision for repurchases  | 293                                     | 117        |
| Origination of mortgage loans held-for-sale                                    | (354,033)                               | (53,444)   |
| Sale and principal reduction on mortgage loans held-for-sale                   | 362,498                                 | 26,554     |
| Change in fair value of net trust assets, excluding REO                        | (10,167)                                | (21,950)   |
| Change in fair value of long-term debt   | 93                                      | (238)      |
| Accretion of interest income and expense                                       | 69,553                                  | 87,158     |
| Change in REO impairment reserve   | (7,785)                                 | (10,305)   |
| Stock-based compensation   | 67                                      | 76         |
| Net change in restricted cash  | 3,615                                   | (1,012)    |
| Amortization of discount on note payable                                       | 89                                      |            |
| Net cash provided by (used in) operating activities of discontinued operations | 26                                      | (1,076)    |
| Net change in other assets and liabilities                                     | 1,340                                   | (1,741)    |
| Net cash provided by operating activities                                      | 62,511                                  | 26,470     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                   |   |            |
| Net change in securitized mortgage collateral                                  | 136,934                                 | 178,988    |
| Net change in mortgages held-for-investment                                    | 3                                       | 3          |
| Purchase of premises and equipment   | (33)                                    | (351)      |
| Net principal change on investment securities available-for-sale               | 69                                      | 56         |
| Proceeds from the sale of real estate owned                                    | 26,763                                  | 49,736     |
| Net cash provided by investing activities                                      | 163,736                                 | 228,432    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                   |   |            |
| Repayment of warehouse borrowings  | (350,228)                               | (25,675)   |
| Borrowings under warehouse agreement   | 346,952                                 | 55,884     |
| Repayment of line of credit  | (5,500)                                 |            |
| Borrowings under line of credit  | 1,500                                   |            |
| Repayment of securitized mortgage borrowings                                   | (220,239)                               | (287,146)  |
| Issuance of note payable   | 7,500                                   |            |
| Principal payments on notes payable  | (6,457)                                 | (1,826)    |
| Principal payments on capital lease  | (91)                                    |            |
| Proceeds from exercise of stock options  | 9                                       |            |
| Net cash used in financing activities  | (226,554)                               | (258,763)  |



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|  |          |          |
|--|----------|----------|
| Net change in cash and cash equivalents                            | (307)    | (3,861)  |
| Cash and cash equivalents at beginning of year                     | 7,665    | 11,620   |
| Cash and cash equivalents at end of year - continuing operations   | 7,302    | 7,750    |
| Cash and cash equivalents at end of year - discontinued operations | 56       | 9        |
| Cash and cash equivalents at end of year                           | \$ 7,358 | \$ 7,759 |

**NON-CASH TRANSACTIONS (Continuing and Discontinued Operations):**

|  |           |           |
|--|-----------|-----------|
| Transfer of securitized mortgage collateral to real estate owned | \$ 22,002 | \$ 25,735 |
| Acquisition of equipment purchased through capital leases        | 199       |           |

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, Market Conditions, and Financial Statement Presentation**

***Business Summary***

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

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

The information set forth in these notes is presented on a continuing operations basis, unless otherwise stated.

***Market Update and Liquidity***

While there were positive economic signs during the first quarter of 2012, the United States economy continues to face a number of challenges. Employment conditions began to show signs of improvement during the first quarter. Unemployment continues to be on a favorable downward trend, although still remains high above 8%. However, according to the Wall Street Journal, most of the declines were due to more Americans leaving the work force. As economic recovery continues at a slow rate, Federal Reserve policymakers currently anticipate that economic conditions are likely to warrant exceptionally low levels for the federal funds interest rate at least through late 2014.

Real estate activity showed some encouraging signs of stability although home prices continued to decline in many parts of the U.S. during the first quarter. Although the pace of new foreclosures has fallen from its peak, in part due to industry-wide compliance issues, further declines in home prices may be necessary before substantial progress in reducing the inventory of homes occurs. Serious threats to economic growth remain however, including continued pressure and uncertainty in the housing market and elevated unemployment levels. Although the economy added jobs in 2012, the pace of new job creation continues to be slower than needed to meaningfully reduce unemployment. As a result, there continues to be uncertainty as to how pronounced the economic recovery will be and whether it can be sustained.

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The Company believes that current cash balances, cash flows from its mortgage lending activities, mortgage and real estate services fees generated from the long-term mortgage portfolio, and residual interest cash flows from the long-term mortgage portfolio are adequate for current operating needs. However, the Company believes the mortgage lending and real estate services markets are volatile, highly competitive and subject to increased regulation. Competition in mortgage lending comes primarily from mortgage bankers, commercial banks, credit unions and other finance companies which have offices in the Company's market area as well as operations throughout the United States. The Company competes for loans principally on the basis of the interest rates and loan fees charged, the types of loans originated and the quality of services provided to borrowers. Additionally, competition for real estate recovery services, loss mitigation servicing, loan modification services and other portfolio services has increased due to the unprecedented difficult mortgage environment and severe credit tightening, coupled with the stagnant economy. The Company's competitors include large mortgage servicers, established special servicers, and newer entrants to the specialty servicing and recovery collections business. Efforts to market the Company's ability to provide mortgage and real estate services for others is more difficult than many of its competitors because the Company has not historically provided such services to unrelated third parties, and the Company is not a rated primary or special servicer of residential mortgage loans as designated by a rating agency. Additionally, performance of the long-term mortgage portfolio is subject to the continued deterioration in the real estate market and current economic conditions. Cash flows from the residual interests in securitizations can be volatile, because they are sensitive to delinquencies, defaults and credit losses associated with the securitized loans and interest rates associated with the securitized bonds. Losses in excess of current estimates will reduce the residual interest cash receipts from the long-term mortgage portfolio.

### *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

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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 months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011, 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, mortgage servicing rights and mortgage loans held-for-sale. Actual results could differ from those estimates and assumptions.

***Recently Adopted Accounting Pronouncements***

In September 2011, the FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment*. Under this new standard, entities testing goodwill for impairment now have an option of performing a qualitative assessment before having to calculate the fair value of a reporting unit. If an entity determines, on the basis of qualitative factors, that the fair value of the reporting unit is more-likely-than-not less than the carrying amount, the existing quantitative impairment test is required. Otherwise, no further impairment testing is required. This ASU was effective beginning January 1, 2012, with early adoption permitted under certain conditions. The adoption of this standard did not have a material impact on the Company's consolidated results of operations or financial condition.

In May 2011, the Financial Accounting Standards Board ( FASB ) issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 amends guidance listed under ASC Topic 820, *Fair Value Measurement*, and represents the converged guidance of the FASB and the International Accounting Standards Board on fair value measurement. This Update also permits entities to measure fair value on a net basis for financial instruments that are managed based on net exposure to market risks and/or counterparty credit risk. ASU 2011-04 requires new disclosures for financial instruments classified as Level 3, including: 1) quantitative information about unobservable inputs used in measuring fair value, 2) qualitative discussion of the sensitivity of fair value measurements to changes in unobservable inputs, and 3) a description of valuation processes used. This update also requires disclosure of fair value levels for financial instruments that are not recorded at fair value but for which fair value is required to be disclosed. ASU 2011-04 became effective prospectively for interim and annual periods beginning after December 15, 2011. The Company has conformed to the new disclosures required in ASU 2011-04 during the first quarter of 2012.

***Legal Proceedings***

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The Company is a defendant in or a party to a number of legal actions or proceedings that arise in the ordinary course of business. In some of these actions and proceedings, claims for monetary damages are asserted against the Company. In view of the inherent difficulty of predicting the outcome of such legal actions and proceedings, the Company generally cannot predict what the eventual outcome of the pending matters will be, what the timing of the ultimate resolution of these matters will be, or what the eventual loss related to each pending matter may be, if any.

In accordance with applicable accounting guidance, the Company establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and estimable. In any case, there may be an exposure to losses in excess of any such amounts whether accrued or not. Any estimated loss is subject to significant judgment and is based upon currently available information, a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimated loss will change from time to time, and actual results may vary significantly from the current estimate. Therefore, an estimate of possible loss represents what the Company believes to be an estimate of possible loss only for certain matters meeting these criteria. It does not represent the Company's maximum loss exposure. At March 31, 2012, the Company does not have an accrued liability recorded for such estimated loss exposure.

Based on the Company's current understanding of these pending legal actions and proceedings, management cannot ascertain whether the judgments or settlements arising from pending or threatened legal matters, individually or in the aggregate, will have a material adverse effect on the consolidated financial position, operating results or cash flows of the Company. However, in light of the inherent uncertainties involved in these matters, some of which are beyond the Company's control, and the very large or indeterminate damages sought in some of these matters, an adverse outcome in one or more of these matters could be material to the Company's results of operations or cash flows for any particular reporting period.

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Updates to legal matters since the filing of our Form 10-K for the year ended December 31, 2011 are as follows:

On April 30, 2012 a matter was filed in the Superior Court of the State of California, Orange County entitled Rene Marentes and Martha Marentes v. Impac Mortgage Holdings, Inc. The complaint is a putative class action matter contending that certain loan modification activities of the company constitute an unfair business practice, that they constitute false advertising and marketing and that the fees charged are improper. The complaint seeks unspecified damages, restitution, injunctive relief, attorney's fees and pre-judgment interest.

On May 26, 2011, a matter was filed in the United States District Court, Central District of California as Case No. CV11-4514 DSF entitled Citigroup Global Markets, Inc. v. Impac Secured Assets Corp., Impac Funding Corporation and Impac Mortgage Holdings, Inc. The action alleges a violation of Section 18 and Section 20 of the Securities and Act of 1933 and negligent misrepresentation, all involved in the issuance and sale of bonds from a securitization trust. The plaintiff alleges they relied on certain documents filed with the Securities and Exchange Commission (SEC) that were subsequently the subject of an amended filing. The matter seeks unspecified damages, interest, legal fees and litigation expenses. On May 3, 2012, the Court granted a motion by the plaintiffs for partial summary judgment except with respect to the negligent misrepresentation claim against Impac Mortgage Holdings, Inc.

## **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.

The following table presents the estimated fair value of financial instruments included in the consolidated financial statements as of the dates indicated:

|                                 | March 31, 2012     |                         | December 31, 2011  |                         |
|---------------------------------|--------------------|-------------------------|--------------------|-------------------------|
|                                 | Carrying<br>Amount | Estimated<br>Fair Value | Carrying<br>Amount | Estimated<br>Fair Value |
| <b><u>Assets</u></b>            |                    |                         |                    |                         |
| Cash and cash equivalents       | \$ 7,302           | \$ 7,302                | \$ 7,653           | \$ 7,653                |
| Restricted cash                 | 1,404              | 1,404                   | 5,019              | 5,019                   |
| Investment securities           |                    |                         |                    |                         |
| available-for-sale              | 189                | 189                     | 688                | 688                     |
| Securitized mortgage collateral | 5,573,365          | 5,573,365               | 5,449,001          | 5,449,001               |
| Derivative assets, securitized  |                    |                         |                    |                         |
| trusts                          | 38                 | 38                      | 37                 | 37                      |
| Derivative assets, lending      | 1,674              | 1,674                   | 1,179              | 1,179                   |
| Mortgage servicing rights       | 4,807              | 4,807                   | 4,141              | 4,141                   |
| Mortgage loans held-for-sale    | 58,916             | 58,916                  | 61,718             | 61,718                  |
| Call option                     | 280                | 280                     | 253                | 253                     |
| <b><u>Liabilities</u></b>       |                    |                         |                    |                         |
| Securitized mortgage borrowings | 5,579,512          | 5,579,512               | 5,454,901          | 5,454,901               |
|                                 | 21,685             | 21,685                  | 24,786             | 24,786                  |

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Derivative liabilities, securitized

trusts

|                                 |        |        |        |        |
|---------------------------------|--------|--------|--------|--------|
| Derivative liabilities, lending |        |        | 624    | 624    |
| Long-term debt                  | 12,163 | 12,163 | 11,561 | 11,561 |
| Warehouse borrowings            | 55,415 | 55,415 | 58,691 | 58,691 |
| Notes payable                   | 6,797  | 6,797  | 5,182  | 5,941  |
| Line of credit                  |        |        | 4,000  | 4,000  |

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.

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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.

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, long-term debt, mortgage servicing rights, loans held-for-sale, and call and put options.

The carrying amount of cash and cash equivalents and restricted cash approximates fair value.

Warehouse borrowings fair value approximates carrying amounts due to the short-term nature of the liabilities and do not present unanticipated interest rate or credit concerns.

Line of credit fair value approximates carrying amount due to the short-term nature of the liability and does not present unanticipated interest rate or credit concerns.

Notes payable includes notes with maturities ranging from less than a year to three years. Notes payable is recorded at amortized cost, net of any discounts. The estimated fair value is determined using a discounted cash flow model using estimated market rates.

***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.



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- 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 securitized trusts, long-term debt, mortgage servicing rights, and call and put options as Level 3 fair value measurements. Level 3 assets and liabilities were 99% and 100%, respectively, of total assets and total liabilities measured at estimated fair value at March 31, 2012 and December 31, 2011.

Table of Contents***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 months ended March 31, 2012.

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 March 31, 2012 and December 31, 2011, based on the fair value hierarchy:

|   | Recurring Fair Value Measurements |                           |              |         |                              |              |
|---|-----------------------------------|---------------------------|--------------|---------|------------------------------|--------------|
|   | Level 1                           | March 31, 2012<br>Level 2 | Level 3      | Level 1 | December 31, 2011<br>Level 2 | Level 3      |
| <b>Assets</b>                                       |                                   |                           |              |         |                              |              |
| Investment securities available-for-sale            | \$                                | \$                        | \$ 189       | \$      | \$                           | \$ 688       |
| Mortgage loans held-for-sale                        |                                   | 58,916                    |              |         | 61,718                       |              |
| Derivative assets, net, lending (1)                 |                                   | 1,674                     |              |         | 555                          |              |
| Mortgage servicing rights (2)                       |                                   |                           | 4,807        |         |                              | 4,141        |
| Call option (2)                                     |                                   |                           | 280          |         |                              | 253          |
| Securitized mortgage collateral                     |                                   |                           | 5,573,365    |         |                              | 5,449,001    |
| Total assets at fair value                          | \$                                | \$ 60,590                 | \$ 5,578,641 | \$      | \$ 62,273                    | \$ 5,454,083 |
| <b>Liabilities</b>                                  |                                   |                           |              |         |                              |              |
| Securitized mortgage borrowings                     | \$                                | \$                        | \$ 5,579,512 | \$      | \$                           | \$ 5,454,901 |
| Derivative liabilities, net, securitized trusts (3) |                                   |                           | 21,647       |         |                              | 24,749       |
| Long-term debt                                      |                                   |                           | 12,163       |         |                              | 11,561       |
| Total liabilities at fair value                     | \$                                | \$                        | \$ 5,613,322 | \$      | \$                           | \$ 5,491,211 |

(1) At March 31, 2012, derivative assets, net, lending, included \$1.6 million in interest rate lock commitments (IRLCs) and \$118 thousand in hedging instruments, respectively, associated with the Company's mortgage lending operations, and is included in other assets and other liabilities in the accompanying consolidated balance sheets.

(2) Included in other assets in the accompanying consolidated balance sheets.

(3) At March 31, 2012, derivative liabilities, net securitized trusts, included \$38 thousand in derivative assets and \$21.7 million in derivative liabilities, included within trust assets and trust liabilities, respectively. At December 31, 2011, derivative liabilities, net securitized trusts, included \$37 thousand in derivative assets and \$24.8 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

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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 months ended March 31, 2012 and 2011:

|  | Level 3 Recurring Fair Value Measurements<br>For the three months ended March 31, 2012 |                                       |                                       |                                |                                 |                |                   |
|--|--|---------------------------------------|---------------------------------------|--------------------------------|---------------------------------|----------------|-------------------|
|  | Investment<br>securities available-<br>for-sale  | Securitized<br>mortgage<br>collateral | Securitized<br>mortgage<br>borrowings | Derivative<br>liabilities, net | Mortgage<br>servicing<br>rights | Call<br>option | Long-term<br>debt |
| Fair value,<br>December 31,<br>2011              | \$ 688   | \$ 5,449,001                          | \$ (5,454,901)                        | \$ (24,749)                    | \$ 4,141                        | \$ 253         | \$ (11,561)       |
| Total gains<br>(losses) included<br>in earnings: |  |                                       |                                       |                                |                                 |                |                   |
| Interest income<br>(1)                           | 13   | 51,940                                |                                       |                                |                                 |                |                   |
| Interest expense<br>(1)                          |  |                                       | (120,997)                             |                                |                                 |                | (509)             |
| Change in fair<br>value                          | (443)  | 231,360                               | (223,956)                             | (561)                          | 257                             | 27             | (93)              |
| Total gains<br>(losses) included<br>in earnings  | (430)  | 283,300                               | (344,953)                             | (561)                          | 257                             | 27             | (602)             |
| Transfers in<br>and/or out of<br>Level 3         |  |                                       |                                       |                                |                                 |                |                   |
| Purchases,<br>issuances and<br>settlements       |  |                                       |                                       |                                |                                 |                |                   |
| Purchases  |  |                                       |                                       |                                |                                 |                |                   |
| Issuances  |  |                                       |                                       |                                | 2,454                           |                |                   |
| Settlements                                      | (69)   | (158,936)                             | 220,342                               | 3,663                          | (2,045)                         |                |                   |
| Fair value,<br>March 31, 2012                    | \$ 189   | \$ 5,573,365                          | \$ (5,579,512)                        | \$ (21,647)                    | \$ 4,807                        | \$ 280         | \$ (12,163)       |
| Unrealized gains<br>(losses) still held<br>(2)   | \$ 72  | \$ (3,685,532)                        | \$ 5,694,493                          | \$ (20,884)                    | \$                              | \$             | \$ 58,600         |

(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 \$1.1 million for the three months ended March 31, 2012, as reflected in the accompanying consolidated statement of operations. The difference between accretion of interest income and expense and the amounts of interest income and expense recognized in the consolidated statements of operations is primarily from contractual interest on the securitized mortgage collateral and borrowings.

(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 March 31, 2012.

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|  | Level 3 Recurring Fair Value Measurements<br>For the three months ended March 31, 2011 |                                 |                                 |                             |                           |             |            |                |  |
|--|--|---------------------------------|---------------------------------|-----------------------------|---------------------------|-------------|------------|----------------|--|
|  | Investment securities available-for-sale   | Securitized mortgage collateral | Securitized mortgage borrowings | Derivative liabilities, net | Mortgage servicing rights | Call option | Put option | Long-term debt |  |
| Fair value, December 31, 2010              | \$ 645   | \$ 6,011,675                    | \$ (6,012,745)                  | \$ (65,876)                 | \$ 1,439                  | \$ 706      | \$ (61)    | \$ (11,728)    |  |
| Total gains (losses) included in earnings: |  |                                 |                                 |                             |                           |             |            |                |  |
| Interest income (1)                        | 28   | 107,369                         |                                 |                             |                           |             |            |                |  |
| Interest expense (1)                       |  |                                 | (194,015)                       |                             |                           |             |            | (540)          |  |
| Change in fair value                       | (202)  | 139,446                         | (137,278)                       | 2,930                       | (99)                      | (223)       |            | 238            |  |
| Total gains (losses) included in earnings  | (174)  | 246,815                         | (331,293)                       | 2,930                       | (99)                      | (223)       |            | (302)          |  |
| Transfers in and/or out of Level 3         |  |                                 |                                 |                             |                           |             |            |                |  |
| Purchases, issuances and settlements       |  |                                 |                                 |                             |                           |             |            |                |  |
| Purchases                                  |  |                                 |                                 |                             |                           |             |            |                |  |
| Issuances                                  |  |                                 |                                 |                             |                           |             |            |                |  |
| Settlements                                | (56)   | (204,724)                       | 287,461                         | 16,741                      |                           |             |            |                |  |
| Fair value, March 31, 2011                 | \$ 415   | \$ 6,053,766                    | \$ (6,056,577)                  | \$ (46,205)                 | \$ 1,340                  | \$ 483      | \$ (61)    | \$ (12,030)    |  |
| Unrealized gains (losses) still held (2)   | \$ 202   | \$ (4,342,090)                  | \$ 6,222,257                    | \$ (46,475)                 | \$                        | \$          | \$         | \$ 58,733      |  |

(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 \$1.5 million for the three months ended March 31, 2011, 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 March 31, 2011.

The following table presents quantitative information about the valuation techniques and unobservable inputs applied to Level 3 fair value measurements for financial instruments measured at fair value on a recurring and non-recurring basis at March 31, 2012.

| Financial Instrument   | Estimated Fair Value     | Valuation Technique | Unobservable Input                                   | Range of Inputs                            |
|--|--------------------------|---------------------|--|--|
| <b><u>Assets and liabilities backed by real estate</u></b>           |                          |                     |  |  |
| Investment securities available-for-sale,                            | \$ 189                   |                     | Discount rates                                       | 6.00 - 30.0%                               |
| Securitized mortgage collateral, and Securitized mortgage borrowings | 5,573,365<br>(5,579,512) | DCF                 | Prepayment rates<br>Default rates<br>Loss severities | 0.9 - 15.5%<br>0.23 - 8.2%<br>15.4 - 71.8% |
| <b><u>Other assets and liabilities</u></b>                           |                          |                     |  |  |
| Mortgage servicing rights  | \$ 4,807                 | DCF                 | Discount rate<br>Prepayment rates                    | 12.0%<br>11.9 - 14.7%                      |
| Derivative liabilities, net, securitized trusts                      | (21,647)                 | DCF                 | 1M forward LIBOR                                     | 0.24 - 3.8%                                |

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|                 |          |     |               |       |
|-----------------|----------|-----|---------------|-------|
| Long-term debt  | (12,163) | DCF | Discount rate | 25.0% |
| Lease Liability | (2,201)  | DCF | Discount rate | 12.0% |

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DCF = Discounted Cash Flow

1M = 1 Month

For assets and liabilities backed by real estate, a significant increase in discount rates, default rates or loss severities would result in a significantly lower estimated fair value. The impact of changes in prepayment speeds would have differing impacts depending on the seniority or other characteristics of the instrument. For other assets and liabilities, a significant increase in discount rates would result in a significantly lower estimated fair value. A significant increase in one-month LIBOR would result in a significantly higher estimated fair value for derivative liabilities, net, securitized trusts. The Company believes that the imprecision of an estimate could be significant.

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The following tables present the changes in recurring fair value measurements included in net earnings (loss) for the three months ended March 31, 2012 and 2011:

|  | Recurring Fair Value Measurements<br>Change in Fair Value Included in Net Earnings<br>For the three months ended March 31, 2012 |                         |   |   |                              |   |                    | Total |
|--|---|-------------------------|---|---|------------------------------|---|--------------------|-------|
|  | Interest<br>Income (1)  | Interest<br>Expense (1) | Change in Fair Value of<br>Net Trust Assets | Change in Fair Value of<br>Long-term Debt | Other Non-interest<br>Income | Mortgage and real<br>estate services fees |                    |       |
| Investment securities available-for-sale     | \$ 13   | \$                      | \$ (443)                                    | \$  | \$                           | \$  | \$ (430)           |       |
| Securitized mortgage collateral              | 51,940  |                         | 231,360                                     |   |                              |   | 283,300            |       |
| Securitized mortgage borrowings              |   | (120,997)               | (223,956)                                   |   |                              |   | (344,953)          |       |
| Mortgage servicing rights                    |   |                         |   |   | 257                          |   | 257                |       |
| Call option                                  |   |                         |   |   | 27                           |   | 27                 |       |
| Derivative liabilities, net                  |   |                         | (561) (2)                                   |   |                              |   | (561)              |       |
| Long-term debt                               |   | (509)                   |   | (93)                                      |                              |   | (602)              |       |
| Mortgage loans held-for-sale                 |   |                         |   |   |                              | (534)                                     | (534)              |       |
| Derivative assets - IRLCs                    |   |                         |   |   |                              | 377                                       | 377                |       |
| Derivative liabilities - Hedging Instruments |   |                         |   |   |                              | 742                                       | 742                |       |
| <b>Total</b>                                 | <b>\$ 51,953</b>  | <b>\$ (121,506)</b>     | <b>\$ 6,400 (3)</b>                         | <b>\$ (93)</b>                            | <b>\$ 284</b>                | <b>\$ 585</b>                             | <b>\$ (62,377)</b> |       |

(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.

(2) Included in this amount is \$3.2 million in change in the fair value of derivative instruments, offset by \$3.8 million in cash payments from the securitization trusts for the three months ended March 31, 2012.

(3) For the three months ended March 31, 2012, change in the fair value of trust assets, excluding REO was \$6.4 million. Excluded from the \$10.2 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$3.8 million in cash payments from the securitization trusts related to the Company's net derivative liabilities.

|  | Recurring Fair Value Measurements<br>Change in Fair Value Included in Net Loss<br>For the three months ended March 31, 2011 |                         |   |   |                              |   |          | Total |
|--|---|-------------------------|---|---|------------------------------|---|----------|-------|
|  | Interest<br>Income (1)  | Interest<br>Expense (1) | Change in Fair Value of<br>Net Trust Assets | Change in Fair Value of<br>Long-term Debt | Other Non-interest<br>Income | Mortgage and real<br>estate services fees |          |       |
| Investment securities available-for-sale | \$ 28   | \$                      | \$ (202)                                    | \$  | \$                           | \$  | \$ (174) |       |
|  | 107,369   |                         | 139,446                                     |   |                              |   | 246,815  |       |

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|                                 |           |                |           |                  |           |                  |           |            |           |              |           |            |           |                 |
|---------------------------------|-----------|----------------|-----------|------------------|-----------|------------------|-----------|------------|-----------|--------------|-----------|------------|-----------|-----------------|
| Securitized mortgage collateral |           |                |           |                  |           |                  |           |            |           |              |           |            |           |                 |
| Securitized mortgage borrowings |           | (194,015)      | (137,278) |                  |           |                  |           |            | (331,293) |              |           |            |           |                 |
| Mortgage servicing rights       |           |                |           |                  |           | (99)             |           |            | (99)      |              |           |            |           |                 |
| Call option                     |           |                |           |                  |           | (223)            |           |            | (223)     |              |           |            |           |                 |
| Derivative liabilities, net     |           |                | 2,930 (2) |                  |           |                  |           |            | 2,930     |              |           |            |           |                 |
| Long-term debt                  |           | (540)          |           | 238              |           |                  |           |            | (302)     |              |           |            |           |                 |
| Mortgage loans held-for-sale    |           |                |           |                  |           |                  |           | 625        | 625       |              |           |            |           |                 |
| <b>Total</b>                    | <b>\$</b> | <b>107,397</b> | <b>\$</b> | <b>(194,555)</b> | <b>\$</b> | <b>4,896 (3)</b> | <b>\$</b> | <b>238</b> | <b>\$</b> | <b>(322)</b> | <b>\$</b> | <b>625</b> | <b>\$</b> | <b>(81,721)</b> |

(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.

(2) Included in this amount is \$20.0 million in change in the fair value of derivative instruments, offset by \$17.1 million in cash payments from the securitization trusts for the three months ended March 31, 2011.

(3) For the three months ended March 31, 2011, change in the fair value of trust assets, excluding REO was \$4.9 million. Excluded from the \$22.0 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$17.1 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* Investment securities available-for-sale are carried 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 March 31, 2012 and December 31, 2011, the estimated fair value of the investment securities available-for-sale was measured using significant internal expectations of market participants' assumptions. Investment securities available-for-sale are considered a Level 3 measurement at March 31, 2012.

*Mortgage servicing rights* The Company elected to carry all of its mortgage servicing rights arising from its mortgage loan origination operation at fair value. The fair value of mortgage servicing rights is based upon an internal discounted cash flow model. The valuation model incorporates assumptions that market participants would use in estimating the fair value of servicing. These assumptions include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, prepayment and late fees, among other considerations. Mortgage servicing rights are considered a Level 3 measurement at March 31, 2012.

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*Mortgage loans held-for-sale* The Company elected to carry its mortgage loans held-for-sale originated from its mortgage loan origination operation at fair value. Fair value is based on quoted market prices, where available, prices for other traded mortgage loans with similar characteristics, and purchase commitments and bid information received from market participants. Given the meaningful level of secondary market activity for conforming mortgage loans, active pricing is available for similar assets and accordingly, the Company classifies its mortgage loans held-for-sale as a Level 2 measurement at March 31, 2012.

*Call option* As part of the acquisition of AmeriHome as more fully discussed in Note 21. *Business Combinations* of our Annual Report on Form 10-K for the year ended December 31, 2011, the purchase agreement included a call option to purchase an additional 39% of AmeriHome. The estimated fair value is based on a multinomial model incorporating various assumptions including expected future book value of AmeriHome, the probability of the option being exercised, volatility, expected term and certain other factors. The call option is considered a Level 3 measurement at March 31, 2012.

*Put option* As part of the acquisition of AmeriHome, a put option which allows the noncontrolling interest holder to sell his remaining 49% of AmeriHome to the Company in the event the Company does not exercise the call option discussed above. The estimated fair value is based on a multinomial model incorporating various assumptions including expected future book value of AmeriHome, the probability of the option being exercised, volatility, expected term and certain other factors. The put option is considered a Level 3 measurement at March 31, 2012.

*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 March 31, 2012, securitized mortgage collateral had an unpaid principal balance of \$9.3 billion, compared to an estimated fair value of \$5.6 billion. The aggregate unpaid principal balance exceeds the fair value by \$3.7 billion at March 31, 2012. As of March 31, 2012, the unpaid principal balance of loans 90 days or more past due was \$1.6 billion compared to an estimated fair value of \$0.5 billion. The aggregate unpaid principal balances of loans 90 days or more past due exceed the fair value by \$1.1 billion at March 31, 2012. Securitized mortgage collateral is considered a Level 3 measurement at March 31, 2012.

*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 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. 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 March 31, 2012, securitized mortgage borrowings had an outstanding principal balance of \$9.4 billion compared to an estimated fair value of \$5.6 billion. The aggregate outstanding principal balance exceeds the fair value by \$3.8 billion at March 31, 2012. Securitized mortgage borrowings is considered a Level 3 measurement at March 31, 2012.

*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 March 31, 2012, long-term debt had an unpaid principal balance of \$70.5 million compared to an estimated fair value of \$12.2 million. The aggregate unpaid principal balance exceeds the fair value by \$58.3 million at March 31, 2012. The long-term debt is considered a Level 3 measurement at March 31, 2012.



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*Derivative assets and liabilities, Securitized trusts* 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. As of March 31, 2012, the notional balance of derivative assets and liabilities, securitized trusts was \$1.3 billion. These derivatives are included in the consolidated securitization trusts, which are nonrecourse to the Company, and thus the economic risk from these derivatives is limited to the Company's residual interests in the securitization trusts. Derivative assets and liabilities, securitized trusts are considered a Level 3 measurement at March 31, 2012.

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*Derivative assets and liabilities, Lending* The Company's derivative assets and liabilities are carried at fair value as required by GAAP and are accounted for as free standing derivatives. The derivative assets are IRLCs with prospective residential mortgage borrowers whereby the interest rate on the loan is determined prior to funding and the borrowers have locked in that interest rate. These commitments are determined to be derivative instruments. The derivative liabilities are Hedging Instruments used to hedge the fair value changes associated with changes in interest rates relating to its mortgage loan origination operations. The Company hedges the period from the interest rate lock (assuming a fall-out factor) to the date of the loan sale. The estimated fair value is based on current market prices for similar instruments. Given the meaningful level of secondary market activity for derivative contracts, active pricing is available for similar assets and accordingly, the Company classifies its derivative assets and liabilities, lending as a Level 2 measurement at March 31, 2012.

The following table includes information for the derivative assets and liabilities lending for the periods presented:

|                                     | Notional Balance<br>March 31, 2012 | Total Gains (Losses)<br>For the Three Months Ended<br>March 31, 2012 (1) |
|-------------------------------------|------------------------------------|--|
| Derivative assets - IRLC's          | \$ 138,675                         | 377  |
| Derivative liabilities - TBA/FNMA's | 127,317                            | (1,287)  |

(1) Amounts included in mortgage and real estate services fees within the accompanying consolidated statements of operations.

***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 March 31, 2012 and 2011, respectively:

|                     | Nonrecurring Fair Value Measurements<br>March 31, 2012 |           |         | Total Gains (Losses)<br>For the Three Months Ended<br>March 31, 2012 (3) |
|---------------------|--|-----------|---------|--|
|                     | Level 1  | Level 2   | Level 3 |  |
| REO (1)             | \$   | \$ 37,814 | \$      | \$ (9,427)   |
| Lease liability (2) |  |           | (2,201) | (217)  |

(1) Balance represents REO at March 31, 2012 which have been impaired subsequent to foreclosure. Amounts are included in continuing operations. For the three months ended March 31, 2012, the \$9.4 million loss represents additional impairment write-downs attributable to higher expected loss severities on properties held during the period which resulted in a decrease to net realizable value (NRV).

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(2) Amounts are included in discontinued operations. For the three months ended March 31, 2012, the Company recorded \$217 thousand in losses resulting from changes in lease liabilities as a result of changes in our expected minimum future lease payments.

(3) Total losses reflect losses from all nonrecurring measurements during the period.

|                     | Nonrecurring Fair Value Measurements<br>March 31, 2011 |           |         | Total Gains (Losses)<br>For the Three Months Ended<br>March 31, 2011 (3) |
|---------------------|--|-----------|---------|--|
|                     | Level 1  | Level 2   | Level 3 |  |
| REO (1)             | \$   | \$ 62,656 | \$      | \$ (4,247)   |
| Lease liability (2) |  |           | (2,246) | (217)  |

(1) Balance represents REO at March 31, 2011 which have been impaired subsequent to foreclosure. Amounts are included in continuing operations. For the three months ended March 31, 2011, the \$4.3 million loss related to additional impairment write-downs during the period is within continuing operations.

(2) Amounts are included in discontinued operations. For the three months ended March 31, 2011, the Company recorded \$217 thousand in losses resulting from changes in lease liabilities as a result of changes in our expected minimum future lease payments.

(3) Total gains (losses) reflect gains and losses from all nonrecurring measurements during the period.

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*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. REO balance representing REOs which have been impaired subsequent to foreclosure are subject to nonrecurring fair value measurement and included in the nonrecurring fair value measurements tables. Fair values of REO are generally based on observable market inputs, and considered Level 2 measurements at March 31, 2012.

*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 March 31, 2012.

**Note 3. Stock Options**

There were no options granted during the three months ended March 31, 2012 or 2011, respectively.

The following table summarizes activity, pricing and other information for the Company's stock options for the three months ended March 31, 2012:

|  | Number of<br>Shares |    | Weighted-<br>Average<br>Exercise<br>Price |
|--|---------------------|----|---|
| Options outstanding at beginning of period | 1,241,808           | \$ | 3.64                                      |
| Options granted                            |                     |    |   |
| Options exercised                          | (23,500)            |    | 0.53                                      |
| Options forfeited / cancelled              | (17,601)            |    | 20.20                                     |
| Options outstanding at end of period       | 1,200,707           | \$ | 3.46                                      |
| Options exercisable at end of period       | 984,176             | \$ | 3.61                                      |

As of March 31, 2012, there was approximately \$506 thousand of total unrecognized compensation cost related to stock option compensation arrangements granted under the plan, net of estimated forfeitures. That cost is expected to be recognized over the remaining weighted average period of 1.63 years.

The following table summarizes activity, pricing and other information for the Company's restricted stock units (RSU's), also referred to as deferred stock units as the issuance of the stock is deferred until termination of service, for the three months ended March 31, 2012:

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|  | Number of<br>Shares |    | Weighted-<br>Average<br>Grant Date<br>Fair Value |
|--|---------------------|----|--|
| RSU s outstanding at beginning of period | 24,000              | \$ | 2.73   |
| RSU s granted                            |                     |    |  |
| RSU s exercised                          |                     |    |  |
| RSU s forfeited / cancelled              |                     |    |  |
| RSU s outstanding at end of period       | 24,000              | \$ | 2.73   |

As of March 31, 2012, there was approximately \$37 thousand of total unrecognized compensation cost related to the RSU compensation arrangements granted under the plan. That cost is expected to be recognized over a weighted average period of 1.68 years.

Table of Contents**Note 4. Reconciliation of Loss Per Share**

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

|  | <b>For the Three Months<br/>Ended March 31,</b> |             |
|--|---|-------------|
|  | <b>2012</b>                                     | <b>2011</b> |
| <b>Numerator for basic loss per share:</b>                       |   |             |
| Loss from continuing operations                                  | \$ (3,286)                                      | \$ (952)    |
| Net (earnings) loss attributable to noncontrolling interest      | (236)   | 315         |
| Loss from continuing operations attributable to IMH              | (3,522)   | (637)       |
| Loss from discontinued operations                                | (1,268)   | (350)       |
| Loss available to common stockholders                            | \$ (4,790)                                      | \$ (987)    |
| <b>Denominator for basic loss per share (1):</b>                 |   |             |
| Basic weighted average common shares outstanding during the year | 7,819   | 7,788       |
| <b>Denominator for diluted loss per share (1):</b>               |   |             |
| Basic weighted average common shares outstanding during the year | 7,819   | 7,788       |
| Net effect of dilutive stock options and RSU s                   |   |             |
| Diluted weighted average common shares                           | 7,819   | 7,788       |
| Loss per common share - basic and diluted:                       |   |             |
| Loss from continuing operations attributable to IMH              | \$ (0.45)                                       | \$ (0.08)   |
| Loss from discontinued operations                                | (0.16)  | (0.04)      |
| Net loss per share available to common stockholders              | \$ (0.61)                                       | \$ (0.12)   |

(1) Number of shares presented in thousands.

For the three months ended March 31, 2012 and 2011, stock options to purchase 1.2 million and 1.4 million shares, respectively, were outstanding but not included in the above weighted average share calculations because they were anti-dilutive.

Table of Contents**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<br>Portfolio | Mortgage and<br>Real Estate<br>Services | Discontinued<br>Operations | Reclassifications (1) | Consolidated |
|--|------------------------|---|----------------------------|-----------------------|--------------|
| <b>Balance Sheet Items as of March 31, 2012:</b> |                        |   |                            |                       |              |
| Cash and cash equivalents                        | \$                     | \$ 7,314                                | \$ 56                      | \$ (68)               | \$ 7,302     |
| Restricted cash                                  | 823                    | 581                                     |                            |                       | 1,404        |
| Trust assets                                     | 5,623,656              |   |                            |                       | 5,623,656    |
| Mortgage loans held-for-sale                     |                        | 58,916                                  |                            |                       | 58,916       |
| Other assets                                     | 22,658                 | 9,740                                   | 260                        | 56                    | 32,714       |
| Total assets                                     | 5,647,137              | 76,551                                  | 316                        | (12)                  | 5,723,992    |
| Total liabilities                                | 5,626,080              | 61,399                                  | 9,966                      | (12)                  | 5,697,433    |
| Total stockholders equity (deficit)              | 21,057                 | 15,152                                  | (9,650)                    |                       | 26,559       |

|   | Long-term<br>Portfolio | Mortgage and<br>Real Estate<br>Services | Discontinued<br>Operations | Reclassifications (1) | Consolidated |
|---|------------------------|---|----------------------------|-----------------------|--------------|
| <b>Balance Sheet Items as of December 31, 2011:</b> |                        |   |                            |                       |              |
| Cash and cash equivalents                           |                        | 7,685                                   | 12                         | (44)                  | 7,653        |
| Restricted cash                                     | 4,450                  | 569                                     |                            |                       | 5,019        |
| Trust assets  | 5,506,193              |   |                            |                       | 5,506,193    |
| Mortgage loans held-for-sale                        |                        | 61,718                                  |                            |                       | 61,718       |
| Other assets  | 18,824                 | 12,369                                  | 252                        | 12                    | 31,457       |
| Total assets  | 5,529,467              | 82,341                                  | 264                        | (32)                  | 5,612,040    |
| Total liabilities                                   | 5,502,175              | 68,868                                  | 9,932                      | (32)                  | 5,580,943    |
| Total stockholders equity (deficit)                 | 27,292                 | 13,473                                  | (9,668)                    |                       | 31,097       |

|   | Long-term<br>Portfolio | Mortgage and<br>Real Estate<br>Services | Discontinued<br>Operations | Reclassifications (1) | Consolidated |
|---|------------------------|---|----------------------------|-----------------------|--------------|
| <b>Statement of Operations Items for the three months ended March 31, 2012:</b> |                        |   |                            |                       |              |
| Net interest income (expense)   | \$ 1,111               | \$ (57)                                 | \$                         | \$                    | \$ 1,054     |
| Non-interest (loss) income- net trust assets                                    | (3,027)                |   |                            |                       | (3,027)      |
| Change in fair value of long-term debt  | (93)                   |   |                            |                       | (93)         |
| Mortgage and real estate services fees  |                        | 14,036                                  |                            |                       | 14,036       |
| Other non-interest (expense) income   | (549)                  | 27                                      | (504)                      | 504                   | (522)        |
| Non-interest expense and income taxes   | (4,016)                | (10,718)                                | (764)                      | 764                   | (14,734)     |
| (Loss) earnings from continuing operations                                      | \$ (6,574)             | \$ 3,288                                |                            |                       | (3,286)      |
| Loss from discontinued operations, net of tax                                   |                        |   | \$ (1,268)                 |                       | (1,268)      |
| Net loss  |                        |   |                            |                       | \$ (4,554)   |

**Statement of Operations Items for the three months ended March 31,**

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**2011:**

|   |    |         |    |          |    |       |     |          |
|---|----|---------|----|----------|----|-------|-----|----------|
| Net interest income                           | \$ | 1,535   | \$ |          | \$ |       | \$  | 1,535    |
| Non-interest income- net trust assets         |    | 647     |    |          |    |       |     | 647      |
| Change in fair value of long-term debt        |    | 238     |    |          |    |       |     | 238      |
| Mortgage and real estate services fees        |    |         |    | 12,240   |    |       |     | 12,240   |
| Other non-interest income (expense)           |    | (32)    |    | (223)    |    | (131) | 131 | (255)    |
| Non-interest expense and income taxes         |    | (4,270) |    | (11,087) |    | (219) | 219 | (15,357) |
| (Loss) earnings from continuing operations    | \$ | (1,882) | \$ | 930      |    |       |     | (952)    |
| Loss from discontinued operations, net of tax |    |         |    |          | \$ | (350) |     | (350)    |
| Net loss                                      |    |         |    |          |    |       | \$  | (1,302)  |

(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.

**Note 6. Warehouse Borrowings**

The Company, through IRES and its subsidiaries, enters into Master Repurchase Agreements with lenders providing warehouse facilities. The warehouse facilities are used to fund, and are secured by, residential mortgage loans that are held for sale.

At March 31, 2012, the Company was in compliance with all financial covenants.



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The following table presents certain information on warehouse borrowings for the periods indicated:

|                               | Maximum<br>Borrowing<br>Capacity | Balance Outstanding At |                   |
|-------------------------------|----------------------------------|------------------------|-------------------|
|                               |                                  | March 31, 2012         | December 31, 2011 |
| <b>Short-term borrowings:</b> |                                  |                        |                   |
| Repurchase agreement 1 (1)    | \$ 32,500                        | \$ 20,930              | \$ 20,163         |
| Repurchase agreement 2        | 30,000                           | 15,760                 | 24,769            |
| Repurchase agreement 3 (2)    | 25,000                           | 18,725                 | 13,759            |
| Total short-term borrowings   | \$ 87,500                        | \$ 55,415              | \$ 58,691         |

- (1) In April 2012, the maximum borrowing capacity increased from \$32.5 million to \$38.5 million.
- (2) In May 2012, the maximum borrowing capacity increased from \$25.0 million to \$50.0 million.

**Note 7. Notes Payable***Note payable Debt Agreement*

In February 2012, the Company entered into a \$7.5 million structured debt agreement using eight of the Company's residual interests (net trust assets) as collateral. The Company used a portion of the proceeds to pay off the \$408 thousand balance owed on the previous debt agreement. The Company received proceeds of \$7.0 million, net of the aforementioned payoff and transaction costs of approximately \$50 thousand.

The structured debt agreement is evidenced by an Indenture with Deutsche Bank National Trust Company, as trustee. It bears interest at a fixed rate of 25% per annum and is amortized in equal principal payments over 18 months with all distributions from the underlying residual interests being used to make the monthly payments, and was recorded as a note payable in the accompanying consolidated balance sheets. If the cumulative cash flows received from the collateralized residual interests are not sufficient to pay the required monthly principal and interest, the Company would be required to pay the difference to avoid the transfer of the residual interests and the rights to the associated future cash flows to the note holder. Any excess cash flows from the residual interests are included in a reserve account, which is available to cover future shortfalls. To the extent there is excess cash flows after the reserve account reaches a balance of \$1.5 million, the Company will receive 70% of the excess cash flows to a monthly maximum of \$300 thousand. Subsequent to the new structured debt agreement through March 31, 2012, the Company received \$823 thousand in excess cash flows from the residual interests collateralizing the note payable. The \$823 thousand in excess cash flows is included in restricted cash on the consolidated balance sheets. If the amount of restricted cash becomes sufficient to satisfy the remaining obligation, the note payable can be paid off and the residuals listed as security are released. The carrying value of the debt agreement at March 31, 2012 was \$6.8 million and was current as to principal and interest payments.

**Note 8. Line of Credit Agreement**

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In April 2012, the Company, through its subsidiaries, amended the \$4.0 million working capital line of credit agreement with a national bank at an interest rate of one-month LIBOR plus 3.5%. The amendment extends the expiration to April 2013. Under the terms of the agreement the Company and its subsidiaries are required to maintain various financial and other covenants. There was no outstanding balance on the working capital line of credit as of March 31, 2012.

### **Note 9. Subsequent Events**

In April 2012, Repurchase agreement 1 was amended primarily to increase the maximum borrowing capacity from \$32.5 million to \$38.5 million.

In April 2012, the Company, through its subsidiaries, amended the \$4.0 million working capital line of credit agreement with a national bank extending the expiration to April 2013.

In May 2012, Repurchase agreement 3 was amended to increase the maximum borrowing capacity from \$25.0 million to \$50.0 million.

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

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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), 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 thereof. 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 manage successfully through the current market environment; our compliance with applicable local, state and federal laws and regulations and other general market and economic conditions; our ability to meet liquidity needs from current cash flows or generate new sources of revenue; management's ability to manage successfully and grow the Company's mortgage and real estate business activities including mortgage lending operations; the ability to make interest payments; increases in default rates or loss severities and mortgage related losses; 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.

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, 2011, and 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.

### **Market Update**

While there were positive economic signs during the first quarter of 2012, the United States economy continues to face a number of challenges. Employment conditions began to show signs of improvement during the first quarter. Unemployment continues to be on a favorable downward trend, although still remains high above 8%. However, according to the Wall Street Journal, most of the declines were due to more Americans leaving the work force. As the economic recovery continues at a slow rate, Federal Reserve policymakers currently anticipate that economic conditions are likely to warrant exceptionally low levels for the federal funds interest rate at least through late 2014.

Real estate activity showed some encouraging signs of stability although home prices continued to decline in many parts of the U.S. during the first quarter. Although the pace of new foreclosures has fallen from its peak, in part due to industry-wide compliance issues, further declines in home prices may be necessary before substantial progress in reducing the inventory of homes occurs. Serious threats to economic growth remain however, including continued pressure and uncertainty in the housing market and elevated unemployment levels. Although the economy added jobs in 2012, the pace of new job creation continues to be slower than needed to meaningfully reduce unemployment. As a result, there continues to be uncertainty as to how pronounced the economic recovery will be and whether it can be sustained.

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**Selected Financial Results for the Three Months Ended March 31, 2012**

*Continuing Operations*

- Loss from continuing operations increased to \$3.3 million for the three months ended March 31, 2012, compared to a loss of \$1.0 million for the comparable 2011 period primarily due to a decrease in fair value of net trust assets associated with cash received and an increase in expected forward LIBOR rates in the first quarter offset by an increase in mortgage and real estate service fees and a decline in expenses.
- Non-interest (loss) income net trust assets was a loss of \$3.0 million for the three months ended March 31, 2012, compared to income of \$647 thousand for the comparable 2011 period. Loss in the first quarter was due to a change in fair value of net trust assets and REO losses of \$3.0 million associated with \$3.2 million in cash received and an increase in expected forward LIBOR rates in the first quarter. The estimated fair values of securitized mortgage collateral and securitized mortgage bonds increased in the quarter primarily due to improvement in bond prices and yields since December 31, 2011. Should this trend continue, estimated bond prices and yield assumptions may need to be updated in future periods.
- Earnings from the mortgage and real estate services segment increased to \$3.3 million in the first quarter of 2012, compared to \$930 thousand in the comparable period in 2011.
- The mortgage lending operations originated \$365.0 million and sold \$355.7 million of loans during the three months ended March 31, 2012 as compared to \$57.3 million and \$26.3 million of loans originated and sold, respectively, for the comparable 2011 period. Additionally, mortgage lending revenues increased to \$9.2 million during the three months ended March 31, 2012 as compared to \$551 thousand for the comparable 2011 period.

*Discontinued Operations*

- Loss from discontinued operations, net of tax was \$1.3 million for the three months ended March 31, 2012, compared to a loss of \$350 thousand for the comparable 2011 period primarily due to a change in the discontinued operations repurchase provision related to additional repurchase claims received from Fannie Mae and legal costs associated with previously disclosed discontinued operations matters..

**Status of Operations, Liquidity and Capital Resources**

*Mortgage and Real Estate Services*

The mortgage and real estate services include the mortgage lending operations and portfolio loss mitigation and real estate services, and had net earnings of \$3.3 million in the first quarter of 2012, compared to \$930 thousand in the comparable period in 2011. The increase was due to an increase in revenues and a decrease in expenses. Mortgage and real estate services fees were \$14.0 million for the three months ended March 31, 2012, compared to \$12.2 million for 2011 with the increase primarily due to an increase in mortgage lending net revenues, partially offset by a decrease in title and escrow fees due to the sale of the title company. The increase was primarily due to an increase in lending activities which produced revenues of \$9.2 million while portfolio loss mitigation and real estate services revenues were \$4.8 million. Additionally, title and escrow fees declined \$4.3 million due to the sale of the title insurance company in 2011. As expected the portfolio loss mitigation and real estate services activities and revenues declined as lending activities and revenues increased including the increase in sales to and of the respective servicing portfolios of Fannie Mae and Ginnie Mae loans.

*Mortgage Lending Operations* During the three months ended March 31, 2012, the Company originated \$365.0 million and sold \$355.7 million of loans, respectively, as compared to \$57.3 million and \$26.3 million of loans originated and sold, respectively, during the three months ended March 31, 2011.

The Company is currently focusing on originating Fannie Mae, Freddie Mac, and government loans as it believes that having the ability to sell loans to Fannie Mae, Freddie Mac, and issue Ginnie Mae securities makes it more competitive in the overall mortgage origination market with regard to products, pricing, operational efficiencies and overall recruitment of higher quality loan originators. Consistent with the Company's strategy, during 2012, the Company sold \$249.2 million in service retained loans to Fannie Mae and Freddie Mac, issued \$78.0 million in Ginnie Mae securities through its AmeriHome Mortgage Corporation indirect subsidiary and sold \$28.5 million in loans on a service released basis to other investors. In March 2012, the Company sold \$250

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million in unpaid principal balance of Fannie Mae servicing rights with an expected transfer date in May 2012. The mortgage servicing portfolio increased to \$891.7 million in unpaid principal balance at March 31, 2012 (including \$250 million sold but not transferred) as compared to \$605.4 million at December 31, 2011.

In April and May 2012, two of the Company's warehouse lenders approved increases from \$32.5 million and \$25.0 million to \$38.5 million and \$50.0 million, respectively. As of May 2012, the Company increased its warehouse borrowings capacity to \$118.5 million from \$87.5 million at December 31, 2011.

*Portfolio Loss Mitigation and Real Estate Services* The Company provides portfolio loss mitigation and real estate services including REO surveillance and disposition services, default surveillance and loss recovery services, short sale and real estate brokerage services, portfolio monitoring and reporting services. During the three months ended March 31, 2012, fees from real estate services, loss mitigation and portfolio services decreased to \$4.8 million as compared to \$7.2 million for the three months ended March 31, 2011, primarily due to a decline in the real estate and recovery activities declined in the long-term mortgage portfolio.

Although the Company seeks to expand its portfolio loss mitigation and real estate services to more third parties in the marketplace, the revenues from these business activities have historically been generated from the Company's long-term mortgage portfolio. Furthermore, as the distressed mortgage and real estate markets remain unstable and uncertain due to the number of foreclosure properties that need to be sold, there remains uncertainty about the ongoing need and delivery of these services in the future.

For the three months ended March 31, 2012 and 2011, mortgage and real estate services fees were as follows:

|  | For the Three Months<br>Ended March 31, |        |    |        |
|--|---|--------|----|--------|
|  |   | 2012   |    | 2011   |
| Mortgage lending                                   | \$                                      | 9,209  | \$ | 551    |
| Portfolio loss mitigation and real estate services |   | 4,827  |    | 7,381  |
| Title and escrow (1)                               |   |        |    | 4,308  |
| Total mortgage and real estate services fees       | \$                                      | 14,036 | \$ | 12,240 |

(1) In September and October 2011, the Company sold its interest in Experience 1, Inc., the parent of the title insurance company.

*Long-Term Mortgage Portfolio*

Although we have seen some stabilization and improvement in defaults, the portfolio continues to suffer losses and may continue for the foreseeable future until the real estate market becomes more stable, home prices improve across the United States, and there is a significant

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decline in the number of foreclosure properties in the market. Existing conditions are unprecedented and result in uncertainty around the long-term performance of the portfolio.

At March 31, 2012, our residual interest in securitizations (represented by the difference between total trust assets and total trust liabilities) decreased to \$22.5 million, compared to \$26.5 million at December 31, 2011. The decrease in residual fair value for the three months ended March 31, 2012 was primarily due to \$3.2 million in cash received and an increase in expected forward LIBOR interest rates.

To estimate fair value of the assets and liabilities within the securitization trusts each reporting period, management uses an industry standard valuation and analytical model that is updated monthly with current collateral, real estate, derivative, bond and cost (servicer, trustee, etc.) information for each securitization trust. The Company employs an internal process to validate the accuracy of the model as well as the data within this model. Forecasted assumptions, sometimes referred to as curves, for defaults, loss severity, interest rates (LIBOR) and prepayments are input into the valuation model for each securitization trust. The Company hires third party experts to provide forecasted curves for the aforementioned assumptions for each of the securitizations. Before inputting this information into the model, management employs a process to qualitatively and quantitatively review the assumption curves for reasonableness using other information gathered from the mortgage and real estate market (*i.e.*, third party home price indices, published industry reports discussing regional mortgage and commercial loan performance and delinquency) as well as actual default and foreclosure information for each trust from the respective trustees.

The Company uses the valuation model to generate the expected cash flows to be collected from the trust assets and the expected required bondholder distribution (trust liabilities). To the extent that the trusts are overcollateralized, the Company may receive the excess interest as the holder of the residual interest. The information above provides us with the future expected cash flows for the securitized mortgage collateral, real estate owned, securitized mortgage borrowings, derivative assets/liabilities, and the residual interests.



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To determine the discount rates to apply to these cash flows, the Company gathers information from the bond pricing services and other market participants regarding estimated investor required yields for each bond tranche. Based on that information and the collateral type and vintage, the Company determines an acceptable range of expected yields an investor would require including an appropriate risk premium for each bond tranche. The Company uses the blended yield of the bond tranches together with the residual interests to determine an appropriate yield for the securitized mortgage collateral in each securitization (after taking into consideration any derivatives in the securitization).

The following table presents changes in the Company's trust assets and trust liabilities for the three months ended March 31, 2012:

|   | TRUST ASSETS                              |                                 |                   |                   |                     | TRUST LIABILITIES                         |                        |                         | Net trust assets and trust liabilities |
|---|---|---------------------------------|-------------------|-------------------|---------------------|---|------------------------|-------------------------|--|
|   | Level 3 Recurring Fair Value Measurements | Fair Value Measurements         | NRV (2)           |                   |                     | Level 3 Recurring Fair Value Measurements |                        |                         |  |
|   | Investment securities available-for-sale  | Securitized mortgage collateral | Derivative assets | Real estate owned | Total trust assets  | Securitized mortgage borrowings           | Derivative liabilities | Total trust liabilities |  |
| <b>Recorded book value at 12/31/2011</b>        | <b>688</b>                                | <b>5,449,001</b>                | <b>37</b>         | <b>56,467</b>     | <b>5,506,193</b>    | <b>(5,454,901)</b>                        | <b>(24,786)</b>        | <b>(5,479,687)</b>      | <b>26,506</b>                          |
| Total gains/(losses) included in earnings:      |   |                                 |                   |                   |                     |   |                        |                         |  |
| Interest income                                 | 13  | 51,940                          |                   |                   | 51,953              |   |                        |                         | 51,953                                 |
| Interest expense                                |   |                                 |                   |                   |                     | (120,997)                                 |                        | (120,997)               | (120,997)                              |
| Change in FV of net trust assets, excluding REO | (443)                                     | 231,360                         | 1                 |                   | 230,918 (1)         | (223,956)                                 | (562)                  | (224,518) (1)           | 6,400                                  |
| Change in FV of long-term debt                  |   |                                 |                   |                   |                     |   |                        |                         |  |
| Losses from REO - not at FV but at NRV          |   |                                 |                   | (9,427)           | (9,427) (1)         |   |                        |                         | (9,427)                                |
| Total gains (losses) included in earnings       | (430)                                     | 283,300                         | 1                 | (9,427)           | 273,444             | (344,953)                                 | (562)                  | (345,515)               | (72,071)                               |
| Transfers in and/or out of level 3              |   |                                 |                   |                   |                     |   |                        |                         |  |
| Purchases, issuances and settlements            | (69)                                      | (158,936)                       |                   | 3,024             | (155,981)           | 220,342                                   | 3,663                  | 224,005                 | 68,024                                 |
| <b>Recorded book value at 3/31/2012</b>         | <b>\$ 189</b>                             | <b>\$ 5,573,365</b>             | <b>\$ 38</b>      | <b>\$ 50,064</b>  | <b>\$ 5,623,656</b> | <b>\$ (5,579,512)</b>                     | <b>\$ (21,685)</b>     | <b>\$ (5,601,197)</b>   | <b>\$ 22,459</b>                       |

(1) Represents non-interest income-net trust assets on the Company's consolidated statements of operations for the three months ended March 31, 2012.

(2) Accounted for at net realizable value.

The increase in fair value of securitized mortgage collateral resulted in gains of \$231.4 million, offset by losses of \$224.0 million resulting from the increase in the fair value of securitized mortgage borrowings for the three months ended March 31, 2012. For the three months ended March 31, 2012, the change in the net realizable value (NRV) of REO resulted in a loss of \$9.4 million. Inclusive of losses from REO, trust assets reflect a net gain of \$221.5 million as a result of an increase in fair value of securitized mortgage collateral of \$231.4 million, losses from REO of \$9.4 million and losses from other trust assets of \$443 thousand. Net losses on trust liabilities were \$224.5 million as a result of \$224.0 million in losses from the increase in fair value of securitized mortgage borrowings and losses from derivative liabilities of \$562 thousand. As a result, non-interest income net trust assets totaled \$3.0 million for the three months ended March 31, 2012.

*Liquidity and capital resources*

During the first three months of 2012, the Company continued to fund its operations primarily from mortgage and real estate services fees which includes mortgage lending activities, portfolio loss mitigation and real estate services fees primarily generated from its long-term mortgage portfolio, and cash flows from our residual interests in securitizations. In addition, the Company funded mortgage loan production using warehouse facilities which are repaid once the loan is sold as well as cash to fund associated haircuts.

The Company believes that current cash balances, cash flows from its mortgage lending activities, mortgage and real estate services fees generated from the long-term mortgage portfolio, and residual interest cash flows from the long-term mortgage portfolio are adequate for current operating needs. However, the Company believes the mortgage lending and real estate services markets are volatile, highly competitive and subject to increased regulation. Competition in mortgage lending comes primarily from mortgage bankers, commercial banks, credit unions and other finance companies which have offices in the Company's market area as well as operations throughout the United States. The Company competes for loans principally on the basis of the interest rates and loan fees charged, the types of loans originated and the quality of services provided to borrowers. Additionally, competition for real estate recovery services, loss mitigation servicing, loan modification services and other portfolio services has increased due to the unprecedented difficult mortgage environment and severe credit tightening, coupled with the stagnant economy. The Company's competitors include mega mortgage servicers, established special servicers, and newer entrants to the specialty servicing and recovery collections business. Efforts to market the Company's ability to provide mortgage and real estate services for others is more difficult

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than many of its competitors because the Company has not historically provided such services to unrelated third parties, and the Company is not a rated primary or special servicer of residential mortgage loans as designated by a rating agency. Additionally, performance of the long-term mortgage portfolio is subject to the continued deterioration in the real estate market and current economic conditions. Cash flows from the residual interests in securitizations can be volatile, because they are sensitive to delinquencies, defaults and credit losses associated with the securitized loans and interest rates associated with the securitized bonds. Losses in excess of current estimates will reduce the residual interest cash receipts from the long-term mortgage portfolio.

At March 31, 2012 and December 31, 2011, the condensed components of stockholders' equity were comprised of the following significant assets and liabilities:

|                                       | Condensed Components of |                   |
|---------------------------------------|-------------------------|-------------------|
|                                       | Stockholders' Equity    | Equity            |
|                                       | March 31, 2012          | December 31, 2011 |
| Cash                                  | \$ 7,358                | \$ 7,665          |
| Restricted cash                       | 1,404                   | 5,019             |
| Residual interests in securitizations | 22,459                  | 26,506            |
| Loans held-for-sale                   | 58,916                  | 61,718            |
| Warehouse borrowings                  | (55,415)                | (58,691)          |
| Mortgage servicing rights             | 4,807                   | 4,141             |
| Line of credit                        |                         | (4,000)           |
| Note payable                          | (6,797)                 | (5,182)           |
| Long-term debt (\$71,120 par)         | (12,163)                | (11,561)          |
| Repurchase reserve (1)                | (6,361)                 | (5,816)           |
| Lease liability (2)                   | (2,201)                 | (2,131)           |
| Deferred charge                       | 11,974                  | 11,974            |
| Net other assets (liabilities)        | 2,578                   | 1,455             |
| <b>Stockholders' equity</b>           | <b>\$ 26,559</b>        | <b>\$ 31,097</b>  |

(1) \$5.5 million and \$5.1 million included within discontinued operations at March 31, 2012 and December 31, 2011, respectively.

(2) Included within discontinued operations and guaranteed by IMH

At March 31, 2012, cash decreased to \$7.4 million from \$7.7 million at December 31, 2011. The primary sources of cash between periods were \$14.0 million in fees generated from the mortgage and real estate services, \$2.4 million from residual interests in securitizations (net of the \$823 thousand restricted excess cash in the reserve account) and \$7.0 million from the issuance of the note payable. Offsetting the sources of cash were operating expenses totaling \$14.7 million, repayments of the line of credit totaling \$4.0 million, payments on the notes payable of \$6.5 million (including \$3.9 million which came from the reserve account) and settlements of repurchase requests associated with loans sold by the discontinued non-conforming mortgage operations of approximately \$251 thousand.

Since our consolidated and unconsolidated securitization trusts are nonrecourse to us, 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 specified overcollateralization levels and other specified parameters (such as maximum

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delinquency and cumulative default) within the trusts. The estimated fair value of the residual interests, represented by the difference in the fair value of total trust assets and total trust liabilities, was \$22.5 million at March 31, 2012, compared to \$26.5 million at December 31, 2011.

At March 31, 2012, the note payable was \$6.8 million as compared to \$5.2 million at December 31, 2011. During 2012, the Company entered into a new \$7.5 million structured debt agreement using eight of the Company's residual interests (net trust assets) as collateral. The Company used a portion of the proceeds to pay off the \$408 thousand balance (net of the reserve account) on the previous debt agreement. The Company received proceeds of \$7.0 million, net of the aforementioned payoff and transaction costs of approximately \$50 thousand. The note payable bears interest at a fixed rate of 25% per annum, is amortized in equal principal payments over 18 months and matures in July 2013.

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At March 31, 2012, the balance of deferred charge was \$12.0 million. For the three months ended March 31, 2012, the Company was not required to record income tax expense resulting from deferred charge impairment write-downs based on changes in estimated fair value of securitized mortgage collateral. The deferred charge arose as a result of 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 (when IMH was a REIT.) This balance is recorded as required by GAAP and does not have any realizable cash value.

In previous years when our discontinued operations sold loans to investors, we were required to make normal and customary representations and warranties on 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 three months ended March 31, 2012, the Company paid approximately \$251 thousand to settle previous repurchase claims received by the discontinued operations. The Company's discontinued operations also continued to receive repurchase requests from Fannie Mae resulting in increases in estimated repurchase obligations. At March 31, 2012, the repurchase reserve within discontinued operations was \$5.5 million as compared to \$5.2 million at December 31, 2011. Additionally, the Company has approximately \$896 thousand in repurchase reserves related to the loans sold by the continuing mortgage lending operations.

In connection with the discontinuation of our non-conforming 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 March 31, 2012, the Company had a liability of \$2.2 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.

**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 those issues included in IMH's report on Form 10-K of Management's Discussion and Analysis of Results of Operations for the year ended December 31, 2011. Such policies have not changed during 2012.

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## Condensed Balance Sheet Data

|   | March 31,<br>2012   | December 31,<br>2011 | Increase<br>(Decrease) | %<br>Change |
|---|---------------------|----------------------|------------------------|-------------|
| Securitized mortgage collateral                   | \$ 5,573,365        | \$ 5,449,001         | \$ 124,364             | 2%          |
| Other trust assets                                | 50,291              | 57,192               | (6,901)                | (12)        |
| <b>Total trust assets</b>                         | <b>5,623,656</b>    | <b>5,506,193</b>     | <b>117,463</b>         | <b>2</b>    |
| Mortgage loans held-for-sale                      | 58,916              | 61,718               | (2,802)                | (5)         |
| Assets of discontinued operations                 | 316                 | 264                  | 52                     | 20          |
| Other assets                                      | 41,104              | 43,865               | (2,761)                | (6)         |
| <b>Total assets</b>                               | <b>\$ 5,723,992</b> | <b>\$ 5,612,040</b>  | <b>\$ 111,952</b>      | <b>2%</b>   |
| Securitized mortgage borrowings                   | \$ 5,579,512        | \$ 5,454,901         | \$ 124,611             | 2%          |
| Other trust liabilities                           | 21,685              | 24,786               | (3,101)                | (13)        |
| <b>Total trust liabilities</b>                    | <b>5,601,197</b>    | <b>5,479,687</b>     | <b>121,510</b>         | <b>2</b>    |
| Warehouse borrowings                              | 55,415              | 58,691               | (3,276)                | (6)         |
| Liabilities of discontinued operations            | 9,966               | 9,932                | 34                     | 0           |
| Other liabilities                                 | 30,855              | 32,633               | (1,778)                | (5)         |
| <b>Total liabilities</b>                          | <b>5,697,433</b>    | <b>5,580,943</b>     | <b>116,490</b>         | <b>2</b>    |
| Total IMH stockholders' equity                    | 25,254              | 29,968               | (4,714)                | (16)        |
| Noncontrolling interest                           | 1,305               | 1,129                | 176                    | 16          |
| Total equity                                      | 26,559              | 31,097               | (4,538)                | (15)        |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 5,723,992</b> | <b>\$ 5,612,040</b>  | <b>\$ 111,952</b>      | <b>2%</b>   |

Total assets and total liabilities were \$5.7 billion at March 31, 2012 as compared to \$5.6 billion at December 31, 2011. The changes 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, 2012, the Company decreased the investor yield requirements for senior bonds of the securitized mortgage borrowings as estimated bond prices have improved and corresponding yields have tightened significantly over the past few quarters. Should the trend of improving bond prices and declining yields continue, the Company may decrease investor yield requirements for other bonds in the securitized mortgage bond portfolio. 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 quarter of 2012.

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- Securitized mortgage collateral increased \$124.4 million during the three months ended March 31, 2012, primarily due to an increase in fair value due to a reduction in investor yield requirements, partially offset by an increase in loss assumptions, reductions in principal from borrower payments and transfers of loans to REO for single-family and multi-family collateral. Additionally the \$6.9 million reduction in other trust assets during the three months ended March 31, 2012 was primarily due to REO liquidations of \$19.0 million and additional impairment write-downs of \$9.4 million. Partially offsetting the decrease from liquidations were increases in REO from foreclosures of \$22.0 million.
- Securitized mortgage borrowings increased \$124.6 million during the three months ended March 31, 2012, primarily due to an increase in fair value due to a reduction in investor yield requirements, partially offset by an increase in loss assumptions and reductions in principal balances from principal payments during the period for single-family and multi-family collateral. The \$3.1 million dollar reduction in other trust liabilities during the three months ended March 31, 2012 was primarily due to \$3.7 million in derivative cash payments from the securitization trusts, partially offset by a \$561 thousand increase in derivative fair value resulting from changes in forward LIBOR interest rates.

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.

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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 March 31, 2012:

| Origination Year              | Estimated Fair Value of Residual Interests by Vintage Year |               |                 |                  |
|-------------------------------|--|---------------|-----------------|------------------|
|                               |  | SF            | MF              | Total            |
| 2002-2003 (1)                 | \$   | 12,452        | \$ 4,253        | \$ 16,705        |
| 2004                          |  | 2,843         | 2,812           | 5,655            |
| 2005 (2)                      |  |               | 99              | 99               |
| 2006 (2)                      |  |               |                 |                  |
| 2007 (2)                      |  |               |                 |                  |
| <b>Total</b>                  | <b>\$</b>  | <b>15,295</b> | <b>\$ 7,164</b> | <b>\$ 22,459</b> |
| Weighted avg. prepayment rate |  | 3%            | 6%              | 3%               |
| Weighted avg. discount rate   |  | 30%           | 20%             | 27%              |

(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:

|           | Estimated Future Losses (1) |     | Investor Yield Requirement (2) |    |     |
|-----------|-----------------------------|-----|--------------------------------|----|-----|
|           | SF                          | MF  | SF                             | MF |     |
| 2002-2003 | 7%                          | 0%  | 9%                             |    | 11% |
| 2004      | 14%                         | 3%  | 9%                             |    | 7%  |
| 2005      | 33%                         | 9%  | 10%                            |    | 8%  |
| 2006      | 47%                         | 16% | 12%                            |    | 10% |
| 2007      | 32%                         | 7%  | 12%                            |    | 6%  |

(1) Estimated future losses derived by dividing future projected losses by unpaid principal balances at March 31, 2012.

(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.



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During the first three months of 2012, home prices continued to decline in many markets as housing prices remain under pressure due to elevated foreclosure levels as evidenced below by the Standard & Poor's Case-Shiller 10-City Composite Home Price Index for February 2012.

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Although the pace of new foreclosures has fallen from its peak, in part due to industry-wide compliance issues, further declines in home prices may be necessary before substantial progress in reducing the inventory of homes occurs. Elevated unemployment could cause continued downward pressure and uncertainty in the housing market. Reported unemployment rates in nine states are at or above 9.0%, including California and Florida. California and Florida represent the states with the highest concentration in our long-term mortgage portfolio.

As illustrated in S&P's 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 April 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.

The mortgage lending operations are affected by the following market and operational risks:

- interest rate risk,

- liquidity risk; and
- compliance risk.

*Interest Rate Risk Mortgage Lending.* The Company is exposed to interest rate risks relating to its ongoing mortgage lending operations. The Company uses derivative instruments to manage some of its interest rate risk. However, the Company does not attempt to hedge interest rate risk completely. The Company enters into interest rate lock commitments and commitments to sell mortgages to help mitigate some of the exposure to the effect of changing interest rates on mortgage lending cash flows.

Interest rate lock commitments expose the Company to interest rate risk. The mortgage lending operations currently utilizes forward sold Fannie Mae and Ginnie Mae mortgage backed securities to hedge the fair value changes associated with changes in interest rates relating to its mortgage loan origination operations.

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*Liquidity risk.* The Company is exposed to liquidity risks relating to its ongoing mortgage lending operations. We primarily fund our mortgage lending originations through warehouse facilities with third party lenders. We primarily use facilities with regional banks. The warehouse facilities are secured by and used to fund single-family residential mortgage loans. In order to mitigate the liquidity risk associated with warehouse borrowings, we attempt to sell our mortgage loans within 10-15 days from acquisition or origination.

*Compliance risk.* As a mortgage banking lender and servicer, the Company is exposed to various compliance related market and operational risks.

The Company is licensed to originate mortgage loans in several states and licensed to originate loans guaranteed by the government, including Federal Housing Authority (FHA) and Veteran's Administration (VA) loans, as well as approved to sell Fannie Mae and Freddie Mac loans and issue Ginnie Mae securities. The Company is also approved to service Fannie Mae, Freddie Mac and Ginnie Mae loans. The Company currently sells a significant portion of its loan production volume to Fannie Mae and Ginnie Mae and holds Fannie Mae, Freddie Mac and Ginnie Mae servicing. If the Company fails to maintain required seller/servicer requirements of Fannie Mae, Freddie Mac and Ginnie Mae, submit certain financial and operational information or maintain required licensing and compliance standards along with required FHA guidelines, the Company may be exposed to the risk of:

- losing its ability to originate loans within a state, as well as originate, sell and service loans for Fannie Mae, Freddie Mac and issue Ginnie Mae securities and service Ginnie Mae loans,
- repurchase exposure if loans that are sold to Fannie Mae or Freddie Mac or included in a Ginnie Mae security issuance are later determined to have compliance or underwriting deficiencies, and
- any losses from funding a loan ineligible to be sold to an approved secondary marketing investor (government agency, private investor) that ultimately is sold at a loss.

To mitigate these risks, the Company has established certain procedures to monitor the requirements of these government agencies. In addition, the Company has:

- (i) established procedures and controls on implementing new products and the approval of associated underwriting guidelines for the new products,
- (ii) performs both pre-funding and post-funding quality control procedures on originated loans,
- (iii) has established a process for management to review the quality control findings in implementing process improvements,
- (iv) reviews all funded loans that dwell on the warehouse lines for an unexpected period of time, and
- (v) reviews the performance of the servicing portfolio including any early payment defaults and compliance with agency servicing guidelines.

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

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

*Interest Rate Risk Securitized Trusts, Long-term Debt.* 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 and long-term debt). 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 in its long-term mortgage portfolio. However, the Company does not attempt to hedge interest rate risk completely. 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

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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.

At March 31, 2012, derivative liabilities, net were \$21.6 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). These interest bearing liabilities include adjustable rate periods based on 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-Securitized Trusts.* 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 when originated were generally within typical Fannie Mae and Freddie Mac guidelines but had loan characteristics, which may have included higher loan balances, higher loan-to-value ratios or lower documentation requirements (including stated-income loans), that made 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 on the long-term mortgage portfolio, 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 or more days 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 \$2.1 billion or 21.6% of the long-term mortgage portfolio as of March 31, 2012.

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The following table summarizes the unpaid principal balances of loans in our mortgage portfolio, included in securitized mortgage collateral, mortgage loans held-for-investment and mortgage 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:

|   | March 31,<br>2012 | Total<br>Collateral<br>% | December 31,<br>2011 | Total<br>Collateral<br>% |
|---|-------------------|--------------------------|----------------------|--------------------------|
| <b><u>Mortgage loans held-for-sale and investment</u></b>                 |                   |                          |                      |                          |
| 60 - 89 days delinquent   | \$                | *                        | \$                   | *                        |
| 90 or more days delinquent  | 529               | *                        | 529                  | *                        |
| Foreclosures (1)  | 1,127             | *                        | 1,127                | *                        |
| Total 60+ days delinquent mortgage loans held-for-sale and investment (2) | 1,656             | *                        | 1,656                | *                        |
| <b><u>Securitized mortgage collateral</u></b>                             |                   |                          |                      |                          |
| 60 - 89 days delinquent   | \$ 193,246        | 2.0%                     | \$ 209,963           | 2.1%                     |
| 90 or more days delinquent  | 728,881           | 7.6%                     | 711,716              | 7.2%                     |
| Foreclosures (1)  | 775,139           | 8.1%                     | 829,817              | 8.4%                     |
| Delinquent bankruptcies (3)   | 382,464           | 4.0%                     | 380,133              | 3.8%                     |
| Total 60+ days delinquent long-term mortgage portfolio                    | 2,079,730         | 21.6%                    | 2,131,629            | 21.5%                    |
| Total 60 or more days delinquent  | \$ 2,081,386      | 21.6%                    | \$ 2,133,285         | 21.6%                    |
| Total collateral  | 9,628,618         | 100%                     | 9,893,205            | 100%                     |

\* Less than 0.1%

- (1) Represents properties in the process of foreclosure.
- (2) Represents legacy mortgage loans held-for-sale included in discontinued operations in the consolidated balance sheets.
- (3) Represents bankruptcies that are 30 days or more delinquent.

The following table summarizes securitized mortgage collateral, mortgage loans held-for-investment, mortgage 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):

|  | March 31,<br>2012 | Total<br>Collateral<br>% | December 31,<br>2011 | Total<br>Collateral<br>% |
|--|-------------------|--------------------------|----------------------|--------------------------|
| 90 or more days delinquent, foreclosures and delinquent bankruptcies | \$ 1,888,140      | 19.6%                    | \$ 1,923,322         | 19.4%                    |
| Real estate owned  | 50,064            | 0.5%                     | 56,467               | 0.6%                     |
| Total non-performing assets  | \$ 1,938,204      | 20.1%                    | \$ 1,979,789         | 20.0%                    |

Non-performing assets consist of non-performing loans (mortgages that are 90 or more days 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



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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. We, as master servicer, may be required to advance funds, or in most cases cause our loan servicers to advance funds, to cover principal and interest payments not received from borrowers depending on the status of their mortgages. As of March 31, 2012, 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 20.1%. At December 31, 2011, non-performing assets to total collateral was 20.0%. As of March 31, 2012, 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) was \$519.5 million or 9.1% of total assets. At December 31, 2011, the estimated fair value of non-performing assets was \$528.0 million or 9.4% of total assets.

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 March 31, 2012 decreased \$6.4 million or 11% from December 31, 2011, as a result of liquidations and a decrease in foreclosures associated with foreclosure delays.

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We realized losses on the sale of real estate owned in the amount \$2 thousand for the three months ended March 31, 2012, compared to gains of \$4 thousand for the comparable 2011 period. Additionally, for the three months ended March 31, 2012, the Company recorded write-downs of the net realizable value of the REO in the amount of \$9.4 million compared to write-downs of \$4.2 million for the comparable 2011 period. These write-downs of the net realizable value reflect declines in value of the REO subsequent to foreclosure date.

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

|                    | March 31,<br>2012 | December 31,<br>2011 |
|--------------------|-------------------|----------------------|
| REO                | \$ 70,628         | \$ 75,418            |
| Impairment (1)     | (20,564)          | (18,951)             |
| Ending balance (2) | \$ 50,064         | \$ 56,467            |

- 
- (1) Impairment represents the cumulative write-downs of net realizable value subsequent to foreclosure.
- (2) REO balances included in trust assets.

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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*For the Three Months Ended March 31, 2012 compared to the Three Months Ended March 31, 2011*

|  | <b>For the three months ended March 31,</b> |             |                                |                     |
|--|---|-------------|--------------------------------|---------------------|
|  | <b>2012</b>                                 | <b>2011</b> | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Change</b> |
| Interest income  | \$ 142,792                                  | \$ 218,082  | \$ (75,290)                    | (35)%               |
| Interest expense   | 141,738                                     | 216,547     | (74,809)                       | (35)                |
| Net interest income  | 1,054                                       | 1,535       | (481)                          | (31)                |
| Total non-interest income  | 10,394                                      | 12,870      | (2,476)                        | (19)                |
| Total non-interest expense   | (14,704)                                    | (15,345)    | 641                            | 4                   |
| Income tax expense   | (30)  | (12)        | (18)                           | (150)               |
| Net earnings from continuing operations                                | (3,286)                                     | (952)       | (2,334)                        | (245)               |
| Loss from discontinued operations, net                                 | (1,268)                                     | (350)       | (918)                          | (262)               |
| Net loss   | (4,554)                                     | (1,302)     | (3,252)                        | (250)               |
| Net loss attributable to noncontrolling interest (1)                   | (236)                                       | 315         | (551)                          | (175)               |
| Net loss attributable to IMH   | \$ (4,790)                                  | \$ (987)    | \$ (3,803)                     | (385)               |
| Loss per share available to common stockholders -<br>basic and diluted | \$ (0.61)                                   | \$ (0.12)   | \$ (0.51)                      | (433)%              |

(1) For the three months ended March 31, 2012, net loss attributable to noncontrolling interest represents the portion of the losses of AmeriHome Mortgage Corporation (a subsidiary of IRES) that the Company does not wholly own. For the three months ended March 31, 2011, net loss attributable to noncontrolling interest represents the portion of the losses of Experience 1, Inc. and AmeriHome Mortgage Corporation (both subsidiaries of IRES) that the Company does not wholly own.

*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 notes payable, warehouse borrowings and line of credit. Interest income and interest expense during the period primarily represents the effective yield, based on the fair value of the trust assets and liabilities.

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.



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|                                    | For the three months ended March 31, |            |        |                    |            |        |
|------------------------------------|--------------------------------------|------------|--------|--------------------|------------|--------|
|                                    | 2012                                 |            |        | 2011               |            |        |
|                                    | Average<br>Balance                   | Interest   | Yield  | Average<br>Balance | Interest   | Yield  |
| <b>ASSETS</b>                      |                                      |            |        |                    |            |        |
| Securitized mortgage collateral    | 5,511,183                            | 142,196    | 10.32% | 6,032,721          | 217,746    | 14.44% |
| Loans held-for-sale                | 54,618                               | 506        | 3.71%  | 7,367              | 86         | 4.67%  |
| Other                              | 4,144                                | 90         | 8.69%  | 32,294             | 250        | 3.10%  |
| Total interest-earning assets      | \$ 5,569,945                         | \$ 142,792 | 10.25% | \$ 6,072,382       | \$ 218,082 | 14.37% |
| <b>LIABILITIES</b>                 |                                      |            |        |                    |            |        |
| Securitized mortgage borrowings    | \$ 5,517,206                         | \$ 139,809 | 10.14% | \$ 6,034,661       | \$ 214,965 | 14.25% |
| Long-term debt                     | 11,862                               | 912        | 30.75% | 11,879             | 938        | 31.59% |
| Note payable                       | 5,738                                | 460        | 32.07% | 5,960              | 555        | 37.25% |
| Warehouse borrowings               | 53,428                               | 557        | 4.17%  | 7,197              | 89         | 4.95%  |
| Total interest-bearing liabilities | \$ 5,588,234                         | \$ 141,738 | 10.15% | \$ 6,059,697       | \$ 216,547 | 14.29% |
| <b>Net Interest Spread (1)</b>     |                                      | \$ 1,054   | 0.10%  |                    | \$ 1,535   | 0.08%  |
| <b>Net Interest Margin (2)</b>     |                                      |            | 0.08%  |                    |            | 0.10%  |

(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 \$481 thousand for the three months ended March 31, 2012 primarily attributable to a decrease in net interest spread on the long-term portfolio due to increases in pricing and the corresponding reduction in investor yield requirements between periods on securitized mortgage collateral and securitized mortgage borrowings, partially offset by a decrease in interest expense on long-term debt and the note payable for the three months ended March 31, 2012. As a result, net interest margin decreased from 0.10% for the three months ended March 31, 2011 to 0.8% for the three months ended March 31, 2012.

During the three months ended March 31, 2012, the yield on interest-earning assets decreased to 10.25% from 14.37% in the comparable 2011 period. The yield on interest-bearing liabilities decreased to 10.15% for the three months ended March 31, 2012 from 14.29% for the comparable 2011 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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## Changes in Non-Interest Income

|   | For the three months ended March 31, |           |                        |             |
|---|--------------------------------------|-----------|------------------------|-------------|
|   | 2012                                 | 2011      | Increase<br>(Decrease) | %<br>Change |
| Change in fair value of net trust assets, excluding REO | \$ 6,400                             | \$ 4,896  | \$ 1,504               | 31%         |
| Losses from REO   | (9,427)                              | (4,249)   | (5,178)                | (122)       |
| Non-interest (loss) income - net trust assets           | (3,027)                              | 647       | (3,674)                | (568)       |
| Mortgage and real estate services fees                  | 14,036                               | 12,240    | 1,796                  | 15          |
| Other   | (615)                                | (17)      | (598)                  | 3518        |
| Total non-interest income                               | \$ 10,394                            | \$ 12,870 | \$ (2,476)             | (19)%       |

*Non-interest (loss) 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 understand the economics on our residual interests in securitizations better, it is necessary to consider the net effect of changes in fair value of net trust assets and losses from REO. 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 \$3.0 million for the three months ended March 31, 2012, compared to a gain of \$647 thousand in the comparable 2011 period. 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 three months ended March 31, 2012, the Company recognized a \$6.4 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 securitized mortgage collateral of \$231.4 million. Offsetting these gains were losses resulting from increases in the fair value of securitized mortgage borrowings and net derivative liabilities, and a decrease in fair value of investment securities available-for-sale of \$224.0 million, \$561 thousand and \$443 thousand, respectively.

For the three months ended March 31, 2011, the Company recognized a \$4.9 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 securitized mortgage collateral and reduction in fair value of net derivative liabilities of \$139.4 million and \$2.9 million, respectively. Offsetting these gains were losses resulting from increases in the fair value of securitized mortgage borrowings and decrease in fair value of investment securities available-for-sale of \$137.7 million and \$202 thousand, respectively.

*Losses from REO.* Losses from REO were \$9.4 million for the three months ended March 31, 2012. This loss was comprised of \$9.4 million in additional impairment write-downs during the period and \$2 thousand gain on sale of REO. During the three months ended March 31, 2012, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period which resulted in a decrease to NRV.

Losses from REO were \$4.2 million for the three months ended March 31, 2011. This loss was comprised of \$4.2 million in additional impairment write-downs during the period partially offset by \$4 thousand in gain on sale of REO. During the three months ended March 31, 2011, 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.

*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 March 31, 2012, mortgage and real estate services fees were \$14.0 million compared to \$12.2 million in fees in the comparable 2011 period. The mortgage and real estate services fees of \$14.0 million for the three months ended March 31, 2012, was primarily comprised of \$9.2 million in mortgage lending, \$2.4 million in real estate services and recovery fees, \$1.2 million in loss mitigation fees and \$1.2 million in portfolio service fees. The \$1.8 million increase in mortgage and real estate services fees was the result of an increase in mortgage lending of approximately \$8.7 million. Offsetting this increase were decreases in title and escrow fees, real estate services and recovery fees, loss mitigation fees and portfolio service fees of approximately \$4.3 million, \$2.2 million, \$238 thousand and \$117 thousand, respectively. The reduction in title and escrow fees is a result of the sale of our interest in Experience 1, Inc., the parent of the title insurance company, during the third quarter of 2011.



Table of Contents*Non-Interest Expense*

## Changes in Non-Interest Expense

|                                   | <b>For the three months ended March 31,</b> |             |                                |                     |  |
|-----------------------------------|---|-------------|--------------------------------|---------------------|--|
|                                   | <b>2012</b>                                 | <b>2011</b> | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Change</b> |  |
| Personnel expense                 | \$ 10,485                                   | \$ 10,766   | \$ (281)                       | (3)%                |  |
| General, administrative and other | 4,219                                       | 4,579       | (360)                          | (8)                 |  |
| Total non-interest expense        | \$ 14,704                                   | \$ 15,345   | \$ (641)                       | (4)%                |  |

Total non-interest expense was \$14.7 million for the three months ended March 31, 2012, compared to \$15.3 million for the comparable period of 2011. The \$641 thousand decrease in non-interest expense was primarily attributable to both a decrease in personnel and related costs associated with the sale of Experience 1, Inc. in the third quarter of 2011, partially offset by an increase in such costs associated with the growth of the Company's mortgage lending platform.

*Income Taxes*

The Company recorded income tax expense of \$30 thousand and \$12 thousand for the three months ended March 31, 2012 and 2011, respectively. The income tax expense for 2012 and 2011 is the result of state income taxes primarily from states where the Company does not have net operating loss carryforwards.

As of December 31, 2011, the Company had estimated federal and California net operating loss carryforwards of approximately \$498.7 million and \$468.2 million, respectively, of which approximately \$280.0 million (federal) relate to discontinued operations. During the years ended December 31, 2011 and 2010, estimated net operating loss carryforwards were reduced as a result of the Company generating taxable income from cancellation of debt in the amount of approximately \$39.2 million and \$426.2 million, respectively, of securitized mortgage borrowings. Federal and state net operating loss carryforwards begin to expire in 2020 and 2017, respectively. The use of NOL carryforwards in California has been suspended.

The Company files numerous tax returns in various jurisdictions. While the Company is subject to examination by various taxing authorities, the Company believes there are no unresolved issues or claims likely to be material to its financial position. A subsidiary of the Company has been examined by the IRS for tax years 2006 and 2008. The subsidiary filed a consent to extend the statute of limitations for year 2008 until December 31, 2013. As of March 31, 2012, the Company has no material uncertain tax positions.

*Results of Operations by Business Segment*

*Mortgage and Real Estate Services*

## Condensed Statements of Operations Data

|  | For the three months ended March 31, |         |                        |  | %      |
|--|--------------------------------------|---------|------------------------|--|--------|
|  | 2012                                 | 2011    | Increase<br>(Decrease) |  | Change |
| Net interest expense                   | \$ (57)                              | \$ (57) | \$ (57)                |  | N/A%   |
| Mortgage and real estate services fees | 14,036                               | 12,240  | 1,796                  |  | 15     |
| Other non-interest income              | 27                                   | (223)   | 250                    |  | 112    |
| Total non-interest income              | 14,063                               | 12,017  | 2,046                  |  | 17     |
| Personnel expense                      | (8,921)                              | (9,039) | 118                    |  | 1      |
| Non-interest expense and income taxes  | (1,797)                              | (2,048) | 251                    |  | 12     |
| Net earnings                           | \$ 3,288                             | \$ 930  | \$ 2,358               |  | 254%   |

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For the three months ended March 31, 2012, mortgage and real estate services fees were \$14.0 million compared to \$12.2 million in fees in the comparable 2011 period. The mortgage and real estate services fees of \$14.0 million for the three months ended March 31, 2012, was primarily comprised of \$9.2 million in mortgage lending, \$2.4 million in real estate services and recovery fees, \$1.2 million in loss mitigation fees and \$1.2 million in portfolio service fees. The \$1.8 million increase in mortgage and real estate services fees was the result of an increase in mortgage lending of approximately \$8.7 million. Offsetting this increase were decreases in title and escrow fees, real estate services and recovery fees, loss mitigation fees and portfolio service fees of approximately \$4.3 million, \$2.2 million, \$238 thousand and \$117 thousand, respectively. The reduction in title and escrow fees is a result of the sale of our interest in Experience 1, Inc., the parent of the title insurance company, during the third quarter of 2011.

The \$8.7 million increase in mortgage lending during the three months ended March 31, 2012 was primarily the result of an increase in net gain on sale of loans slightly offset by an increase in provision for repurchases as compared to the same period in 2011. For the three months ended March 31, 2012, net gain on sale of loans was \$8.9 million as compared to \$652 thousand in the first quarter of 2011. Provision for repurchases increased to \$293 thousand for the three months ended March 31, 2012 as compared to \$117 thousand for the same period in 2011. For the three months ended March 31, 2012, the increase in net gain on sale of loans and provision for repurchase was the result of \$355.7 million in loan sales during the period as compared to \$26.3 million of loans sold for the comparable 2011 period.

The \$250 thousand decrease in other income is primarily the result of decreases during the first quarter of 2011 associated with the reduction in fair value of the call and put option associated with AmeriHome.

The decrease in personnel and non-interest expense and income taxes was primarily attributable to both a decrease in personnel and related costs associated with the sale of Experience 1, Inc. in the third quarter of 2011, partially offset by an increase in such costs associated with the growth of the Company's mortgage lending platform.

*Long-term Portfolio*

Condensed Statements of Operations Data

|   | For the three months ended March 31, |          |                        |             |
|---|--------------------------------------|----------|------------------------|-------------|
|   | 2012                                 | 2011     | Increase<br>(Decrease) | %<br>Change |
| Net interest income                                     | \$ 1,111                             | \$ 1,535 | \$ (424)               | (28)%       |
| Change in fair value of net trust assets, excluding REO | 6,400                                | 4,896    | 1,504                  | 31          |
| Losses from real estate owned                           | (9,427)                              | (4,249)  | (5,178)                | (122)       |
| Non-interest income- net trust assets                   | (3,027)                              | 647      | (3,674)                | (568)       |
| Change in fair value of long-term debt                  | (93)                                 | 238      | (331)                  | (139)       |
| Other non-interest income                               | (549)                                | (32)     | (517)                  | (1616)      |
| Total non-interest income                               | (3,669)                              | 853      | (4,522)                | (530)       |
| Personnel expense                                       | (1,563)                              | (1,727)  | 164                    | 9           |
| Non-interest expense and income taxes                   | (2,453)                              | (2,543)  | 90                     | 4           |

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|          |    |         |    |         |    |         |        |
|----------|----|---------|----|---------|----|---------|--------|
| Net loss | \$ | (6,574) | \$ | (1,882) | \$ | (4,692) | (249)% |
|----------|----|---------|----|---------|----|---------|--------|

Net interest income decreased \$424 thousand for the three months ended March 31, 2012 primarily attributable to a decrease in net interest spread on the long-term portfolio due to reduction in principal balances outstanding and increases in pricing and the corresponding reduction in investor yield requirements between periods on securitized mortgage collateral and securitized mortgage borrowings, partially offset by a decrease in interest expense on long-term debt and the note payable for the three months ended March 31, 2012.

For the three months ended March 31, 2012, the Company recognized a \$6.4 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 securitized mortgage collateral of \$231.4 million. Offsetting these gains were losses resulting from increases in the fair value of securitized mortgage borrowings and net derivative liabilities, and a decrease in fair value of investment securities available-for-sale of \$224.0 million, \$561 thousand and \$443 thousand, respectively. Losses from REO were \$9.4 million for the three months

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ended March 31, 2012. This loss was comprised of \$9.4 million in additional impairment write-downs during the period. During the three months ended March 31, 2012, additional impairment write-downs were attributable to higher expected loss severities on properties held during the period which resulted in a decrease to NRV.

***Discontinued Operations***

## Condensed Statements of Operations Data

|                                       | For the three months ended March 31, |          |                        |             |
|---------------------------------------|--------------------------------------|----------|------------------------|-------------|
|                                       | 2012                                 | 2011     | Increase<br>(Decrease) | %<br>Change |
| Provision for repurchases             | (503)                                | (253)    | (250)                  | (99)%       |
| Other non-interest income             | (1)                                  | 122      | (123)                  | (101)       |
| Total non-interest income             | (504)                                | (131)    | (373)                  | (285)       |
| Non-interest expense and income taxes | (764)                                | (219)    | (545)                  | (249)       |
| Net loss earnings                     | \$ (1,268)                           | \$ (350) | \$ (918)               | (262)%      |

Provision for repurchases increased \$250 thousand to a provision of \$503 thousand for the three months ended March 31, 2012, compared to a provision of \$253 thousand for the same period in 2011. The \$250 thousand increase is the result of increases in estimated repurchase losses during the three months ended March 31, 2012.

Non-interest income and income taxes increased \$545 thousand between periods primarily due to an increase in legal and professional expenses.

**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***

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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 March 31, 2012, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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***PART II. OTHER INFORMATION***

**ITEM 1: LEGAL PROCEEDINGS**

The Company is a defendant in or a party to a number of legal actions or proceedings that arise in the ordinary course of business. In some of these actions and proceedings, claims for monetary damages are asserted against the Company. In view of the inherent difficulty of predicting the outcome of such legal actions and proceedings, the Company generally cannot predict what the eventual outcome of the pending matters will be, what the timing of the ultimate resolution of these matters will be, or what the eventual loss related to each pending matter may be, if any.

In accordance with applicable accounting guidance, the Company establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and estimable. In any cases, there may be an exposure to losses in excess of any such amounts whether accrued or not. Any estimated loss is subject to significant judgment and is based upon currently available information, a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimated loss will change from time to time, and actual results may vary significantly from the current estimate. Therefore, an estimate of possible loss represents what the Company believes to be an estimate of possible loss only for certain matters meeting these criteria. It does not represent the Company's maximum loss exposure. At March 31, 2012, the Company does not have an accrued liability recorded for such estimated loss exposure.

Based on the Company's current understanding of these pending legal actions and proceedings, management does not believe that judgments or settlements arising from pending or threatened legal matters, individually or in the aggregate, will have a material adverse effect on the consolidated financial position, operating results or cash flows of the Company. However, in light of the inherent uncertainties involved in these matters, some of which are beyond the Company's control, and the very large or indeterminate damages sought in some of these matters, an adverse outcome in one or more of these matters could be material to the Company's results of operations or cash flows for any particular reporting period.

Updates to legal matters since the filing of our Form 10-K for the year ended December 31, 2011 are as follows:

On April 30, 2012 a matter was filed in the Superior Court of the State of California, Orange County entitled Rene Marentes and Martha Marentes v. Impac Mortgage Holdings, Inc. The complaint is a putative class action matter contending that certain loan modification activities of the company constitute an unfair business practice, that they constitute false advertising and marketing and that the fees charged are improper. The complaint seeks unspecified damages, restitution, injunctive relief, attorney's fees and pre-judgment interest.

On May 26, 2011, a matter was filed in the United States District Court, Central District of California as Case No. CV11-4514 DSF entitled Citigroup Global Markets, Inc. v. Impac Secured Assets Corp., Impac Funding Corporation and Impac Mortgage Holdings, Inc. The action alleges a violation of Section 18 and Section 20 of the Securities and Act of 1933 and negligent misrepresentation, all involved in the issuance and sale of bonds from a securitization trust. The plaintiff alleges they relied on certain documents filed with the Securities and Exchange Commission (SEC) that were subsequently the subject of an amended filing. The matter seeks unspecified damages, interest, legal fees and litigation expenses. On May 3, 2012, the Court granted a motion by the plaintiffs for partial summary judgment except with respect to the negligent misrepresentation claim against Impac Mortgage Holdings, Inc.

**ITEM 1A: RISK FACTORS**

**OUR OPERATIONS MAY BE AFFECTED BY THE DEFAULT OF A SUB-SERVICER**

We use third parties to service our mortgage loans both on an interim basis and for the servicing and master servicing rights we retain when we have sold or securitized mortgage loans. If our sub-servicer defaults or fails to perform to certain standards this can be deemed to be a default or failure by us to perform those duties or functions. As a result we may be responsible for damages or subject to termination as a servicer or master servicer. The parent of one of our subservicers recently disclosed that they did not make a semi-annual interest payment that was due on one of their obligations on a note. That failure was not a default under the note, however it could become one if it continues. This, by itself, is not necessarily a default under their subsidiary's obligation to service our mortgage loans, and under our servicing or master servicing agreements is not a default by us. However, such an action could give rise to, or be evidence that there may be, a future default on the obligation to service our mortgage loans. If there is such a default to service our mortgage loans, this could adversely affect our rights or obligations to service or master service the loans which could affect our cash flows.

Our Annual Report on Form 10-K for the year ended December 31, 2011 includes 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.



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

None

**ITEM 3: DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4: MINE SAFETY DISCLOSURES**

None.

**ITEM 5: OTHER INFORMATION**

On April 1, 2012, the Company, through its subsidiaries, amended the \$4.0 million working capital line of credit agreement with Wells Fargo Bank extending the expiration to April 2013.

On April 13, 2012, the warehouse facility under the Master Repurchase Agreement with Customers Bank was amended primarily to increase the maximum borrowing capacity to \$38.5 million.

On May 10, 2012, the warehouse facility under the Master Repurchase Agreement with Ever Bank, formerly Metlife, was amended to increase the maximum borrowing capacity from \$25.0 million to \$50.0 million.

The information set forth above is included herewith for the purpose of providing the disclosure required under Item 1.01- Entry into a Material Definitive Agreement and Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant of Form 8-K.

**ITEM 6: EXHIBITS**

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- (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.
  - 101\* The following materials from Impac Mortgage Holdings, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (1) the Condensed Consolidated Balance Sheets, (2) the Condensed Consolidated Statements of Operations, (3) the Condensed Consolidated Statements of Cash Flows, and (4) Notes to Consolidated Financial Statements, tagged as blocks of text.

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\* 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)*

May 15, 2012