IMPAC MORTGAGE HOLDINGS INC
Form 10-K/A
January 16, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
Amendment No. 2

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2000 or

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

For the transition period from _________ to ________.

Commission File Number: 0-19861

IMPAC MORTGAGE HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Maryland	33-0675505
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.I)

1401 Dove Street, Newport Beach, California 92660
(Address of principal executive offices)

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

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

Title of each class	Name of each exchange on which registered
Common Stock $0.01 par value	American Stock Exchange

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement issued in connection with the 2000 Annual Meeting of Stockholders of the Registrant are incorporated by reference into Part III.

IMPAC MORTGAGE HOLDINGS, INC.

2001 FORM 10-K/A ANNUAL REPORT

Explanatory Note: The Registrant is amending the following items of its Annual Report on Form 10-K for the fiscal year ended December 31, 2000 on the pages attached hereto.

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PART I

Certain information contained in this Report constitutes forward-looking statements under the Securities Act and the Exchange Act. These forward-looking statements can be identified by the use of forward-looking terminology including, but not limited to, "may," "will," "expect," "intend," "should," "anticipate," "estimate," or "believe" or comparable terminology. The Company's actual results may differ materially from those contained in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in "Item 1. Business--Risk Factors" as well as those discussed elsewhere in this Report.

ITEM 1. BUSINESS

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

General

Impac Mortgage Holdings, Inc. is a mortgage real estate investment trust ("REIT"), which, together with its subsidiaries and related companies, primarily operates three businesses: (1) the Long-Term Investment Operations, (2) the Mortgage Operations, and (3) the Warehouse Lending Operations. The Long-Term Investment Operations invests primarily in non-conforming residential mortgage loans and securities backed by such loans. The Mortgage Operations purchases and sells and securitizes primarily non-conforming mortgage loans. The Warehouse Lending Operations provides warehouse and repurchase financing to originators of mortgage loans. The Company elects to be taxed as a REIT for federal income tax purposes, which generally allows the Company to pass through income to stockholders without payment of federal income tax at the corporate level.

Long-Term Investment Operations

The Long-Term Investment Operations, conducted by IMH and IMH Assets, a wholly-owned specialty purpose entity through which IMH conducts its Collateralized Mortgage Obligations ("CMO") borrowings, invests primarily in non-conforming residential mortgage loans and mortgage-backed securities secured by or representing interests in such loans and, to a lesser extent, in second mortgage loans. Non-conforming residential mortgage loans are residential mortgages that generally do not qualify for purchase by government-sponsored agencies such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The principal differences between conforming loans and non-conforming loans include applicable loan-to-value ratios, credit and income histories of the mortgagors, documentation required for approval of the mortgagors, type of properties securing the mortgage loans, loan sizes, and the mortgagors' occupancy status with respect to the mortgaged properties. Second mortgage loans are mortgage loans secured by a second lien on the property and made to borrowers owning single-family homes for the purpose of debt consolidation, home improvements, education and a variety of other purposes.

Income is earned primarily from net interest income received by IMH on mortgage loans and mortgage-backed and other collateralized securities acquired and held in its portfolio. Mortgage loans and mortgage-backed and other collateralized securities are financed with capital, borrowings provided from CMOs, warehouse facilities, which are referred to as reverse repurchase agreements, and borrowings secured by mortgage-backed securities. IFC supports the investment objectives of the Long-Term Investment Operations by supplying the Long-Term Investment Operations mortgage loans and mortgage-backed securities at prices that are comparable to those available through investment bankers and other third parties.

Mortgage Loans Held in the Portfolio

The Company originates loans through its network of conduit sellers and brokers, and invests a substantial portion of its portfolio in non-conforming mortgage loans and, to a lesser extent, second mortgage loans. The Company also purchases such loans from third parties for long-term investment and for resale. Management believes that non-conforming mortgage loans provide an attractive net earnings profile and produce higher yields without commensurately higher credit risks when compared with conforming mortgage loans. The Company primarily originates or purchases "A" or "A-" grade mortgage loans (collectively, "A Loans", as defined by the Company) and to a lesser extent "B" and "C" grade mortgage loans (collectively, "B/C Loans", as defined by the company). "A" grade loans generally have a Fair Isaac Credit Score ("FICO") of 620 or better and "A-" grade loans generally have a FICO score of 550 or better. The FICO was developed by Fair Isaac Co., Inc. of San Rafael, California. It is an electronic evaluation of past and present credit accounts on the borrower's credit bureau report. This includes all reported accounts as well as public records and inquiries. The following table summarizes the percentage of mortgage loans by credit grade in the long term investment portfolio for the periods shown.

	At December 31, 2000	At December 31, 1999
"A" Loans	90.3%	89.1%
"B/C" Loans	9.7	10.9
	100.0%	100.0%

The Company believes that a structural change in the mortgage banking industry has occurred which has increased demand for higher yielding non-conforming mortgage loans. This change has been caused by a number of factors, including: (1) investors' demand for higher-yielding assets due to historically low interest rates over the past few years, (2) increased securitization of high-yielding non-conforming mortgage loans by the investment banking industry, (3) quantification and development of standardized credit mortgage loans, and (4) increased competition in the securitization industry, which has reduced borrower interest rates and fees, thereby making non-conforming mortgage loans more affordable.

Investments in Mortgage-Backed Securities

Subsequent to 1997, the Company's investment strategy has been to only acquire or invest in mortgage-backed securities that are secured by mortgage loans underwritten and purchased by the Mortgage Operations. Prior to 1998, the Company acquired other collateralized securities secured by loans generated by third parties. In connection with the issuance of mortgage-backed securities by IFC in the form of real estate mortgage investment conduits ("REMICs"), IMH has and may retain senior or subordinated securities as regular interests on a short-term or long-term basis. Such securities or investments may subject the Company to credit, interest rate and/or prepayment risks. In general, subordinated classes of a particular series of securities bear all losses prior to the related senior classes. Losses in excess of expected losses at the time such securities are purchased would adversely affect the Company's yield on such securities and could result in the failure of the Company to recoup its initial investment. The Company may also acquire REMIC or CMO residual interests created through its own securitizations or those of third parties. See "--Mortgage Operations--Securitization and Sale Process," and "--Risk Factors--Value of Our Portfolio of Mortgage-Backed Securities May be Adversely Affected."

Financing

The Long-Term Investment Operations are primarily financed through the issuance of CMOs, short-term borrowings under reverse repurchase agreements, borrowings secured by mortgage-backed securities, and proceeds from the sale of capital stock. Refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for more information regarding the Company's financing arrangements.

Collateralized Mortgage Obligations. As the Long-Term Investment Operations accumulates mortgage loans in its long-term investment portfolio, the Company may issue CMOs secured by such loans as a means of

financing its Long-Term Investment Operations. The decision to issue CMOs is based on the Company's current and future investment needs, market conditions and other factors. For accounting and tax purposes, the mortgage loans financed through the issuance of CMOs are treated as assets of the Company, and the CMOs are treated as debt of the Company, when for accounting purposes the CMO qualifies as a financing arrangement. Each issue of CMOs is fully payable from the principal and interest payments on the underlying mortgage loans collateralizing such debt, any cash or other collateral required to be pledged as a condition to receiving the desired rating on the debt, and any investment income on such collateral. The Long-Term Investment Operations earns the net interest spread between the interest income on the mortgage loans securing the CMOs and the interest and other expenses associated with the CMO financing. The net interest spread may be directly impacted by the levels of prepayment of the underlying mortgage loans and, to the extent each CMO class has variable rates of interest, may be affected by changes in short-term interest rates.

When the Company issues CMOs for financing purposes, it seeks an investment grade rating for such CMOs by a nationally recognized rating agency. To secure such a rating, it is often necessary to pledge collateral in excess of the principal amount of the CMOs to be issued, or to obtain other forms of credit enhancements such as additional mortgage loan insurance. The need for additional collateral or other credit enhancements depends upon factors such as the type of collateral provided, the interest rates paid, the geographic concentration of the mortgaged property securing the collateral, and other criteria established by the rating agencies. The pledge of additional collateral reduces the capacity of the Company to raise additional funds through short-term secured borrowings or additional CMOs, and diminishes the potential expansion of its investment portfolio. As a result, the Company's objective is to pledge additional collateral for CMOs only in the amount required to obtain an investment grade rating for the CMOs by a nationally recognized rating agency. Total loss exposure to the Company is limited to the equity invested in the CMOs at any point in time.

The Company believes that under prevailing market conditions an issuance of CMOs receiving other than an investment grade rating would require payment of an excessive yield to attract investors. The Company's CMOs typically are structured as one-month London interbank offered rate ("LIBOR") "floaters" and fixed rate securities with interest payable monthly. Interest rates on adjustable rate CMOs range from 0.18% to 3.60% over one-month LIBOR and from 6.65% to 7.25% on fixed rate CMOs depending on the class of the CMOs issued. The CMOs are guaranteed for the holders by a mortgage loan insurer, giving the CMOs the highest rating established by a nationally recognized rating agency.

Reverse Repurchase Agreements. The Company has reverse repurchase agreements at interest rates that are consistent with the Company's financing objectives. A reverse repurchase agreement, although structured as a sale and repurchase obligation, acts as a financing vehicle under which the Company effectively pledges its mortgage loans and mortgage securities as collateral to secure a short-term loan. Generally, the other party to the agreement makes the loan in an amount equal to a percentage of the market value of the pledged collateral. At the maturity of the reverse repurchase agreement, the Company is required to repay the loan and correspondingly receives back its collateral. Under reverse repurchase agreements, the Company retains the instruments of beneficial ownership, including the right to distributions on the collateral and the right to vote on matters as to which certificate holders vote. Upon a payment default under such agreements, the lending party may liquidate the collateral.

The Company's borrowing agreements require the Company to pledge cash, additional mortgage loans or additional securities backed by mortgage loans in the event the market value of existing collateral declines. The Company may be required to sell assets to reduce its borrowings to the extent that cash reserves are insufficient to cover such deficiencies in collateral. To reduce its exposure to the credit risk of reverse repurchase agreement lenders, the Company enters into such agreements with several different parties and follows its own credit exposure procedures. The Company monitors the financial condition of its reverse repurchase agreement lenders on a regular basis, including the percentage of mortgage loans that are the subject of reverse repurchase agreements with a single lender. See "--Risk Factors--Inability to Generate Liquidity May Adversely Affect Our Operations."

Borrowings Secured by Mortgage-Backed Securities. The Company finances a portion of its mortgage-backed securities portfolio with principal only notes. The notes represent senior or subordinated interests in trust funds primarily consisting of a pool of mortgage loans. The notes represent non-recourse obligations of the Company.

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Other Mortgage-Backed Securities. As an additional alternative for the financing of its Long-Term Investment Operations, the Company may issue other mortgage-backed securities. The Company may issue mortgage pass-through certificates representing an undivided interest in pools of mortgage loans. The holders of mortgage pass-through certificates receive their pro rata share of the principal payments made on a pool of mortgage loans and interest at a pass-through interest rate that are fixed at the time of offering. The Company may retain up to a 100% undivided interest in a significant number of the pools of mortgage loans underlying such pass-through certificates. The retained interest, if any, may also be subordinated so that, in the event of a loss, payments to certificate holders will be made before the Company receives its payments. Unlike the issuance of CMOs, the issuance of mortgage pass-through certificates will not create an obligation of the Company to security holders in the event of borrower default. However, as in the case of CMOs, the Company may be required to obtain various forms of credit enhancements in order to obtain an investment grade rating for issues of mortgage pass-through certificates by a nationally recognized rating agency.

Mortgage Operations

The Mortgage Operations, conducted by IFC and Impac Lending Group ("ILG"), a division of IFC, purchases primarily non-conforming mortgage loans and, to a lesser extent, second mortgage loans from its network of third party correspondent sellers, wholesale brokers and retail customers. IFC is the Mortgage Operations and includes correspondent business along with wholesale and retail business from ILG. IFC subsequently securitizes and sells loans to permanent investors, including the Long-Term Investment Operations. All mortgage loans originated or purchased by IFC will be made available for sale to IMH at prices that are comparable to those available through third parties at the date of sale and subsequent transfer to IMH. IMH owns all of the preferred stock of, and 99% of the economic interest in, IFC, while Joseph R. Tomkinson, Chairman and Chief Executive Officer, William S. Ashmore, President, and Richard J. Johnson, Executive Vice President and Chief Financial Officer, are the holders of all of the outstanding voting stock of, and 1% of the economic interest in, IFC.

As of December 31, 2000, IFC maintained relationships with 263 correspondent sellers and 983 wholesale brokers. Correspondents originate and close mortgage loans under IFC's mortgage loan programs on a flow (loan-by-loan) basis or through bulk sale commitments. Correspondents include savings and loan associations, commercial banks, mortgage bankers and mortgage brokers. ILG began operations in January 1999 and markets, underwrites, processes and funds mortgage loans for both of the Company's wholesale and retail customers. Through the wholesale division, ILG allows mortgage brokers to work directly with the Company to originate, underwrite and fund their mortgage loans. Many of the Company's wholesale customers cannot conduct business with the Mortgage Operations as correspondent sellers because they do not meet the higher net worth requirements. Through the retail division, ILG markets mortgage loans directly to the public. Both the wholesale and retail divisions offer all of the loan programs, including Progressive Series and Progressive Express, that are offered by IFC. IFC can compete effectively with other non-conforming mortgage loan conduits through its efficient loan purchasing process, flexible purchase commitment options and competitive pricing and by designing non-conforming mortgage loans to suit the needs of its correspondent loan originators and their borrowers, which are intended to provide sufficient credit quality to its investors. In addition to earnings generated from ongoing securitizations and sales to third-party investors, the Mortgage Operations supports the Long-Term Investment Operations of the Company by supplying IMH with non-conforming mortgage loans and securities backed by such loans.

As a non-conforming mortgage loan conduit, IFC acts as an intermediary between the originators of mortgage loans that do not currently meet the guidelines for purchase by government-sponsored entities that guarantee mortgage-backed securities (i.e. Fannie Mae and Freddie Mac) and permanent investors in mortgage-backed securities secured by or representing an ownership interest in such mortgage loans. IFC also acts as a bulk purchaser of primarily non-conforming mortgage loans. The Company believes that non-conforming mortgage loans provide an attractive net earnings profile, producing higher yields without commensurately higher credit risks when compared to mortgage loans that qualify for purchase by Fannie Mae or Freddie Mac. In addition, based on the Company's experience in the mortgage banking industry and in the mortgage conduit business, the Company believes it provides mortgage loan sellers with an expanded and competitively priced array of non-conforming and, to a lesser extent, B/C Loan products, timely purchasing of loans, mandatory, best efforts and optional rate-lock commitments, and flexible master commitments. See "--Purchase Commitment Process and Pricing."

Marketing and Production

Marketing Strategy. The Company's competitive strategy is to be a low-cost national acquirer of mortgage loans to be held for long-term investment, sold in the secondary market as whole loans or securitized as mortgage-backed securities. A key feature of this approach is the use of a large national network of correspondent originators and wholesale brokers. This allows IFC to shift the high fixed costs of interfacing with the homeowner to its customers. The marketing strategy for the Mortgage Operations is designed to accomplish three objectives: (1) attract a geographically diverse group of both large and small correspondent originators and brokers, (2) establish relationships with correspondents and brokers that facilitate their ability to offer a variety of loan products designed by IFC, and (3) purchase loans and securitize and sell them in the secondary market or to the Long-Term Investment Operations. In order to accomplish these objectives, IFC designs and offers loan products that are attractive to potential non-conforming borrowers and to end-investors in non-conforming mortgage loans and mortgage-backed securities.

IFC has historically emphasized and continues to emphasize flexibility in its mortgage loan product mix as part of its strategy to attract and establish long-term relationships with correspondents and brokers. IFC also maintains relationships with numerous end-investors so that it may develop products that they may be interested in as market conditions change, which in turn may be offered through the correspondent network. As a consequence, IFC is less dependent on acquiring conforming mortgage loans and has acquired significant volumes of non-conforming loans. In response to the needs of its non-conforming mortgage loan correspondents, and as part of its strategy to facilitate the sale of its loans through the Mortgage Operations, IFC's marketing strategy offers efficient response time in the purchase process, direct and frequent contact with its correspondents and brokers through a trained sales force and flexible commitment programs. Finally, due to the price sensitivity of most homebuyers, IFC is competitive in pricing its products in order to attract sufficient numbers of borrowers.

Impac Direct Access System for Lending ("IDASL"). IDASL is not a lead generator for mortgage brokers, but is an interactive internet system that enables our customers to access loan status, current pricing, purchase confirmations and receive consistent and reliable automated loan underwriting decisions within minutes. In addition, IDASL has an integrated credit-reporting interface that provides our customers with a very competitive tool enabling them to render a loan decision at point of sale. IDASL is intended to increase efficiencies not only for our customers but also for the Mortgage Operations by significantly decreasing the processing time for a mortgage loan, while improving employee production and maintaining superior customer service, which together leads to higher closing ratios, improved profit margins and increased profitability at all levels of its business operations. Future enhancements to IDASL, which are expected to be implemented during the second quarter of 2001, are expected to include the ability to provide automated mortgage insurance approval, fraud detection and electronic property appraisal that are intended to further streamline the entire mortgage application and approval process. Most importantly, IDASL allows IFC to move closer to its correspondents and brokers with minimal future capital investment while maintaining centralization, a key factor in the success of the Company's operating strategy. During the fourth quarter of 2000, IFC's customers increased average monthly volume of loans submitted through the IDASL system by 27% over third quarter of 2000 loan submissions. Loan submissions during the fourth quarter of 2000 averaged $555.5 million per month in loan volume as compared to $438.0 million per month during the third quarter of 2000 and $236.0 million per month during the second quarter of 2000. By December 31, 2000, substantially all of IFC's correspondents were submitting loans through IDASL and 100% of all wholesale loans delivered by brokers were directly underwritten through IDASL.

The Progressive Series Loan Program. The underwriting guidelines utilized in the Progressive Series Loan Program ("Progressive Series"), as developed by IFC, are intended to assess the borrower's ability and willingness to repay the mortgage loan obligation and to assess the adequacy of the mortgaged property as collateral for the mortgage loan. Progressive Series is designed to meet the needs of borrowers with excellent credit, as well as those with credit that has been adversely affected. Progressive Series consists of six mortgage loan programs. Each program has different credit criteria, reserve requirements, qualifying ratios and loan-to-value ratio ("LTV") restrictions. Series I is designed with credit history and income requirements typical of "A" credit borrowers. In the event a borrower does not fit the series I criteria, the borrower's mortgage loan is placed into either series II, III, III+, IV, V or VI, depending on which series' mortgage loan parameters meets the borrower's unique credit profile. Series II, III, III+, IV, V or VI allow for less restrictive standards because of certain compensating or offsetting factors such as a lower LTV, verified liquid assets, job stability, pride of ownership and, in the case of refinance mortgage loans, length of time owning the mortgaged property. The philosophy of Progressive Series is that no single borrower characteristic should automatically determine whether an application for a mortgage loan should be approved or disapproved. Lending decisions are based on a risk analysis assessment after the review of the entire mortgage loan file. Each mortgage loan is individually underwritten with emphasis placed on the overall quality of the mortgage loan. All Progressive Series borrowers are required to have debt service-to-income ratios within the range of 45% to 55% (calculated on the basis of monthly income), depending on the LTV of the mortgage loan.

The Progressive Express Loan Program. IFC has also developed an additional program to the Progressive Series, called the Progressive Express Loan Program ("Progressive Express"). The concept of Progressive Express is to underwrite loans focusing on the borrower's FICO, the borrower's ability and willingness to repay the mortgage loan obligation, and assessment of the adequacy of the mortgage property as collateral for the loan. Progressive Express offers six levels of mortgage loan programs. Progressive Express has a minimum FICO that must be met by the borrower's primary wage earner and does not allow for exceptions to the FICO requirement. The FICO requirement is as follows: Progressive Express I - above 680, Progressive Express II - 680-620, Progressive Express III - 619-601, Progressive Express IV - 600-581, Progressive Express V - 580-551, and Progressive VI - 550-500. Each Progressive Express program has different FICO requirements, credit criteria, reserve requirements, and LTV restrictions. Progressive Express I is designed for credit history and income requirements typical of "A+" credit borrowers. In the event a borrower does not fit the Progressive Express I criteria, the borrower's mortgage loan is placed into either Progressive Express II, III, IV, V or VI, depending on which series' mortgage loan parameters meets the borrowers unique credit profile.

Mortgage Loans Acquired. A majority of mortgage loans purchased by the Mortgage Operations are non-conforming mortgage loans. Currently, the maximum principal balance for a conforming loan is $275,000. Loans that exceed such maximum principal balance are referred to as "jumbo loans." Non-conforming mortgage loans generally consist of jumbo loans or other loans that are originated in accordance with underwriting or product guidelines that differ from those applied by Fannie Mae and Freddie Mac. Non-conforming loans may involve greater risk as a result of different underwriting and product guidelines. A portion of the mortgage loans purchased through the Mortgage Operations are B/C Loans, as described below, which may entail greater credit risks than other non-conforming loans. IFC generally does not acquire mortgage loans with principal balances above $750,000 for "A" quality loans, and $500,000 for B/C Loans. Non-conforming loans purchased by IFC pursuant to its underwriting programs typically differ from those purchased pursuant to the guidelines established by Fannie Mae and Freddie Mac primarily with respect to required documentation, LTV ratios, borrower income or credit history, interest rates, borrower occupancy of the mortgaged property, and/or property types. To the extent that these programs reflect underwriting standards different from those of Fannie Mae and Freddie Mac, the performance of loans made may reflect higher delinquency rates and/or credit losses.

Mortgage loans acquired by IFC are generally secured by first liens and, to a lesser extent, second liens on single (one-to-four) family residential properties with either fixed or adjustable interest rates. Fixed rate mortgage loans ("FRMs") have a constant interest rate over the life of the loan, which is generally 15 or 30 years. The interest rate on adjustable rate mortgage loans ("ARMs") are typically tied to an index, such as six-month LIBOR or the one-year constant maturity Treasury index ("CMT Index") and are adjustable periodically at various intervals. ARMs are typically subject to lifetime interest rate caps and periodic interest rate and/or payment caps. The interest rates on ARMs are typically lower than the average comparable fixed rate loan initially, but may be higher than average comparable fixed rate loans over the life of the loan. Currently, IFC purchases (1) FRMs that have original terms to maturity ranging from 10 to 30 years, (2) ARMs that adjust based on LIBOR or the CMT Index, and (3) 2-year and 3-year FRMs that adjust to six-month ARMs approximately two to three years following origination at an interest rate based upon a defined index plus a spread. Substantially all mortgage loans purchased by IFC fully amortize over their remaining terms, however, IFC may purchase mortgage loans with other interest rate and maturity characteristics.

The credit quality of the loans purchased by IFC varies depending upon the specific program under which such loans are purchased. For example, a principal credit risk inherent in adjustable rate mortgage loans is the potential "payment shock" experienced by the borrower as rates rise, which could result in increased delinquencies and credit losses. In the case of negative amortization mortgage loans, a portion of the interest due accrues to the underlying principal balance of the loan, thereby increasing the LTV ratio of the mortgage loans. As a general rule, mortgage loans with higher LTV ratios are vulnerable to higher delinquency rates given the borrower's lower equity

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investment in the underlying property. Limited documentation mortgage loans, by contrast, must meet more rigorous criteria for borrower credit quality in order to compensate for the reduced level of lender review with respect to the borrower's earnings history and capacity.

The following table summarizes IFC's mortgage loan acquisitions by type of loan, including net premiums, for the periods shown:

	Year ended December 31, 2000
	(dollar except for
Non-conforming Loans:	
Volume of loans	$ 2,108.5
Percent of total volume	99.8%
Conforming Loans:	
Volume of loans	$ 4.2
Percent of total volume	0.2%
Total Mortgage Loan Acquisitions	$ 2,112.7
Fixed Rate Loans:	
Volume of loans	$ 1,551.1
Percent of total volume	73.6%
Adjustable Rate Loans:	
Volume of loans	557.6
Percent of total volume	26.4%
Total Mortgage Loan Acquisitions	$ 2,112.7
Average Loan Size	$ 155,000

IFC's loan purchase activities are expected to continue to focus on those regions of the country where higher volumes of non-conforming mortgage loans are originated, including California, Florida, Texas, Georgia, New Jersey, New York, Washington, Illinois, Colorado, and Nevada. The highest concentration of non-conforming mortgage loans purchased by IFC relates to properties located in California and Florida because of generally higher property values and mortgage loan balances. During the years ended December 31, 2000 and 1999, mortgage loans secured by California and Florida properties accounted for approximately 40% and 13%, respectively, and 44% and 11%, respectively, of mortgage loan acquisitions. Of the $2.1 billion in mortgage loans acquired during the year ended December 31, 2000, $1.0 billion, or 48%, were acquired from IFC's top ten sellers. During the year ended December 31, 2000, Express Lending accounted for $223.2 million, or 11%, of mortgage loans acquired by IFC. No other sellers accounted for more than 10% of the total mortgage loans acquired by IFC during the year ended December 31, 2000.

A portion of the mortgage loans acquired by IFC are comprised of B/C Loans. For the year ended December 31, 2000, such loans accounted for 0.5% of IFC's total loan acquisitions as compared to 2% of IFC's total loan acquisitions during 1999. In general, B/C Loans are residential mortgage loans made to borrowers with lower credit ratings than borrowers of higher quality, A Loans, and are normally subject to higher rates of loss and delinquency than other non-conforming loans purchased by IFC. As a result, B/C Loans normally bear a higher rate of interest and are typically subject to higher fees (including greater prepayment fees and late payment penalties) than non-conforming A Loans. In general, greater emphasis is placed upon the value of the mortgaged property and, consequently, the quality of appraisals, and less upon the credit history of the borrower in underwriting B/C Loans than in underwriting A Loans. In addition, B/C Loans are generally subject to lower LTV ratios than A Loans. Under IFC's B/C Loan program, underwriting authority is delegated only to correspondents who meet strict

underwriting guidelines established by IFC, see "--Purchase Guidelines, Underwriting Methods, Seller Eligibility and Quality Control."

High Loan-to-Value Loans. High loan-to-value loans ("125 Loans") consist of second mortgage loans to qualified borrowers who have limited access to traditional mortgage-related financing generally because of a lack of equity in their homes. The loans are typically closed-end (usually 15 years), fixed rate, fully-amortizing loans secured by a first or second lien on the borrower's primary residence, and are typically used by consumers to pay-off credit card and other unsecured indebtedness. Almost all of these loans are made in excess of the value of the underlying collateral available to secure such loans, up to a maximum of 125% of the property's LTV ratio.

Purchase Commitment Process and Pricing

Master Commitments. As part of its marketing strategy, IFC has established mortgage loan purchase commitments ("Master Commitments") with sellers that, subject to certain conditions, entitle the seller to sell and obligate IFC to purchase a specified dollar amount of non-conforming mortgage loans over a period generally ranging from six months to one year. The terms of each Master Commitment specify whether a seller may sell loans to IFC on a mandatory, best efforts or optional rate-lock basis. Master Commitments do not generally obligate IFC to purchase loans at a specific price, but rather provide the seller with a future outlet for the sale of its originated loans based on IFC's quoted prices at the time of purchase. Master Commitments specify the types of mortgage loans the seller is entitled to sell to IFC and generally range from $2 million to $50 million in aggregate committed principal amount. The provisions of IFC's Seller/Servicer Guide are incorporated in each of the Mortgage Operations' Master Commitments and may be modified by negotiations between the parties. In addition, there are individualized Master Commitment options available to sellers, which include alternative pricing structures or specialized loan products. In order to obtain a Master Commitment, a seller may be asked to pay a non-refundable up-front or non-delivery fee, or both, to the Company. As of December 31, 2000, IFC had outstanding Master Commitments with 135 sellers to purchase mortgage loans in the aggregate principal amount of $2.1 billion over periods ranging from six months to one year, of which $1.2 billion had been purchased or committed to be purchased pursuant to rate-locks.

Sellers who have entered into Master Commitments may sell mortgage loans to the Mortgage Operations by executing individual, bulk or other rate-locks (each, a "rate-lock"). Each rate-lock, in conjunction with the related Master Commitment, specifies the terms of the related sale, including the quantity and price of the mortgage loans or the formula by which the price will be determined, the rate-lock type and the delivery requirements. Historically, the up-front fee paid by a seller to IFC to obtain a Master Commitment on a mandatory delivery basis is often refunded pro rata as the seller delivers loans pursuant to rate-locks. Any remaining fee after the Master Commitment expires is retained by the Mortgage Operations.

Following the issuance of a specific rate-lock, IFC is subject to the risk of interest rate fluctuations and enters into hedging transactions to diminish such risk. Hedging transactions may include mandatory or optional forward sales of mortgage loans or mortgage-backed securities, interest rate caps, floors and swaps, mandatory forward sales, mandatory or optional sales of futures, and other financial futures transactions. The nature and quantity of hedging transactions are determined by the management of IFC based on various factors, including market conditions and the expected volume of mortgage loan purchases. Deferred hedging gains and losses are presented on IFC's balance sheet in mortgage loans held-for-sale. These deferred amounts are recognized upon the sale or securitization of the related mortgage loans. As of December 31, 2000 and 1999, IFC had $(7,000) and $792,000, respectively, of deferred hedging gains (losses) included in mortgage loans held-for-sale.

Bulk and Other Rate-Locks. IFC also acquires mortgage loans from sellers that are not purchased pursuant to Master Commitments. These purchases may be made on an individual rate-lock basis. Bulk rate-locks obligate the seller to sell and IFC to purchase a specific group of loans, generally ranging from $500,000 to $125 million in aggregate committed principal amount, at set prices on specific dates. Bulk rate-locks enable IFC to acquire substantial quantities of loans on a more immediate basis. The specific pricing, delivery and program requirements of these purchases are determined by negotiation between the parties but are generally in accordance with the provisions of IFC's Seller/Servicer Guide. Due to the active presence of investment banks and other substantial investors in this area, bulk pricing is extremely competitive. Loans are also purchased from individual sellers (typically smaller originators of mortgage loans) who do not wish to sell pursuant to either a Master Commitment or

bulk rate-lock. The terms of these individual purchases are based primarily on IFC's Seller/Servicer Guide and standard pricing provisions.

Mandatory, Best-Efforts and Optional Rate-Locks. Mandatory rate-locks require the seller to deliver a specified quantity of loans to IFC over a specified period of time regardless of whether the loans are actually originated by the seller or whether circumstances beyond the seller's control prevent delivery. IFC is required to purchase all loans covered by the rate-lock at prices established at the time of rate-lock. If the seller is unable to deliver the specified loans, it may instead deliver comparable loans approved by IFC within the specified delivery time. Failure to deliver the specified mortgage loans or acceptable substitute loans under a mandatory rate-lock obligates the seller to pay IFC a penalty, and, if IFC's mortgage loan yield requirements have declined, the present value of the difference in yield IFC would have obtained on the mortgage loans that the seller agreed to deliver and the yield available on similar mortgage loans subject to mandatory rate-lock issued at the time of such failure to deliver. In contrast, mortgage loans sold on a best-efforts basis must be delivered to IFC only if they are actually originated by the seller. The best-efforts rate-lock provides sellers with an effective way to sell loans during the origination process without any penalty for failure to deliver. Optional rate-locks give the seller the option to deliver mortgage loans to IFC at a fixed price on a future date and requires the payment of up-front fees to IFC. Any up-front fees paid in connection with optional rate-locks are retained by IFC if the loans are not delivered.

Pricing. IFC sets purchase prices at least once every business day for mortgage loans it acquires for its Mortgage Operations based on prevailing market conditions. Different prices are established for the various types of loans, rate-lock periods and types of rate-locks (mandatory or best-efforts). IFC's standard pricing is based on the anticipated price it receives upon sale or securitization of the loans, the anticipated interest spread realized during the accumulation period, the targeted profit margin and the anticipated issuance, credit enhancement, and ongoing administrative costs associated with such sale or securitization. The credit enhancement cost component of IFC's pricing is established for individual mortgage loans or pools of mortgage loans based upon the characteristics of such loans or loan pools. As the characteristics of the loans or loan pools vary, this cost component is correspondingly adjusted upward or downward to reflect the variation. IFC's adjustments are reviewed periodically by management to reflect changes in the costs of credit enhancement. Adjustments to IFC's standard pricing may also be negotiated on an individual basis under Master Commitments or bulk or individual rate-locks with sellers. See "--Securitization and Sale Process."

Purchase Guidelines, Underwriting Methods, Seller Eligibility and Quality Control

Purchase Guidelines. IFC has developed comprehensive purchase guidelines for the acquisition of mortgage loans by the Mortgage Operations. Each loan underwritten assesses the borrower's FICO, ability and willingness to repay the mortgage loan obligation and the adequacy of the mortgaged property as collateral for the mortgage loan. Subject to certain exceptions and the type of loan product, each purchased loan must conform to the loan parameters and eligibility requirements specified in IFC's Seller/Servicer Guide with respect to, among other things, loan amount, type of property, LTV ratio, mortgage insurance, credit history, debt service-to-income ratio, appraisal and loan documentation. IFC also performs a full legal documentation review prior to the purchase of all loans. All mortgage loans originated under IFC's loan programs are underwritten either by employees of IFC or by contracted mortgage insurance companies or delegated sellers.

Underwriting Methods. Under all of IFC's underwriting methods, loan documentation requirements for verifying the borrower's income and assets vary according to LTV ratios and other factors. Generally, as the standards for required documentation are lowered, the borrowers' down payment requirements are increased and the required LTV ratios are decreased. The borrower is also required to have a stronger credit history, larger cash reserves and an appraisal of the property that is validated by an enhanced desk and field review. Lending decisions are based on a risk analysis assessment after the review of the entire mortgage loan file. Each mortgage loan is individually underwritten with emphasis placed on the overall quality of the mortgage loan.

Under the Progressive Series program, IFC underwrites one-to-four family mortgage loans with LTV ratios at origination of up to 97% of the property's appraised value, depending on, among other things, a borrower's credit history, repayment ability and debt service-to-income ratio, as well as the type and use of the mortgaged property. Second lien financing of the mortgaged properties may be provided by lender's other than IFC at origination, however, the combined LTV ratio generally may not exceed 100% of the property's appraised value. Progressive

Express has a minimum FICO that must be met by the borrower's primary wage earner and does not allow for exceptions to the FICO requirement. Each Progressive Express program has different FICO requirements, credit criteria, reserve requirements, and LTV ratio restrictions. Under the Progressive Express program, IFC underwrites single family dwellings with LTV ratios at origination of up to 97% of the property's appraised value. In order for the property to be eligible for the Progressive Express, it must be a single family residence (1 unit only), condominium, and/or planned unit development. Under Progressive Express, the borrower must disclose employment and assets on the application, however there is no verification of the information.

IFC uses the program parameters as guidelines only. On a case-by-case basis, IFC may determine that the prospective mortgagor warrants an exception outside the standard program guidelines. An exception may be allowed if the loan application reflects certain compensating factors, including (1) the prospective mortgagor has demonstrated an ability to save and devote a greater portion of income to basic housing needs, (2) the prospective mortgagor may have a potential for increased earnings and advancement because of education or special job training, even if the prospective mortgagor has just entered the job market, (3) the prospective mortgagor has demonstrated an ability to maintain a debt free position, (4) the prospective mortgagor may have short term income that is verifiable but could not be counted as stable income because it does not meet the remaining term requirements, and (5) the prospective mortgagor's net worth is substantial enough to suggest that repayment of the loan is within the prospective mortgagor's ability.

IFC does not publish an approved appraiser list for its correspondent sellers. Mortgage sellers may select any appraiser of choice, regardless of the LTV ratio of the related loan, from the seller's approved appraiser list. At the discretion of the underwriter, a full appraisal, an enhanced desk review appraisal, or a field review appraisal may be required.

Seller Eligibility Requirements. Mortgage loans acquired by the Mortgage Operations are originated by various sellers, including savings and loan associations, banks and mortgage bankers. Sellers are required to meet certain regulatory, financial, insurance and performance requirements established by IFC before they are eligible to participate in its mortgage loan purchase program, and must submit to periodic reviews by IFC to ensure continued compliance with these requirements. IFC's current criteria for seller participation generally includes a minimum tangible net worth requirement of $500,000, approval as a Fannie Mae or Freddie Mac Seller/Servicer in good standing, a Housing and Urban Development ("HUD") approved mortgagee in good standing or a financial institution that is insured by the Federal Deposit Insurance Corporation ("FDIC") or comparable federal or state agency, and that the seller is examined by a federal or state authority. In addition, sellers are required to have comprehensive loan origination quality control procedures. In connection with its qualification, each seller enters into an agreement that generally provides for recourse by IFC against the seller in the event of a breach of representations or warranties made by the seller with respect to mortgage loans sold to IFC, which includes but is not limited to any fraud or misrepresentation during the mortgage loan origination process or upon early payment default on such loans.

The underwriting program consists of three separate subprograms. IFC's principal delegated underwriting subprogram is a fully delegated program designed for loan sellers that meet higher financial and performance criteria than those applicable to sellers generally. Generally, qualifying sellers have tangible net worth of at least $1.5 million and are granted delegated underwriting authority to a maximum loan amount of $500,000 for all mortgage products under this subprogram. The second subprogram is a delegated program pursuant to which sellers have tangible net worth of $500,000 to $1.5 million and are granted delegated underwriting authority to a maximum loan amount of $300,000. The third program is for sellers with tangible net worth of $500,000 in which sellers are under IFC's non-delegated underwriting program.

IFC has established a delegated underwriting program, which is similar in concept to the delegated underwriting programs established by Fannie Mae and Freddie Mac. Under this program, qualified sellers are required to underwrite loans in compliance with IFC's underwriting guidelines as set forth in IFC's Seller/Servicer Guide and by individual Master Commitment. In order to determine a seller's eligibility to perform under its delegated underwriting program, an internal review is undertaken by IFC's loan committee. In connection with its approval, the seller must represent and warrant to IFC that all mortgage loans sold to IFC will comply with IFC's underwriting guidelines. The current financial, historical loan quality and other criteria for seller participation in this program generally include a minimum net worth requirement and verification of the seller's good standing,

including the seller's experience and demonstrated performance, with Fannie Mae or Freddie Mac or HUD. IFC periodically reviews the sellers participating in its delegated underwriting program and will retain those sellers that it believes are productive.

Mortgage loans acquired under IFC's non-delegated underwriting program are either fully underwritten by IFC's underwriting staff or involve the use of contract underwriters. IFC has contracted with several national mortgage insurance firms that conduct contract underwriting for mortgage loan acquisitions by IFC. Under these contracts, IFC relies on the credit review and analysis of the contract underwriter, as well as its own pre-purchase eligibility review to ensure that the loan meets program acceptance, its own follow-up quality control procedures, and the representations and warranties of the contract underwriter. Loans that are not acquired under either delegated or contract underwriter methods are fully underwritten by IFC's underwriting staff. In such cases, IFC performs a full credit review and analysis to ensure compliance with its loan eligibility requirements. This review specifically includes, among other things, an analysis of the underlying property and associated appraisal, and an examination of the credit, employment and income history of the borrower. Under all of these methods, loans are purchased only after completion of a legal documentation and eligibility criteria review.

Quality Control. IFC performs a post-closing quality control review on a minimum of 25% of the mortgage loans originated or acquired under the Progressive Series and Progressive Express programs for complete re-verification of employment, income and liquid assets used to qualify for such mortgage loans. Such reviews also include procedures intended to detect evidence of fraudulent documentation and/or imprudent activity during the processing, funding, servicing or selling of the mortgage loans. Verification of occupancy and applicable information is made by regular mail.

Securitization and Sale Process

General. The Mortgage Operations primarily utilizes warehouse lines of credit and equity to finance the acquisition and origination of mortgage loans from its customers. When a sufficient volume of mortgage loans with similar characteristics has been accumulated, generally $100 million to $350 million, IFC will securitize them through the issuance of mortgage-backed securities in the form of REMICs or resell them as bulk whole loan sales. The period between the time IFC commits to purchase mortgage loans and the time it sells or securitizes such mortgage loans generally ranges from 10 to 90 days, depending on certain factors including the length of the purchase commitment period, the loan volume by product type and the securitization process.

Any decision by IFC to issue REMICs or to sell the loans in bulk is influenced by a variety of factors. REMIC transactions are generally accounted for as sales of the mortgage loans and can eliminate or minimize any long-term residual investment in such loans. REMIC securities consist of one or more classes of "regular interests" and a single class of "residual interest." The regular interests are tailored to the needs of investors and may be issued in multiple classes with varying maturities, average lives and interest rates. These regular interests are predominantly senior securities but, in conjunction with providing credit enhancement, may be subordinated to the rights of other regular interests. The residual interest represents the remainder of the cash flows from the mortgage loans (including, in some instances, reinvestment income) over the amounts required to be distributed to the regular interests. In some cases, the regular interests may be structured so that there is no significant residual cash flow, thereby allowing IFC to sell its entire interest in the mortgage loans. As a result, in some cases, all of the capital originally invested in the mortgage loans by the Company is redeployed in the Mortgage Operations.

Each series of mortgage-backed securities is typically fully payable from the mortgage assets underlying such series, and the recourse of investors is limited to such assets and any associated credit enhancement features, such as senior/subordinated structures. To the extent the Company holds subordinated securities, the Company generally bears all losses prior to the related senior security holders. Generally, any losses in excess of the credit enhancement obtained are borne by the security holders. Except in the case of a breach of the standard representations and warranties made by the Company when mortgage loans are securitized, such securities are non-recourse to the Company. Typically, the Company has recourse to the sellers of loans for any such breaches, but there are no assurances of the sellers' abilities to honor their respective obligations.

Credit Enhancement. REMICs created by the Mortgage Operations are structured so that one or more of the classes of such securities are rated investment grade by at least one nationally recognized rating agency. In

contrast to Agency Certificates (pass-through certificates guaranteed by Fannie Mae or Freddie Mac) in which the principal and interest payments are guaranteed by the U.S. government or one of its agencies, securities created by the Mortgage Operations do not benefit from any such guarantee. The ratings for the Mortgage Operations' REMICs are based upon the perceived credit risk by the applicable rating agency of the underlying mortgage loans, the structure of the securities and the associated level of credit enhancement. Credit enhancement is designed to provide protection to the security holders in the event of borrower defaults and other losses including those associated with fraud or reductions in the principal balances or interest rates on mortgage loans as required by law or a bankruptcy court.

The Mortgage Operations can utilize multiple forms of credit enhancement, including special hazard insurance, private mortgage insurance reserve funds, letters of credit, surety bonds, over-collateralization and subordination or any combination of the foregoing. In determining whether to provide credit enhancement through subordination or other credit enhancement methods, the Mortgage Operations takes into consideration the costs associated with each method. Ratings of mortgage-backed securities are based primarily upon the characteristics of the pool of underlying mortgage loans and associated credit enhancement. A decline in the credit quality of such pools (including delinquencies and/or credit losses above initial expectations), or of any third-party credit enhancer, or adverse developments in general economic trends affecting real estate values or the mortgage industry, could result in downgrades of such ratings.

In connection with the securitization of B/C Loans, the levels of subordination required as credit enhancement for the more senior classes of securities issued are higher than those with respect to its non-conforming A Loans. Similarly, in connection with the securitization of Mortgage loans secured by second liens, the levels of subordination required as credit enhancement for the more senior classes of securities issued are higher than those with respect to its mortgage loans secured by first liens. Thus, to the extent that the Company retains any of the subordinated securities created in connection with such securitizations and losses with respect to such pools of B/C Loans or mortgage loans secured by second liens are higher than expected, the Company's future earnings could be adversely affected.

Master Servicing and Servicing

Master Servicing

General. IFC generally performs the function of master servicer with respect to mortgage loans it sells and securitizes. The master servicer's function includes collecting loan payments from servicers of loans and remitting loan payments, less master servicing fees receivable and other fees, to a trustee or other purchaser for each series of mortgage-backed securities or loans master serviced. In addition, as master servicer, IFC monitors compliance with its servicing guidelines and is required to perform, or to contract with a third party to perform, all obligations not adequately performed by any servicer. A master servicer typically employs servicers to carry out servicing functions. In addition, IFC acts as the master servicer for all loans acquired by the Long-Term Investment Operations. With respect to its function as a master servicer for loans owned by IMH, IFC and IMH have entered into agreements having terms substantially similar to those described below for servicing agreements. Master servicing fees are generally 0.03% per annum on the declining principal balances of the loans serviced. As of December 31, 2000 and 1999, IFC's master servicing portfolio was $4.0 billion and $2.9 billion, respectively.

IFC offers its sellers of mortgage loans the right to retain servicing. In the case of servicing retained mortgage loans, the Company will enter into servicing agreements with the sellers of mortgage loans to service the mortgage loans they sell to the Company. Each servicing agreement will require the servicer to service the Company's mortgage loans as required under the Company's servicing guide, which is generally consistent with Fannie Mae and Freddie Mac guidelines and procedures. Each servicer will collect and remit principal and interest payments, administer mortgage escrow accounts, submit and pursue insurance claims, and initiate and supervise foreclosure proceedings on the mortgage loans serviced. Each servicer will also provide accounting and reporting services required by the Company for such loans. The servicer will be required to follow such collection procedures as are customary in the industry. The servicer may, at its discretion, arrange with a defaulting borrower a schedule for the liquidation of delinquencies, provided primary mortgage insurance coverage is not adversely affected. Each servicing agreement will provide that the servicer may not assign any of its obligations with respect to the mortgage loans serviced for the Company, except with the Company's consent.

The following table summarizes delinquency statistics for IFC's master servicing portfolio based on principal balance for the periods shown (dollars in millions):

	At December 31, 2000		At Dec
	Principal Balance of Loans	% of Master Servicing Portfolio	Princip Balance Loans
Loans delinquent for:			
60-89 days	$ 65.8	1.63%	$
90 days	26.0	0.64	
	91.8	2.27	
Foreclosures pending	57.1	0.56	
Bankruptcies pending	22.5	1.41	
Total delinquencies, foreclosures and bankruptcies	$171.4	4.24%	$1

Master Servicing Fees. The Company expects to retain master servicing fees on loans sold. Master servicing fees receivable have characteristics similar to "interest-only" securities; accordingly, they have many of the same risks inherent in "interest-only" securities, including the risk that they will lose a substantial portion of their value as a result of rapid prepayments occasioned by declining interest rates. Master servicing fees receivable represent the present value of the difference between the interest rate on mortgage loans purchased by the Mortgage Operations and the interest rate received by investors who purchase the securities backed by such loans, in excess of the normal loan servicing fees charged by either (1) the Mortgage Operations on loans acquired "servicing released" or (2) correspondents who sold loans to the Mortgage Operations with "servicing retained" (the "Excess Servicing Fees). Currently, the secondary market for master servicing fees receivable is limited). IFC intends to hold the master servicing fees receivable for investment. Accordingly, if IFC had to sell these receivables, the value received may or may not be at or above the values at which IFC carried them on its balance sheet.

To the extent that servicing fees on a mortgage loan exceed an adequate compensation (typically ranging from 0.25% to 0.50% per annum of the mortgage loan principal amount), the Mortgage Operations will generate Excess Servicing Fees receivable as an asset that represents an estimated present value of those excess fees assuming a certain prepayment rate on the mortgage loan. In determining present value of future cash flows, the Mortgage Operations will use a market discount rate. Prepayment assumptions will be based on recent evaluations of the actual prepayments of the Mortgage Operations' servicing portfolio or on market prepayment rates on new portfolios on which the Mortgage

Operations has no experience and the interest rate environment at the time the master servicing fees receivable are created. Management of the Company believes that, depending upon the level of interest rates from time to time, investments in current coupon master servicing fees receivable may be prudent, and if interest rates rise, these investments will mitigate declines in income that may occur in the Mortgage Operations.

Servicing

General. IFC subcontracts or sells all of its servicing obligations under such loans to independent third parties pursuant to sub-servicing agreements or the servicing guide. IFC believes that the selection of third-party sub-servicers or the sale of servicing rights is more effective than establishing a servicing department within the Company. However, part of IFC's responsibility is to continually monitor the performance of the sub-servicers or servicers through monthly performance reviews and regular site visits. Depending on these sub-servicer reviews, the Company may in the future rely on its internal collection group to take an ever more active role to assist the sub-servicer in the servicing of these loans. Servicing includes collecting and remitting loan payments, making required advances, accounting for principal and interest, holding escrow or impound funds for payment of taxes and insurance, if applicable, making required inspections of the mortgaged property, contacting delinquent borrowers, and supervising foreclosures and property dispositions in the event of unremedied defaults in accordance with the Company's guidelines. Servicing fees range from 0.25% per annum for FRMs to 0.50% per annum for B/C Loans and ARMs on the declining principal balances of loans serviced.

IFC generally acquires all of its loans on a "servicing released" basis. To the extent IFC finances the acquisition of such loans with its warehouse line with IWLG, IFC pledges such loans and the related servicing rights to IWLG as collateral. As a result, IWLG has an absolute right to control the servicing of such loans (including the right to collect payments on the underlying mortgage loans) and to foreclose upon the underlying real property in the case of default. Typically, IWLG delegates its right to service the mortgage loans securing the warehouse line to IFC.

The following table summarizes certain information regarding IFC's servicing portfolio of mortgage loans for the periods shown (dollars in millions, except average loan size):

	Year ended December 31, 2000
Beginning servicing portfolio	$ 2,393.4
Add: Loan acquisitions	2,078.8
Less: Servicing transferred	(1,266.0)
Principal paydowns (1)	(777.3)
Ending servicing portfolio	$ 2,428.9
Number of loans serviced	20,644
Average loan size	$ 118,000
Weighted average interest rate	9.88%

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(1) Includes normal principal runoff and principal prepayments.

Mortgage Servicing Rights. When the Mortgage Operations purchases loans which include the associated servicing rights, the allocated price paid for the servicing rights is reflected on its financial statements as Mortgage Servicing Rights ("MSRs"). MSRs differ from master servicing fees receivable primarily by the required amount of servicing to be performed, the loss exposure to the owner of the instrument, and the financial liquidity of the instrument. In contrast to MSRs, where the owner of the instrument acts as the servicer, master servicing fees receivable do not require the owner of the instrument to service the underlying mortgage loan. In addition, master servicing fees receivable subject their owners to greater loss exposure from delinquencies or foreclosure on the underlying mortgage loans than MSRs because a master servicer stands behind the servicer and potentially the owner of the mortgage loan in priority of payment. Both MSRs and master servicing fees receivable are purchased and sold in the secondary markets. However, MSRs are generally more liquid and can be sold at less of a discount as compared to master servicing fees receivable. During periods of declining interest rates, prepayments of mortgage loans increase as homeowners look to refinance at lower rates, resulting in a decrease in the value of the Company's MSRs. Mortgage loans with higher interest rates are more likely to result in prepayments. At December 31, 2000 and 1999, IFC had $10.9 million and $15.6 million, respectively, of MSRs.

Warehouse Lending Operations

The Warehouse Lending Operations, conducted by IWLG, provides warehouse and repurchase financing to affiliated companies and to approved mortgage banks, some of which are correspondents of IFC, to finance mortgage loans during the time from the closing of the loans to their sale or other settlement with pre-approved investors. Generally, the non-conforming mortgage loans funded with such warehouse lines of credit are acquired by IFC. IWLG's warehouse lines are non-recourse and IWLG looks mainly to the sale or liquidation of the mortgage loans as a source of repayment. Any claim of IWLG as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay. Borrowings under the warehouse facilities are presented on the Company's balance sheets as finance receivables. IFC's outstanding warehouse line balances on IWLG's balance sheet are structured to qualify under REIT asset tests and to generate income qualifying under the 75% gross income test. Terms of affiliated warehouse lines are based on Bank of America's prime rate with advance rates between 90% and 98% of the fair value of the mortgage loans outstanding. Outstanding warehouse line balances to non-affiliates on IWLG's balance sheet may not qualify under REIT asset tests and may not generate income qualifying under the 75% gross income test. Terms of non-affiliated warehouse lines, including the commitment amount, are determined

based upon the financial strength, historical performance and other qualifications of the borrower. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for a more detailed discussion of IWLG's warehouse line to IFC.

Regulation

The rules and regulations applicable to the Mortgage Operations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers, and fix maximum loan amounts. Mortgage loan acquisition activities are subject to, among other laws, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act and the Real Estate Settlement Procedures Act and the regulations promulgated that prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. IFC is an approved Fannie Mae and Freddie Mac seller/servicer. IFC is subject to the rules and regulations of Fannie Mae and Freddie Mac with respect to acquiring, processing, selling and servicing conforming mortgage loans. In addition, IFC is required annually to submit to Fannie Mae and Freddie Mac audited financial statements, and each regulatory entity has its own financial requirements for sellers/servicers. For any conforming mortgage loan activities, IFC's affairs are also subject to examination by Fannie Mae and Freddie Mac at any time to assure compliance with the applicable regulations, policies and procedures. Additionally, there are various state and local laws and regulations affecting the Mortgage Operations. Mortgage operations also may be subject to applicable state usury statutes. The Company is presently in material compliance with all material rules and regulations to which it is subject.

Competition

In purchasing and acquiring non-conforming mortgage loans and issuing securities backed by such loans, the Company competes with established mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift and loan associations, finance companies, mortgage bankers, insurance companies, other lenders and other entities purchasing mortgage assets. The continued consolidation in the mortgage banking industry may also reduce the number of current sellers available to the Mortgage Operations, thus reducing the Company's potential customer base, resulting in IFC's purchasing a larger percentage of mortgage loans from a smaller number of sellers. Such changes could negatively impact the Mortgage Operations. Mortgage-backed securities issued by the Mortgage Operations and the Long-Term Investment Operations face competition from other investment opportunities available to prospective investors. The Company faces competition in its Mortgage Operations and Warehouse Lending Operations from other financial institutions, including but not limited to banks and investment banks. Competitors of the Company include IndyMac Bancorp, Inc., Greenpoint Financial Corporation, Residential Funding Corporation and Credit Suisse First Boston Corporation. Competition can take place on various levels, including convenience in obtaining a mortgage loan, service, marketing, origination channels and pricing. The Company depends primarily on independent mortgage brokers and correspondent sellers, for the origination and purchase of its mortgage loans. These independent mortgage brokers deal with multiple lenders for each prospective borrower. The Company competes with these lenders for the independent brokers' business on the basis of price, service, loan fees, costs and other factors. The Company's competitors also seek to establish relationships with such brokers, who are not obligated by contract or otherwise to do business with the Company. Many of the institutions with which the Company competes in its Mortgage Operations and Warehouse Lending Operations have significantly greater financial resources than the Company. However, IFC can compete effectively with other non-conforming mortgage loan conduits through its efficient loan purchasing process, flexible purchase commitment options and competitive pricing and by designing non-conforming mortgage loans to suit the needs of its correspondent loan originators and their borrowers, while providing sufficient credit quality to its investors.

Employees

As of December 31, 2000, the Company had 212 full- and part-time employees and 22 temporary and contract employees. IFC employed 199 full- and part-time employees and 20 temporary and contract employees while IWLG employed 13 and 2, respectively. Employees and operating management of the Long-Term Investment Operations and Mortgage Operations are employed by IFC while employees of the Warehouse Lending Operations are employed by IWLG. The Company believes that relations with its employees are good. The Company is not a party to any collective bargaining agreement.

Future Revisions in Policies and Strategies

Our board of directors, including a majority of our unaffiliated directors, has established our investment and operating policies and strategies. Our core operations involve the acquisition and origination of mortgage loans and their subsequent securitization and sale. We also act as a warehouse lender providing financing facilities to mortgage loan originators. These operations, their associated policies and strategies, are further described herein. Any of our policies, strategies and activities may be modified or waived by our board of directors, subject in certain cases to approval by a majority of our unaffiliated directors, without shareholder consent. Developments in the market which affect the policies and strategies mentioned herein or which change our assessment of the market may cause our Board of Directors to revise our policies and financing strategies.

We have elected to qualify as a REIT for tax purposes. We have adopted certain compliance guidelines which include restrictions on the acquisition, holding and sale of assets. Prior to the acquisition of any asset, we determine whether the asset meets REIT requirements. Substantially all of the assets that we have acquired and will acquire for investment are expected to qualify as REIT assets. This requirement limits our investment strategies.

We closely monitor our acquisition and investment in mortgage assets and the sources of our income, including income from our hedging strategies, to ensure at all times that we maintain our qualifications as a REIT. We have developed certain accounting systems and testing procedures to facilitate our ongoing compliance with the REIT provisions of the Internal Revenue Code. No changes in our investment policies and operating strategies, including credit criteria for mortgage asset investments, may be made without the approval of our board of directors, including a majority of the unaffiliated directors.

We may at times and on terms that our board of directors deems appropriate:

- Issue senior securities - In December 1999, we issued $10.0 million of Series B 10.5% Convertible Preferred Stock. In February 2000, all shares of Series B Convertible Preferred Stock were exchanged for Series C 10.5% Cumulative Convertible Preferred Stock and the conversion rate was adjusted to $4.72 per share from $4.95 per share convertible into 5.29661 shares of common stock from 5.050505 shares of common stock. In August 2001, the shares of Series C Preferred Stock were converted to common stock.

- Borrow money - We finance our operations in large part through the issuance of CMOs, short-term borrowings, under reverse repurchase agreements and borrowings secured by mortgage-backed securities. See "Long-Term Investment Operations - Financing." In addition, in March 1999, certain of our shareholders exchanged 1,359,507 shares of our common stock held by them, at an average price of $5.70 per share, for our 11% senior subordinated debentures due February 15, 2004. The debentures bore interest at 11% per annum and mature on February 15, 2004. Commencing on February 15, 2001, the debentures became redeemable at our option, and in June 2001 we redeemed all of the debentures at a price equal to the face amount of the debentures plus accrued and unpaid interest.

- Make loans to other persons

- Invest in the securities of other issuers for the purpose of exercising control

. Engage in the purchase and sale of investments - In connection with the issuance of mortgage-backed securities by our mortgage operations in the form of REMICs , our long-term investment operations may retain senior or subordinated securities on a short-term or long-term basis. See "Long-Term Investment Operations - Investments in Mortgage-Backed Securities."

. Offer securities in exchange for property - In March 1999, certain of our stockholders exchanged 1,359,507 shares of their common stock at an average price of $5.70 per share for 11% senior subordinated debentures.

. Repurchase or otherwise reacquire our shares or other securities in the future - In October 1998, we adopted a repurchase plan to repurchase up to $5.0 million of our common stock in the open market. In

1999, the board of directors approved common stock repurchases up to an additional $5.0 million, or a total of $10.0 million. During 1999, we repurchased 2.0 million shares of our common stock for $9.9 million. During 2000, we adopted a repurchase plan to repurchase up to $3.0 million of our common stock in the open market. As of December 31, 2000, we had repurchased 991,000 shares for $23 million.

We may also underwrite the securities of other issuers, although we have not done so in the past and have no present intention to do so. Historically, we have and intend to continue to distribute annual reports to our stockholders, including financial statements certified by independent public accountants, describing our current business and strategy.

RISK FACTORS

A prolonged economic downturn or recession would likely result in a reduction of our mortgage origination activity which would adversely affect our financial results

Although we have not operated during a period of prolonged general economic downturn or a recession, these events have historically resulted in a reduction in mortgage origination activity and an increase in the rate of mortgage defaults. The United States economy is currently undergoing a period of a recession. This economic condition has been worsened by the September 11, 2001 terrorist attacks in New York, N.Y. and Washington, D.C. and Somerset County, Pennsylvania. A continued recession may have a significant adverse impact on our operations and our financial condition. For example, a reduction in new mortgages will adversely affect our ability to expand our mortgage portfolio, our principal means of increasing our earnings. In addition, a decline in new mortgage activity will likely result in reduced activity for our warehouse lending operations and our long-term portfolio operations. In the case of our mortgage operations, a decline in mortgage activity may result in fewer loans that meet its criteria for purchase and securitization, thus resulting in a reduction in interest income and fees and gain on sale of loans. We may also experience larger than previously reported credit losses on our investment portfolio due to a higher level of defaults on our mortgage loans.

If we are unable to generate sufficient liquidity we will be unable to conduct our operations as planned

If we cannot generate sufficient liquidity, we will be unable to continue our operations, grow our asset base, maintain our hedging policy and pay dividends. We have traditionally derived our liquidity from four primary sources:

- financing facilities provided to us by others to acquire mortgage assets;
- whole loan sales and securitizations of acquired or originated mortgage loans;
- our issuance of equity and debt securities; and
- earnings from operations.

We cannot assure you that any of these alternatives will be available to us, or if available, that we will be able to negotiate favorable terms. Our ability to meet our long-term liquidity requirements is subject to the renewal of our credit and repurchase facilities and/or obtaining other sources of financing, including additional debt or equity from time to time. Any decision by our lenders and/or investors to make additional funds available to us in the future will depend upon a number of factors, such as our compliance with the terms of our existing credit arrangements, our financial performance, industry and market trends in our various businesses, the general availability of, and rates applicable to, financing and investments, the lenders' and/or investors' own resources and policies concerning loans and investments, and the relative attractiveness of alternative investment or lending opportunities. If we cannot raise cash by selling debt or equity securities, we may be forced to sell our assets at unfavorable prices or discontinue various business activities. Our inability to access the capital markets could have a negative impact on our earnings and hence, our ability to pay dividends.

Any significant margin calls under our financing facilities would adversely affect our liquidity and may adversely affect our financial results

Prior to the fourth quarter of 1998, we generally had no difficulty in obtaining favorable financing facilities or in selling acquired mortgage loans. However, during the fourth quarter of 1998, the mortgage industry experienced substantial turmoil as a result of a lack of liquidity in the secondary markets. At that time, investors expressed unwillingness to purchase interests in securitizations due in part to:

- the lack of financing to acquire these securitization interests;
- the widening of returns expected by institutional investors on securitization interests over the prevailing Treasury rate; and
- market uncertainty.

As a result, many mortgage loan originators, including our company, were unable to access the securitization market on favorable terms, which resulted in some companies declaring bankruptcy. Originators, like our company, were required to sell loans on a whole loan basis and liquidate holdings of mortgage-backed securities to repay short-term borrowings. However, the large amount of loans available for sale on a whole loan basis affected the pricing offered for these loans, which in turn reduced the value of the collateral underlying the financing facilities. Therefore, many providers of financing facilities initiated margin calls. Margin calls resulted when our lenders evaluated the market value of the collateral securing our financing facilities and required us to provide them with additional equity or collateral to secure our borrowings.

Our financing facilities were short-term borrowings and due to the turmoil in the mortgage industry during the latter part of 1998 many traditional providers of financing facilities were unwilling to provide facilities on favorable terms, or at all. Our current financing facilities continue to be short-term borrowings and we expect this to continue. If we cannot renew or replace maturing borrowings, we may have to sell, on a whole loan basis, the loans securing these facilities which, depending upon market conditions, may result in substantial losses.

We incurred losses for fiscal years 1997, 1998 and 2000 and may incur losses in the future

During the year ended December 31, 2000, we experienced a net loss of $54.2 million. The net loss incurred during 2000 included non-recurring, non-cash accounting charges of $68.9 million. The non-recurring, non-cash accounting charges were the result of write-downs of non-performing investment securities secured by mortgages and additional increases in allowance for loan losses to provide for the deteriorating performance of collateral supporting specific investment securities. During the year ended December 31, 1998, we experienced a net loss of $5.9 million. During the year ended December 31, 1997, we experienced a net loss of $16.0 million. The net loss incurred during 1997 included a non-recurring, non-cash accounting charge of $44.4 million that was the result of expenses related to the termination and buyout of our management agreement with Imperial Credit Advisors, Inc. We cannot be certain that revenues will remain at current levels or improve or that we will be profitable in the future, which could prevent us from effectuating our business strategy.

If we are unable to complete securitizations, we would face a liquidity shortage which would adversely affect our operating results.

We rely significantly upon securitizations to generate cash proceeds to repay borrowings and to create credit availability. Any reduction in our ability to complete securitizations may require us to utilize other sources of financing, which, if available at all, may be on unfavorable terms. In addition, delays in closing securitizations of our mortgage loans increase our risk by exposing our company to credit and interest rate risks for this extended period of time. Furthermore, gains on sales from our securitizations represent a significant portion of our earnings.

Several factors could affect our ability to complete securitizations of our mortgages, including:

- conditions in the securities and secondary markets;

- credit quality of the mortgage loans acquired or originated through our mortgage operations;

- volume of our mortgage loan purchases and originations;

- our ability to obtain credit enhancements; and

- lack of investors purchasing higher risk components of the securities.

If we are unable to profitably securitize a significant number of our mortgage loans in a particular financial reporting period, then we could experience lower income or a loss for that period. As a result of turmoil in the securitization market during the latter part of 1998, many mortgage lenders, including our company, were required to sell mortgage loans on a whole loan basis under adverse market conditions in order to generate liquidity. Many of these sales were made at prices lower than our carrying value of the mortgage loans and we experienced substantial losses. We cannot assure you that we will be able to continue to profitably securitize or sell our loans on a whole loan basis, or at all.

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

Our borrowings and use of substantial leverage may cause losses

Our use of collateralized mortgage obligations may expose our operations to credit losses

To grow our investment portfolio, we borrow a substantial portion of the market value of substantially all of our investments in mortgage loans in the form of collateralized mortgage obligations. Historically, we have borrowed approximately 98% of the market value of such investments. There are no limitations on the amount we may borrow, other than the aggregate value of the underlying mortgage loans. We currently prefer to use collateralized mortgage obligations as financing vehicles to increase our leverage, since mortgage loans held for collateralized mortgage obligation collateral are retained for investment rather than sold in a secondary market transaction. Retaining mortgage loans as collateral for collateralized mortgage obligations exposes our operations to greater credit losses than does the use of other securitization techniques that are treated as sales as the equity holder in the security, we are allocated losses from the liquidation of defaulted loans first prior to any other security holder. Although our liability under a collateralized mortgage obligation is limited to the collateral used to create the collateralized mortgage obligation, we generally are required to make a cash equity investment to fund collateral in excess of the amount of the securities issued in order to obtain the appropriate credit ratings for the securities being sold, and therefore obtain the lowest interest rate available, on the collateralized mortgage obligations. If we experience greater credit losses than expected on the pool of loans subject to the collateralized mortgage obligation greater than we expected, the value of our equity investment will decrease and we would have to increase the allowance for loan losses on our financial statements.

The cost of our borrowings may exceed the return on our assets

The cost of borrowings under our financing facilities corresponds to a referenced interest rate plus or minus a margin. The margin varies depending on factors such as the nature and liquidity of the underlying collateral and the availability of financing in the market. We will experience net interest losses if the returns on our assets financed with borrowed funds fail to cover the cost of our borrowings, and we did not implement any applicable financial hedges.

If we default under our financing facilities, we may be forced to liquidate the collateral at prices less than the amount borrowed

If we default under our financing facilities, our lenders could force us to liquidate the collateral. If the value of the collateral is less than the amount borrowed, we could be required to pay the difference in cash. If we were to declare bankruptcy, some of our reverse repurchase agreements may obtain special treatment and our creditors would then be allowed to liquidate the collateral without any delay. On the other hand, if a lender with whom we have a reverse repurchase agreement declares bankruptcy, we might experience difficulty repurchasing our collateral, or enforcing our claim for damages, and it is possible that our claim could be repudiated and we could be treated as an unsecured creditor. If this occurs, our claims would be subject to significant delay and we may receive substantially less than our actual damages or nothing at all.

If we are forced to liquidate we may have few unpledged assets for distribution to unsecured creditors

We have pledged a substantial portion of our assets to secure the repayment of collateralized mortgage obligations issued in securitizations, our financing facilities and our other borrowings. We will also pledge substantially all of our current and future mortgage loans to secure borrowings pending their securitization or sale. The cash flows we receive from our investments that have not yet been distributed, pledged or used to acquire mortgage loans or other investments may be the only unpledged assets available to our unsecured creditors and you if our company was liquidated.

Interest rate fluctuations may adversely affect our operating results

Our operations, as a portfolio manager, a mortgage loan acquirer and originator or a warehouse lender, may be adversely affected by rising and falling interest rates. Higher interest rates may discourage potential borrowers from refinancing mortgages, borrowing to purchase homes or seeking second mortgages. This may decrease the amount of mortgages available to be acquired or originated by our mortgage operations and decrease the demand for warehouse financing provided by our warehouse lending operations to originators of mortgage loans. If short- term interest rates exceed long-term interest rates, there is a higher risk of increased loan prepayments, as borrowers may seek to refinance their fixed and adjustable rate mortgage loans at lower long-term fixed interest rates. Increased loan prepayments could lead to a reduction in the number of loans in our investment portfolio and reduce our net interest income.

We are subject to the risk of rising mortgage interest rates between the time we commit to purchase mortgages at a fixed price through the issuance of individual, bulk or other rate-locks and the time we sell or securitize those mortgages. An increase in interest rates will generally result in a decrease in the market value of mortgages that we have committed to purchase at a fixed price, but have not yet sold or securitized or have not been properly hedged. As a result, we may record a smaller gain, or even a loss, upon the sale or securitization of those mortgage loans.

We may experience losses if our liabilities reprice at different rates than our assets

Our principal source of revenue is net interest income or net interest spread from our investment portfolio, which is the difference between the interest we earn on our interest earning assets and the interest we pay on our interest bearing liabilities. The rates we pay on our borrowings are independent of the rates we earn on our assets and may be subject to more frequent periodic rate adjustments. Therefore, we could experience a decrease in net interest income or a net interest loss because the interest rates on our borrowings could increase faster than the interest rates on our assets. If our net interest spread becomes negative, we will be paying more interest on our borrowings than we will be earning on our assets and we will be exposed to a risk of loss.

Additionally, the rates paid on our borrowings and the rates received on our assets may be based upon different indices (i.e., LIBOR, U.S. Treasuries, etc.). If the index used to determine the rate on our borrowings increases faster than the index used to determine the rate on our assets, we will experience a declining net interest spread, which will have a negative impact on our profitability and may result in losses.

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An increase in our adjustable interest rate borrowings may decrease the net interest margin in our adjustable rate mortgages

As of December 31, 2000, approximately 65% of the mortgages held by our long-term investment operations were fixed rate mortgages. These mortgages will become adjustable rate mortgages or begin bearing interest based upon short-term interest rate indices. We generally fund mortgages with variable interest rate borrowings that are indexed to short-term interest rates and can adjust daily. To the extent that there is an increase in the interest rate index used to determine our adjustable interest rate borrowings that is not offset by various interest rate hedges that we have in place at any given time, our net interest margin will decrease or become negative. As of December 31, 200, our fixed rate mortgages that become adjustable over time had a weighted average months to interest rate adjustment of 16 months.

We may suffer a net interest loss on our adjustable rate mortgages that have interest rate caps if the interest rates on our related borrowings increase

Adjustable rate mortgages typically have interest rate caps, which limit interest rates charged to the borrower during any given period. Our borrowings are not subject to similar restrictions. As a result, in a period of rapidly increasing interest rates, the interest rates we pay on our borrowings could increase without limitation, while the interest rates we earn on our adjustable rate mortgage assets would be capped. If this occurs, our net earnings could be significantly reduced or we could suffer a net interest loss.

Increased levels of prepayments of our adjustable rate mortgage loans may accelerate our expenses and decrease our net income

Mortgage prepayments generally increase on our adjustable rate mortgages when fixed mortgage interest rates fall below the then-current interest rates on outstanding adjustable rate mortgage loans. Prepayments on mortgage loans are also affected by the terms and credit grades of the loans, conditions in the housing and financial markets and general economic conditions. Most of the adjustable rate mortgages that we acquire are originated within three months of the time we purchased the mortgages and generally bear initial interest rates which are lower than their fully-indexed amount (the applicable index plus the margin). If we acquire these mortgages at a premium and they are prepaid prior to or soon after the time of adjustment to a fully-indexed rate without payment of any prepay penalty, we would not have received interest at the fully-indexed rate during such period and we must expense the unamortized premium that was paid for the loan at the time of the prepayment. This means we would lose the opportunity to earn interest at that rate over the expected life of the mortgage. Also, if prepayments on our adjustable rate mortgage loans increase when interest rates are declining, our net interest income may decrease if we cannot reinvest the prepayments in mortgage assets bearing comparable rates. As of December 31, 2000, approximately 30% of our mortgage loan investment portfolio had active prepayment penalty features.

We generally acquire mortgages on a "servicing released" basis, meaning we acquire both the mortgages and the rights to service them. This strategy requires us to pay a higher purchase price or premium for the mortgages. If our mortgage loans that we acquire at a premium prepay faster than originally projected, generally accepted accounting principles require us to write down the remaining capitalized premium amounts at a faster speed than was originally projected, which would decrease our current net interest income.

The value of our portfolio of mortgage-backed securities may be adversely affected by unforeseen events

Our prior investments in residual interest and subordinated debt instruments exposed us to greater risks as compared to senior mortgage-backed securities

Prior to 1998, we invested in mortgage-backed securities known as interest-only, principal-only, residual interest and subordinated securities. Investments in residual interest and subordinated securities are much riskier than investments in senior mortgage-backed securities because these subordinated securities bear all credit losses prior to the related senior securities. The risk associated with holding residual interest and subordinated securities is greater than holding the underlying mortgage loans directly due to the concentration of losses in the subordinated securities.

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If the projected value of our portfolio of residual interest and subordinated debt instruments is incorrect we would have to write down the value of these securities

We estimate future cash flows from these securities and value them utilizing assumptions based in part on projected discount rates, mortgage loan prepayments and credit losses. If our actual experience differs from our assumptions, we would be required to reduce the value of these securities. The market for our asset-backed securities is extremely limited and we cannot assure you that we could sell these securities at their reported value, or at any value or that we could recoup our initial investment.

In addition, we may not obtain our anticipated yield or we may incur losses if the credit support available within certain mortgage-backed securities is inadequate due to unanticipated levels of losses, or due to difficulties experienced by the credit support provider. Delays or difficulties encountered in servicing mortgage-backed securities may cause greater losses and, therefore, greater resort to credit support than was originally anticipated, and may cause a rating agency to downgrade certain classes of our mortgage-backed securities, which might then equate to a reduction of the value of the security.

We undertake additional risks by acquiring and investing in mortgage loans

We may be subject to losses on mortgage loans for which we do not obtain credit enhancements

We do not obtain credit enhancements such as mortgage pool or special hazard insurance for all of our mortgage loans and investments. Generally, we require mortgage insurance on any loan with a loan-to-value ratio greater than 80%. During the time we hold mortgage loans for investment, we are subject to risks of borrower defaults and bankruptcies and special hazard losses that are not covered by standard hazard insurance. If a borrower defaults on a mortgage loan that we hold, we bear the risk of loss of principal to the extent there is any deficiency between the value of the related mortgaged property and the amount owing on the mortgage loan and any insurance proceeds available to us through the mortgage insurer. In addition, since defaulted mortgage loans, which under our financing arrangements are mortgage loans that are generally 60 to 90 days delinquent in payments, may be considered ineligible collateral under our borrowing arrangements, we could bear the risk of being required to own these loans without the use of borrowed funds until they are ultimately liquidated or sold at a loss.

Non-conforming Alt-A mortgage loans expose us to greater credit risks

We are an acquirer and originator of non-conforming Alt-A residential mortgage loans. These are residential mortgages that do not qualify for purchase by government sponsored agencies such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Our operations may be negatively affected due to our investments in non-conforming Alt-A mortgage loans. Credit risks associated with non- conforming Alt-A mortgage loans are greater than conforming mortgage loans. The interest rates we charge on non-conforming Alt-A loans are often higher than those charged for conforming loans in order to compensate for the higher risk and lower liquidity. Lower levels of liquidity may cause us to hold loans or other mortgage-related assets supported by these loans that we otherwise would not hold. By doing this, we assume the potential risk of increased delinquency rates and/or credit losses as well as interest rate risk. Additionally, the combination of different underwriting criteria and higher rates of interest leads to greater risk, including higher prepayment rates and higher delinquency rates and/or credit losses.

Lending to non-conforming Alt-A borrowers may expose us to a higher risk of delinquencies, foreclosures and losses

As a lender of non-conforming Alt-A mortgage loans, our market includes borrowers who may be unable to obtain mortgage financing from conventional mortgage sources. Loans made to such non-conforming Alt-A borrowers generally entail a higher risk of delinquency and higher losses than loans made to borrowers who utilize conventional mortgage sources. Delinquency, foreclosures and losses generally increase during economic slowdowns or recessions. The actual risk of delinquencies, foreclosures and losses on loans made to non-conforming Alt-A borrowers could be higher under adverse economic conditions than those currently experienced in the mortgage lending industry in general. Further, any material decline in real estate values increase the loan-to-

value ratios of loans previously made by us, thereby weakening collateral coverage and increasing the possibility of a loss in the event of a borrower default. Any sustained period of increased delinquencies, foreclosures or losses after the loans are sold could adversely affect the pricing of our future loan sales and our ability to sell our loans in the future. In the past, certain of these factors have caused revenues and net income of many participants in the mortgage industry, including us, to fluctuate from quarter to quarter.

Our use of second mortgages exposes us to greater credit risks

Our security interest in the property securing second mortgages is subordinated to the interest of the first mortgage holder and the second mortgages have a higher cumulative loan-to-value ratio. As of December 31, 2000, 5% of our mortgages were second mortgages. If the value of the property is equal to or less than the amount needed to repay the borrowers obligation to the first mortgage holder upon foreclosure, all or a portion of our second mortgage loan will not be repaid.

The geographic concentration of our mortgage loans increases our exposure to risks in those areas

We do not set limitations on the percentage of our mortgage asset portfolio composed of properties located in any one area (whether by state, zip code or other geographic measure). Concentration in any one area increases our exposure to the economic and natural hazard risks associated with that area. As of December 31, 2000, 53% of the loans included in securitizations in which we hold residual interests are secured by properties in California. Certain parts of California have experienced an economic downturn in past years and have suffered in the past the effects of certain natural hazards.

We may experience losses related to our recourse obligations

Mortgage-backed securities issued in connection with our securitizations have been non-recourse to us, except in the case of a breach of standard representations and warranties made by us when the loans are securitized. While we have recourse against our customers, the correspondent sellers and mortgage brokers of mortgage loans, we cannot assure you that they will honor their obligations. We also engage in bulk whole loan sales pursuant to agreements that provide for recourse by the purchaser against us. In some cases, the remedies available to a purchaser of mortgage loans from us are broader than those available to us against those who sell us these loans. If a purchaser exercises its rights against us, we may not always be able to enforce whatever remedies we may have against our customers.

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

In connection with our securitizations, we transfer loans acquired or originated by us into a trust in exchange for cash and, in the case of a CMO, residual certificates issued by the trust. The trustee will have recourse to us with respect to the breach of the standard representations and warranties made by us at the time such loans are transferred. While we generally have recourse to our customers for any such breaches, there can be no assurance of our customers' abilities to honor their respective obligations. Also, we engage in bulk whole loan sales pursuant to agreements that generally provide for recourse by the purchaser against us in the event of a breach of one of our representations or warranties, any fraud or misrepresentation during the mortgage loan origination process, or upon early default on such mortgage loan. We generally limit the potential remedies of such purchasers to the potential remedies we receive from the people from whom we acquired or originated the mortgage loans. However, in some cases, the remedies available to a purchaser of mortgage loans from us may be broader than those available to us against the sellers of the loans and should a purchaser enforce its remedies against us, we may not always be able to enforce whatever remedies we have against our customers.

In the ordinary course of our business, we are subject to claims made against us by borrowers and trustees in our securitizations arising from, among other things, losses that are claimed to have been incurred as a result of alleged breaches of fiduciary obligations, misrepresentations, errors and omissions of our employees, officers and agents (including our appraisers), incomplete documentation and our failure to comply with various laws and

regulations applicable to our business. Any claims asserted against us in the future may result in legal expenses or liabilities that could have a material adverse effect on our results of operations or financial condition.

We face conflicts of interest based on the ownership of the voting stock of Impac Funding Corporation by certain officers and directors of Impac Mortgage Holdings, Inc.

We are subject to conflicts of interest arising from our relationship with Impac Mortgage Holdings, Inc., our long-term investment operations, Impac Funding Corporation, our mortgage operations, and their officers and directors. Our long-term investment operations acquires non-confirming Alt-A mortgage loans from our mortgage operations. Impac Mortgage Holdings, Inc. owns all of the preferred stock, and 99% of the economic interest in, Impac Funding Corporation. Joseph R. Tomkinson, our Chairman and Chief Executive Officer, William S. Ashmore, our Chief Operating Officer, President and a director, and Richard J. Johnson, our Executive Vice President and Chief Financial Officer, are holders of all of the outstanding voting stock of, and 1% of the economic interest in, Impac Funding Corporation. They have the right to elect all directors of Impac Funding Corporation and the ability to control the outcome of all matters for which the consent of the holders of the common stock of Impac Funding Corporation is required. Messer's Tomkinson, Ashmore and Johnson are also the sole directors of Impac Funding Corporation. Decisions made by these officers at one company may be at conflict with and have an adverse affect on the operations of the other.

A substantial interruption in our use of IDASL may adversely affect our level of mortgage loan acquisitions and originations

We utilize the Internet in our business principally for the implementation of our automated loan origination program, IDASL, which stands for Impac Direct Access System for Lending. IDASL is not a lead generator for mortgage brokers. IDASL allows our customers to pre-qualify borrowers for various loan programs based on criteria requested from the borrower and renders an automated underwriting decision by issuing an approval of the mortgage loan or a referral for further review or additional information. IDASL may be interrupted if the Internet experiences periods of poor performance, if our computer systems or the systems of our third-party service providers contain defects, or if customers are reluctant to use or have inadequate connectivity to the Internet. Increased government regulation of the Internet could also adversely affect our use of the Internet in unanticipated ways and discourage our customers from using our services. If our ability to use the Internet in providing our services is impaired, our ability to originate or acquire loans on an automated basis could be delayed or reduced. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period.

We are subject to risks of operational failure that are beyond our control

Substantially all of our operations are located in Newport Beach, California. Our systems and operations are vulnerable to damage and interruption from fire, flood, telecommunications failure, break-ins, earthquake and similar events. Our operations may also be interrupted by power disruptions, including rolling black-outs currently implemented in California due to the state's continuing acute power shortage. We do not maintain alternative power sources. Furthermore, our security mechanisms may be inadequate to prevent security breaches to our computer systems, including from computer viruses, electronic break-ins and similar disruptions. Such security breaches or operational failures could expose us to liability, impair our operations, result in losses, and harm our reputation.

Our reliance on third-party software for the implementation of IDASL exposes us to risks

We have a licensing agreement with a third-party vendor for the use of hardware and software for IDASL. All of our correspondents are submitting loans through IDASL and all of our wholesale loans delivered by brokers are directly underwritten through the use of IDASL. The termination or impairment of this license could result in delays and reductions in the acquisition and origination of mortgage loans until equivalent hardware and software could be licensed and integrated, if at all possible, which may harm our business. In addition, we would be harmed if the provider from whom we license software ceases to deliver and support reliable products, enhance their current products or respond to emerging industry standards. If the hardware or software provided by our vendor fails for any reason, and the back-up hardware and software is not implemented in a timely manner, it may also delay and reduce those mortgage loan acquisitions and originations done through IDASL. The third-party hardware and

software also may not continue to be available to us on commercially reasonable terms or at all. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period.

Competition for mortgage loans is intense and may adversely affect our operations

We compete in acquiring and originating non-conforming Alt-A mortgage loans and issuing mortgage-backed securities with:

- other mortgage conduit programs;
- investment banking firms;
- savings and loan associations;
- banks;
- thrift and loan associations;
- finance companies;
- mortgage bankers;
- insurance companies;
- other lenders; and
- other entities purchasing mortgage assets.

Some of our competitors are larger and have greater resources than we do.

Consolidation in the mortgage banking industry may adversely affect us by reducing the number of current customers of our mortgage operations and our potential customer base. As a result, we may have to purchase a larger percentage of mortgage loans from a smaller number of customers, which may reduce our profit margins, or increase the cost to acquire these types of loans.

We are exposed to potential credit losses in providing warehouse financing

As a warehouse lender, we lend money to mortgage bankers on a secured basis and we are subject to the risks associated with lending to mortgage banks, including the risks of fraud, borrower default and bankruptcy, any of which could result in credit losses for us. Our claims as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay.

We may not pay dividends to stockholders

REIT provisions of the Internal Revenue Code generally require us to distribute to our stockholders at least 90% of all of our taxable income. These provisions restrict our ability to retain earnings and thereby renew capital for our business activities. We may decide at a future date to terminate our REIT status, which would cause us to be taxed at the corporate level, and cease paying regular dividends.

In addition, for any year that we do not generate taxable income, we are not required to declare and pay dividends to maintain our REIT status. For instance, due to losses incurred in 2000, we did not declare any dividends from September 2000 until September 25, 2001.

To date, a portion of our taxable income and cash flow has been attributable to our receipt of dividend distributions from Impac Funding Corporation, our mortgage operations affiliate. Impac Funding Corporation is not a REIT and is not, therefore, subject to the above-described REIT distribution requirements. Because Impac Funding Corporation is seeking to retain earnings to fund the future growth of our mortgage operations business, its board may decide that Impac Funding Corporation should cease making dividend distributions in the future. This would materially reduce the amount of our taxable income and, in turn, would reduce the amount we would be required to distribute as dividends.

We may be exposed to potential alternative minimum tax liability

To the extent we have a net operating loss carryover for federal income tax purposes, we can offset our regular taxable income for the 2001 taxable year with the net operating loss carryover and thereby eliminate our liability for regular corporate income tax on the amount of income so offset. In computing alternative minimum tax, however, we will be allowed to use only 90% of the net operating loss deduction allowable for purposes of computing the regular income tax. Thus, to the extent we shelter our income with the net operating loss carryover deduction, we will be subject to alternative minimum tax at a rate of 20% on 10% of the income offset by the net operating loss for regular tax purposes. In other words, the effective federal income tax rate on the amount offset by the net operating loss deduction is 2%.

If we fail to maintain our REIT status, we may be subject to taxation as a regular corporation

We believe that we have operated