

ANTHRACITE CAPITAL INC  
Form 10-Q  
November 09, 2007

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2007

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 001-13937

ANTHRACITE CAPITAL, INC.

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(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of  
incorporation or organization) 13-3978906  
(I.R.S. Employer  
Identification No.) 40 East 52nd Street, New York, New York  
(Address of principal executive offices) 10022  
(Zip Code)  
(Registrant's telephone number including area code): (212) 810-3333

NOT APPLICABLE

(Former name, former address, and for new fiscal year; if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

accelerated filer Accelerated filer Non-accelerated filer Large  
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

At November 9, 2007, 63,170,977 shares of common stock (\$0.001 par value per share) were outstanding.

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|      |                                |                              |   |  |   |   |   |  |   |   |   |  |   |   |    |  |    |                                 |    |                             |                           |    |                       |    |   |    |   |    |   |    |                           |    |                  |    |            |    |
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Cautionary Statement Regarding Forward-Looking Statements

Certain statements contained herein constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to future financial or business performance, strategies or expectations. Forward-looking statements are typically identified by words or phrases such as “trend,” “opportunity,” “pipeline,” “believe,” “comfortable,” “expect,” “anticipate,” “current,” “intention,” “estimate,” “position,” “assume,” “potential,” “outlook,” “maintain,” “sustain,” “seek,” “achieve” and similar expressions, or future or conditional verbs such as “will,” “would,” “could,” “may” or similar expressions. Anthracite Capital, Inc. (the “Company”) cautions that forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Forward-looking statements speak only as of the date they are made, and the Company assumes no duty to and does not undertake to update forward-looking statements. Actual results could differ materially from those anticipated in forward-looking statements and future results could differ materially from historical performance.

In addition to factors previously disclosed in the Company’s SEC reports and those identified elsewhere in this report, the following factors, among others, could cause actual results to differ materially from forward-looking statements or historical performance:

- (1) the introduction, withdrawal, success and timing of business initiatives and strategies;
- (2) changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in changes in the value of the Company’s assets;
- (3) the relative and absolute investment performance and operations of BlackRock Financial Management, Inc. (“BlackRock”), the Company’s Manager;
- (4) the impact of increased competition;
- (5) the impact of future acquisitions or divestitures;
- (6) the unfavorable resolution of legal proceedings;
- (7) the impact of legislative and regulatory actions and reforms and regulatory, supervisory or enforcement actions of government agencies relating to the Company or BlackRock;
- (8) terrorist activities and international hostilities, which may adversely affect the general economy, domestic and global financial and capital markets, specific industries, and the Company;
- (9) the ability of BlackRock to attract and retain highly talented professionals;
- (10) fluctuations in foreign currency exchange rates; and
- (11) the impact of changes to tax legislation and, generally, the tax position of the Company.

The Company’s Annual Report on Form 10-K for the year ended December 31, 2006 and the Company’s subsequent reports filed with the SEC, accessible on the SEC’s website at [www.sec.gov](http://www.sec.gov), identify additional factors that can affect forward-looking statements.



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## Part I — FINANCIAL INFORMATION

Item 1.

## Financial Statements

## Anthracite Capital, Inc. and Subsidiaries

## Consolidated Statements of Financial Condition (Unaudited)

(in thousands, except share data)

|  |   |   |  |  |                                     |
|--|---|---|--|--|-------------------------------------|
| September 30, 2007   | December 31, 2006   | ASSETS  |  | Cash and cash equivalents                    | \$ 122,185                          |
| \$ 66,388  | Restricted cash equivalents                                 | 30,547  | 59,801   | Securities available-for-sale, at fair value | \$ 883,432                          |
|  | Subordinated commercial mortgage-backed securities (“CMBS”) | \$ 1,067,347                                  |  |  |                                     |
| Investment grade CMBS  | 1,213,971   | 1,588,284                                     | Residential mortgage-backed securities (“RMBS”)                  |  |                                     |
| 10,084   | 144,140   | Total securities available-for-sale           | 2,291,402  | 2,615,856                                    | Commercial                          |
| mortgage loan pools, at amortized cost   | 1,246,494   | 1,271,014                                     | Securities held-for-trading, at estimated                        |  |                                     |
| fair value   | CMBS 18,638   | 22,383  | RMBS 913   | 132,204                                      | Total                               |
| securities held-for-trading  | 19,551  | 154,587                                       | Commercial mortgage loans, net                                   | 912,675                                      |                                     |
| 481,745  | Equity investments  | 106,855                                       | 182,147  | Derivative instruments, at fair value        | 592,712                             |
| 317,574  | Receivable for investments sold                             | 104,476                                       | —  | Other assets                                 | 89,064                              |
| 69,151   |   |   |  |  |                                     |
| Total Assets   | \$ 5,515,961  | \$ 5,218,263                                  | LIABILITIES AND STOCKHOLDERS’ EQUITY                             |  |                                     |
| Liabilities:   | Borrowings:   | Collateralized debt obligations (“CDOs”)      |  |  |                                     |
| 1,814,231  | \$ 1,812,574  | Secured by subordinated CMBS                  | 278,728  | 48,628                                       | Secured by                          |
| other securities available-for-sale  | 185,348   | 666,275                                       | Secured by commercial mortgage loan pools                        |  |                                     |
| 1,230,251  | 1,256,897   | Secured by securities held-for-trading        | —  | 127,249                                      | Secured by                          |
| commercial mortgage loans  | 215,033   | 26,570  | Secured by receivable for investments sold                       |  |                                     |
| 50,000   | —   | Senior unsecured notes                        | 162,500  | 75,000                                       | Senior convertible debt             |
| 80,000   |   |   |  |  | —                                   |
| Junior unsecured notes   | 71,107  | —   | Junior subordinated notes to subsidiary trust issuing preferred  |  |                                     |
| securities   | 180,477   | 180,477                                       | Total borrowings   | 4,267,675                                    | 4,193,670                           |
| Payable for  |   |   |  |  |                                     |
| investments purchased  | —   | 23,796  | Distributions payable  | 21,014                                       | 17,669                              |
| Derivative   |   |   |  |  |                                     |
| instruments, at fair value   | 605,174   | 304,987                                       | Other liabilities  | 28,638                                       | 22,032                              |
| Total  |   |   |  |  |                                     |
| Liabilities  | 4,922,501   | 4,562,154                                     | Stockholders’ Equity:  |  |                                     |
| Preferred stock,   |   |   |  |  |                                     |
| 100,000,000 shares authorized;   |   |   | 9.375% Series C Preferred stock, liquidation preference \$57,500 |  |                                     |
| \$57,500   |   |   | 8.25% Series D Preferred stock, liquidation preference \$86,250  |  |                                     |
| \$86,250   |   |   | 83,267   |  |                                     |
| Common Stock, par value \$0.001 per share; 400,000,000 shares  |   |   |  |  |                                     |
| authorized; 63,097,248 shares issued and outstanding in 2007; 57,830,964 shares issued and outstanding in 2006 |   |   |  |  |                                     |
| 63   | 58  | Additional paid-in capital                    | 689,654  | 629,785                                      | Distributions in excess of earnings |
| (119,163)  | (120,976)   | Accumulated other comprehensive income (loss) | (115,796)  | 91,807                                       |                                     |
| Total Stockholders’ Equity   | 593,460   | 656,109                                       | Total Liabilities and Stockholders’ Equity                       | \$   |                                     |
| 5,515,961  | \$ 5,218,263  |   |  |  |                                     |

The accompanying notes are an integral part of these consolidated financial statements.



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Anthracite Capital, Inc. and Subsidiaries  
 Consolidated Statements of Operations (Unaudited)  
 (in thousands, except share and per share data)

| For the Three Months Ended                                      |            |  |                                   | For the Nine Months Ended                                   |   |            |  |                           |        |
|---|------------|--|-----------------------------------|---|---|------------|--|---------------------------|--------|
| September 30  |            | September 30                                 |                                   | 2007  |   | 2006       |  | Income:                   |        |
| \$ 49,176   | \$ 44,707  | \$ 144,923                                   | \$ 126,684                        | Interest from securities available-for-sale                 |   |            |  |                           |        |
| 49,942  | 28,041     | Interest from commercial mortgage loan pools | 12,985                            | 13,230  | 39,119                                      | 39,743     | Interest   | 20,494                    | 11,052 |
| 2,986   | 28,982     | 22,001                                       | 384                               | 1,750   | 2,272                                       | 5,522      | Earnings from equity investments                 | 6,611                     |        |
| income  | 91,434     | 74,553                                       | 268,886                           | 223,737   | Expenses:                                   |            | Interest   | 62,525                    | 54,185 |
| 176,976   | 148,345    | Interest – securities held-for-trading       | —                                 | 1,875   | 1,474                                       | 5,597      | Management and incentive                         |                           |        |
| 3,382   | 3,970      | 4,176  | 18,652                            | 13,900  | General and administrative expense          |            | 1,624  | 1,144                     | 4,448  |
| (loss)  | 3,382      | Total expenses                               | 68,119                            | 61,380  | 201,550                                     | 171,224    | Other gains (losses):                            |                           | Gain   |
| 997   | (1,892)    | (2,115)                                      | Income from Continuing Operations | 15,386  | 13,922                                      | 65,444     | 50,398   | Gain (loss) on securities |        |
| Income from Discontinued Operations                             | —          | —  | —                                 | 1,366   | Net income                                  | 15,386     | 13,922   | 65,444                    | 51,764 |
| Dividends on preferred stock                                    | 3,127      | 1,348  | 8,530                             | 4,044   | Net income available to common stockholders |            |  |                           |        |
| \$ 12,259   | \$ 12,574  | \$ 56,914                                    | \$ 47,720                         | Net income per common share, basic: \$ 0.19 \$ 0.22 \$ 0.94 |   |            |  |                           |        |
| \$ 0.84   | \$ 0.82    | Diluted                                      | \$ 0.19                           | \$ 0.22   | \$ 0.94                                     | \$ 0.83    | Income from continuing                           |                           |        |
| operations per share of common stock, after preferred dividends | Basic      |  | \$ 0.19                           | \$ 0.22   | \$  |            |  |                           |        |
| 0.94  | \$ 0.82    | Diluted                                      | \$ 0.19                           | \$ 0.22   | \$ 0.94                                     | \$ 0.81    | Income from discontinued operations per share of |                           |        |
| common stock  | Basic      |  | —                                 | —   | —   | \$ 0.02    | Diluted  |                           |        |
| number of shares outstanding:                                   | Basic      |  | 63,861,985                        | 57,166,795  | 60,450,020                                  | 56,969,930 |  |                           |        |
| Diluted   | 64,178,519 | 57,457,913                                   | 60,662,477                        | 57,164,205  | Dividend declared per share of common stock |            |  |                           |        |
| \$ 0.30   | \$ 0.29    | \$ 0.89                                      | \$ 0.86                           |   |   |            |  |                           |        |

The accompanying notes are an integral part of these consolidated financial statements.



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Anthracite Capital, Inc. and Subsidiaries  
Consolidated Statement of Changes in Stockholders' Equity (Unaudited)  
For the Nine Months Ended September 30, 2007  
(in thousands)

| Common   |                                   |                             |  |                          |                                     |               |               |
|--|-----------------------------------|-----------------------------|--|--------------------------|-------------------------------------|---------------|---------------|
| Stock,<br>Par Value Series C<br>Preferred<br>Stock Series D<br>Preferred<br>Stock Additional<br>Paid-In<br>Capital Distributions<br>in Excess<br>of Earnings Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) Comprehensive<br>Income Total<br>Stockholders'<br>Equity Balance at January 1, 2007 | \$ 58                             | \$ 55,435                   | \$ 629,785   | \$ (120,976 )            | \$ 91,807                           | \$            |               |
| 656,109 Net income   |                                   | 65,444                      | \$ 65,444  | 65,444                   | Unrealized loss on cash flow hedges |               |               |
| (3,649 )   | (3,649 )                          | (3,649 )                    | Reclassification adjustments from cash flow hedges                     |                          |                                     |               |               |
| included in net income   |                                   | 928                         | 928  | 928                      | Foreign currency translation        |               |               |
| (661 )   | (661 )                            | (661 )                      | Change in net unrealized gain on securities available-for-sale, net of |                          |                                     |               |               |
| reclassification adjustment  |                                   | (204,221 )                  | (204,221 )   | (204,221 )               | Other comprehensive                 |               |               |
| income   |                                   | (207,603 )                  | Comprehensive income   |                          |                                     | \$            |               |
| (142,159 )   | Dividends declared – common stock |                             | (55,101 )  | (55,101 )                |                                     |               |               |
| Dividends on preferred stock   |                                   | (8,530 )                    | (8,530 )   | Issuance of common stock | 5                                   |               |               |
| 59,869   | 59,874                            | Issuance of preferred stock | \$ 83,267  |                          |                                     |               |               |
| 83,267   | Balance at September 30, 2007     | \$ 63                       | \$ 55,435  | \$ 83,267                | \$ 689,654                          | \$ (119,163 ) | \$ (115,796 ) |
| \$ 593,460   |                                   |                             |  |                          |                                     |               |               |

Disclosure of reclassification adjustment:

ended  
September 30,  
2007 Unrealized holding loss on securities available-for-sale \$ (202,889 ) Reclassification for realized gains  
previously recorded as unrealized (1,332 ) \$ (204,221 )  
The accompanying notes are an integral part of these consolidated financial statements.

For the nine months



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Anthracite Capital, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (Unaudited)  
 (in thousands)

For

the Nine

Months Ended

September 30,

2007 For the Nine

Months Ended

September 30,

|  |  |   |  |  |
|--|--|---|--|--|
| 2006 Cash flows from operating activities:                         | Net income   | \$ 65,444   | \$ 51,764  | Adjustments to reconcile net income to net cash provided by        |
| (used in) operating activities:                                    | Net decrease in trading securities                                   | 130,973   | 28,487   | Net gain on sale of securities (1,513) (2,683)                     |
| Gain on sale of real estate held for sale                          | —  | (1,366)   | Earnings from subsidiary trust (316) (325)                                 | Distributions from subsidiary trust 316 294                        |
| Earnings from equity investments (28,982) (22,001)                 | Distributions of earnings from equity investments                    | 11,948  | 13,215   | Amortization of debt obligation issuance costs 3,161 2,039         |
| Discount accretion/amortization (net) (9,010)                      | 3,670  | Loss on impairment of assets 7,036 5,795                            | Unrealized net foreign currency gain (28,947) (9,926)                      | Non-cash management and incentive fees 3,838 2,665                 |
| Proceeds from sale of interest rate swap agreements 18,665         | 15,253   | Increase in other assets (6,410) (2,325)                            | Increase in other liabilities 8,021 11,106                                 | Net cash provided by operating activities 174,224 95,662           |
| Cash flows from investing activities:                              | Purchase of securities available-for-sale (505,119) (651,852)        | Proceeds from sale of securities available-for-sale 591,360 109,021 | Principal payments received on securities available-for-sale 58,857 34,898 | Funding of commercial mortgage loans (687,316) (234,098)           |
| Repayments received from commercial mortgage loans 275,127 100,079 | Repayments received from commercial mortgage loan pools 14,835 6,607 | Purchase of real estate held-for-sale — (5,435)                     | Proceeds from sale of real estate held-for-sale — 6,801                    | (Increase) decrease in restricted cash equivalents 29,254 (19,255) |
| Return of capital from equity investments 25,000 14,742            | Investment in equity investments (38,555) (72,202)                   | Net cash used in investing activities (236,557) (710,694)           |  |  |

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Anthracite Capital, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (Unaudited)  
 (in thousands)

For

the Nine

Months Ended

September 30,

2007 For the Nine

Months Ended

September 30,

2006 Cash flows from financing activities: Net increase (decrease) in borrowings under reverse repurchase agreements and credit facilities (144,798) 154,685 Repayments of borrowings secured by commercial mortgage loan pools (16,065) (11,811) Issuance of collateralized debt obligations 23,875 417,000 Issuance costs for collateralized debt obligations (1,537) (7,057) Repayments of collateralized debt obligations (50,018) (4,073) Issuance of senior convertible debt 80,000 Issuance costs of senior convertible debt (2,419) Issuance of junior subordinated notes to subsidiary trust — 100,000 Issuance costs of junior subordinated notes — (3,208) Issuance of senior unsecured notes 87,500 — Issuance costs of senior unsecured notes (2,456) — Issuance of junior unsecured notes 68,557 — Issuance costs of junior unsecured notes (2,113) — Dividends paid on preferred stock (7,344) (4,044) Proceeds from issuance of preferred stock, net of offering costs 83,267 — Proceeds from issuance of common stock, net of offering costs 66,624 12,937 Repurchase of common stock (12,000) Dividends paid on common stock (52,943) (48,307) Net cash provided by financing activities 118,130 606,122 Net increase (decrease) in cash and cash equivalents 55,797 (8,910) Cash and cash equivalents, beginning of period 66,388 40,556 Cash and cash equivalents, end of period \$ 122,185 \$ 31,646 2007 2006 Supplemental disclosure of cash flow information:

Interest paid \$ 168,889 \$ 149,806 Investments purchased not settled \$ — \$ 42,519 Investments sold not settled \$ 104,476 — Supplemental disclosure of non-cash investing and financing activities: Investments in subsidiary trusts \$ — \$ 3,097 Incentive fees paid by the issuance of common stock \$ 5,250 \$ 2,100

The accompanying notes are an integral part of these consolidated financial statements.

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Anthracite Capital, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (Unaudited)  
(Dollar amounts in thousands, except share and per share data)

Note 1 ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anthracite Capital, Inc., a Maryland corporation, and its subsidiaries (the “Company”) is a specialty finance company that invests in commercial real estate assets on a global basis. The Company primarily generates income based on the spread between the interest income, gains and net operating income on its commercial real estate assets and the interest expense from borrowings to finance its investments. The Company seeks to earn high returns on a risk-adjusted basis to support a consistent quarterly dividend. The Company has elected to be taxed, and intends to continue to qualify, as a real estate investment trust (“REIT”) under the United States Internal Revenue Code of 1986, as amended (the “Code”). The Company commenced operations on March 24, 1998.

The Company’s ongoing investment activities primarily encompass three core investment activities:

- |                                   |                    |
|-----------------------------------|--------------------|
|                                   | 1)                 |
| Commercial Real Estate Securities |                    |
| Estate Loans                      | 2) Commercial Real |
| Estate Equity                     | 3) Commercial Real |

The accompanying September 30, 2007 unaudited consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and changes in cash flows have been made. These consolidated financial statements should be read in conjunction with the annual audited financial statements and notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the “SEC”).

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the statements of financial condition and revenues and expenses for the periods covered. Actual results could differ from those estimates and assumptions. Significant estimates in the financial statements include the valuation and credit analysis related to certain of the Company’s mortgage-backed securities, commercial mortgage loans, and certain other investments.

Recent Accounting Developments

Reverse Repurchase Agreements

In July 2007, the Financial Accounting Standards Board (“FASB”) issued proposed FSP FAS 140-d, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This FSP addresses the accounting for the transfer of financial assets and a subsequent repurchase financing. The proposed FSP focuses on the circumstances

that would permit a transferor and a transferee to separately evaluate the accounting for a transfer of a financial asset and a repurchase financing under Statement of Financial Accounting Standards (“SFAS”) No. 140, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

The proposed FSP states that a transfer of a financial asset and a repurchase agreement involving the transferred financial asset should be considered part of the same arrangement when the counterparties to the two transactions are the same unless certain criteria are met. The criteria in the proposed FSP are intended to identify whether (1) there is a valid and distinct business or economic purpose for entering separately into the two transactions and (2) the repurchase financing does not

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result in the initial transferor regaining control over the previously transferred financial assets. The FASB has stated that the proposed FSP's purpose is to limit diversity of practice in accounting for these situations, resulting in more consistent financial reporting. Consequently, the FASB has stated that it is the FASB's desire to have the proposed FSP effective as soon as practicable.

Currently, the Company records such assets and the related financing gross on its consolidated statement of financial condition, and the corresponding interest income and interest expense gross on the consolidated statement of operations. Any change in fair value of the security is reported through other comprehensive income pursuant to SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, because the security is classified as available-for-sale. However, in a transaction where the mortgage-backed securities are acquired from and financed under a repurchase agreement with the same counterparty, the acquisition may not qualify as a sale from the seller's perspective under the provisions of SFAS No. 140. In such cases, the seller may be required to continue to consolidate the assets sold to the Company, based on their continuing involvement with such investments. Depending on the ultimate outcome of the accounting standard setters' deliberations, the Company may be precluded from presenting the assets gross on the Company's consolidated statement of financial condition and should instead be treating the Company's net investment in such assets as a derivative. If it is determined that these transactions should be treated as investments in derivatives, the derivative instruments entered into by the Company to hedge the Company's interest rate exposure with respect to the borrowings under the associated repurchase agreements may no longer qualify for hedge accounting, and would then, as with the underlying asset transactions, also be marked to market through the consolidated statement of operations. This potential change in accounting treatment does not affect the economics of the transactions but does affect how the transactions would be reported on the Company's consolidated financial statements. The Company's cash flows, liquidity and ability to pay a dividend would be unchanged, and the Company does not believe its REIT taxable income or REIT status would be affected. The Company believes net equity would not be materially affected. At September 30, 2007, the Company has identified available-for-sale securities with a fair value of approximately \$106,334 which had been purchased from and financed with reverse repurchase agreements totaling approximately \$85,219 with the same counterparty since their purchase. If the Company were to change the current accounting treatment for these transactions at September 30, 2007 to that required by the proposed FSP, total assets and total liabilities would be reduced by approximately \$85,219.

## Investment Companies

In June, 2007, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 07-1, Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting for Parent Companies and Equity Method Investors for Investments in Investment Companies. This SOP provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide- Investment Companies, (the "Guide"). Entities that are within the scope of the Guide are required, among other things, to carry their investments at fair value, with changes in fair value included in earnings. On October 17, 2007 the FASB decided to indefinitely defer the effective date of this SOP.

## Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (which have inputs to the valuation techniques that are unobservable and require significant management judgment), including a reconciliation of the beginning and ending balances separately

for each major category of assets and liabilities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and all interim periods within those fiscal years. The Company currently is analyzing the potential impact of adoption of SFAS No. 159 to its consolidated financial statements.

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### Fair Value Accounting

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS No. 159”). SFAS No. 159 permits entities to choose to measure eligible financial instruments at fair value. The unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis, it should be applied to an entire instrument, and it is irrevocable. Assets and liabilities measured at fair value pursuant to the fair value option should be reported separately in the consolidated statement of financial condition from those instruments measured using another measurement attribute. SFAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company currently is analyzing the potential impact of adoption of SFAS No. 159 to its consolidated financial statements.

### Variable Interest Entities

The consolidated financial statements include the financial statements of Anthracite Capital, Inc. and its subsidiaries, which are wholly owned or controlled by the Company or entities which are variable interest entities (“VIEs”) in which the Company is the primary beneficiary under FASB Interpretation No. 46, Consolidation of Variable Interest Entities (revised December 2003) (“FIN 46R”). FIN 46R requires a VIE to be consolidated by its primary beneficiary. The primary beneficiary is the party that absorbs the majority of the VIE’s anticipated losses and/or the majority of the expected returns. All inter-company balances and transactions have been eliminated in consolidation.

The Company considers the CMBS securities where it maintains the right to influence the foreclosure/workout process on the underlying loans its controlling class CMBS (“Controlling Class”). The Company has analyzed the governing pooling and servicing agreements for each of its Controlling Class CMBS and believes that the terms are industry standard and are consistent with the qualifying special-purpose entity (“QSPE”) criteria. However, there is uncertainty with respect to QSPE treatment due to ongoing review by accounting standard setters, potential actions by various parties involved with the QSPE, as well as varying and evolving interpretations of the QSPE criteria under SFAS No. 140. Future guidance from the accounting standard setters may require the Company to consolidate CMBS trusts in which the Company has invested.

### Certain Hybrid Financial Instruments

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140. SFAS No. 155 provides, among other things, that:

- For embedded derivatives which would otherwise be required to be bifurcated from their host contracts and accounted for at fair value in accordance with SFAS No. 133, an irrevocable election may be made on an instrument-by-instrument basis, to be measured as hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings.

- Concentrations of credit risk in the form of subordination are not considered embedded derivatives.

- Clarification regarding interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133.

SFAS No. 155 is effective for all financial instruments acquired, issued or subject to remeasurement after the beginning of an entity’s first fiscal year that begins after September 15, 2006. Upon adoption, differences between the

total carrying amount of the individual components of an existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative effect adjustment to beginning retained earnings. Prior periods should not be restated. The adoption of SFAS No. 155 on January 1, 2007 did not have a material impact on the Company's consolidated financial statements.

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## Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes and Related Implementation Issues (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a Company’s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a threshold and measurement attribute for recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 was effective for public companies as of the beginning of fiscal years that began after December 15, 2006. The adoption of FIN 48 on January 1, 2007 did not have a material impact on the Company’s consolidated financial statements.

## Note 2 NET INCOME PER SHARE

Net income per share is computed in accordance with SFAS No. 128, Earnings Per Share. Basic income per share is calculated by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted income per share is calculated using the weighted average number of shares of common stock outstanding during the period plus the additional dilutive effect of common stock equivalents. The dilutive effect of outstanding stock options is calculated using the treasury stock method.

## For the Three Months

Ended September 30, For the Nine Months

|   |            |            |            |            |   |                                    |
|---|------------|------------|------------|------------|---|------------------------------------|
| Ended September 30,   | 2007       | 2006       | 2007       | 2006       | Numerator:  | Net income available to common     |
| stockholders  | \$ 12,259  | \$ 12,574  | \$ 56,914  | \$ 47,720  | Numerator for basic and diluted earnings per share                          | \$                                 |
|   | 12,259     | \$ 12,574  | \$ 56,914  | \$ 47,720  | Denominator:  | Denominator for basic earnings per |
| share   |            |            |            |            |   | share                              |
| – weighted average common shares outstanding                | 63,861,985 | 57,166,798 | 60,450,020 | 56,969,930 | Dilutive  |                                    |
| effect of stock options                                     | 1,048      | 2,925      | 2,133      | 2,148      | effect of stock based incentive fee   | 315,486                            |
|   | 288,190    | 210,324    | 192,127    |            | Denominator for diluted earnings per share – weighted average common shares |                                    |
| outstanding and common stock equivalents outstanding        | 64,178,519 | 57,457,913 | 60,662,477 | 57,164,205 |   |                                    |
| Basic net income per weighted average common share:         | \$ 0.19    | \$ 0.22    | \$ 0.94    | \$ 0.84    | Diluted net income per  |                                    |
| weighted average common share and common share equivalents: | \$ 0.19    | \$ 0.22    | \$ 0.94    | \$ 0.83    |   |                                    |

Total anti-dilutive stock options excluded from the calculation of diluted net income per share were 1,362,151 for the three and nine months ended September 30, 2007, respectively. Total anti-dilutive stock options excluded from the calculation of diluted net income per share were 1,380,151 and 1,384,151 for the three and nine months ended September 30, 2006, respectively.

The convertible senior notes offering of \$80,000 on August, 29, 2007 were determined to be anti-dilutive for the three and nine months ended September 30, 2007. In the three and nine months

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ended September 30, 2007, the anti-dilutive weighted average common share equivalents that were excluded from the above calculation of diluted net income per share were 2,363,557 and 790,749, respectively.

## Note 3 SECURITIES AVAILABLE-FOR-SALE

The Company's securities available-for-sale are carried at estimated fair value. The amortized cost and estimated fair value of U.S. dollar denominated and non-U.S. dollar denominated securities available-for-sale at September 30, 2007 are summarized as follows:

| Security Description  | Amortized |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
|---|-----------|---------|-------------------------------------|-----------------------|--|-----------|--------------|-----------------------------------|---------|---|-----------|--------|-----------|-----------|
| Cost  | Gross     |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Unrealized  |           |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Gain  | Gross     |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Unrealized  |           |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Loss  | Estimated |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Fair  |           |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Value U.S. Dollar Denominated:                                  |           |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| \$ 17,195   | \$ 1,026  | \$ —    | \$ 18,220                           | Investment grade CMBS | 734,324  | 26,757    | (20,509)     | 740,573                           |         |   |           |        |           |           |
| Non-investment grade rated subordinated securities              | 114,848   | 3,945   | (12,805)                            | 105,988               | 28,629   | (89,366)  | 632,367      | Non-rated subordinated securities | 24,118  | Investment grade REIT debt                                  | 247,733   | 3,490  | (4,318)   | 246,905   |
| securities  | 37,260    | 140     | (160)                               | 37,240                | CDO investments                                    | 65,831    | 18,154       | (25,166)                          | 58,819  | Total CMBS  | 1,934,294 | 82,652 | (152,716) | 1,864,230 |
| Total CMBS  | 1,237     | —       | (2)                                 | 1,235                 | Residential CMOs                                   | 124       | 77           | —                                 | 201     | Agency adjustable rate securities                           | 1,237     | —      | (2)       | 1,235     |
| mortgages ("ARMs")  | 8,782     | —       | (134)                               | 8,648                 | Total RMBS   | 10,143    | 77           | (136)                             | 10,084  | Total U.S. dollar denominated securities available-for-sale | 1,944,437 | 82,728 | (152,852) | 1,874,314 |
| Non-U.S. Dollar Denominated:                                    |           |         |                                     |                       |  |           |              |                                   |         |   |           |        |           |           |
| Investment grade CMBS   | 144,163   | 4,872   | (2,119)                             | 146,916               | Non-investment grade rated subordinated securities | 234,682   | 9,788        | (10,906)                          | 233,564 | Non-rated subordinated securities                           | 1,140     | —      | 36,608    | 417,088   |
| Total non-U.S. dollar denominated securities available-for-sale | (13,025)  | 417,088 | Total securities available-for-sale | \$ 2,358,750          | 98,529   | (165,877) | \$ 2,291,402 |                                   |         |   |           |        |           |           |

At September 30, 2007, the estimated fair value of the Company's securities available-for-sale that were pledged to secure its collateralized borrowings were \$1,747,972 and \$377,104 for U.S. dollar denominated and non-U.S. dollar denominated assets, respectively.



At September 30, 2007, the anticipated reported yield based upon the adjusted cost of the Company's entire subordinated CMBS portfolio was 10.2% per annum. The anticipated reported yield of the Company's investment grade securities available-for-sale was 6.6%. The Company's anticipated yields to maturity on its subordinated CMBS and other securities available-for-sale are based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples of these include, among other things, the rate and timing of principal payments (including prepayments, repurchases, defaults, liquidations, and related expenses), the pass-through or coupon rate, and interest rate fluctuations. Additional factors that may affect the

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Company's anticipated yields to maturity on its Controlling Class CMBS include interest payment shortfalls due to delinquencies on the underlying mortgage loans, and the timing and magnitude of credit losses on the mortgage loans underlying the Controlling Class CMBS that are a result of the general condition of the real estate market (including competition for tenants and their related credit quality), and changes in market rental rates. As these uncertainties and contingencies are difficult to predict and are subject to future events that may alter these assumptions, no assurance can be given that the anticipated yields to maturity, discussed above and elsewhere, will be achieved.

The RMBS held by the Company consist of adjustable rate and fixed rate residential pass-through or mortgage-backed securities collateralized by adjustable and fixed rate single-family residential mortgage loans. All of the Company's RMBS were issued by FHLMC, FNMA or GNMA. The Company does not have any subprime exposure. The Company's securities available-for-sale are subject to credit, interest rate, and/or prepayment risks. The agency adjustable rate RMBS held by the Company are subject to periodic and lifetime caps that limit the amount the interest rates of such securities can change during any given period and over the life of the loan. At September 30, 2007, adjustable rate RMBS with an estimated fair value of \$10,084 was included in securities available-for-sale on the consolidated statements of financial condition.

### Note 4 IMPAIRMENTS — CMBS

The Company updates its estimated cash flows for securities subject to Emerging Issues Task Force Issue 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets ("EITF 99-20") on a quarterly basis. The Company compares the yields resulting from the updated cash flows to the current accrual yields. An impairment charge is required under EITF 99-20 if the updated yield is lower than the current accrual yield and the security has a market value less than its adjusted purchase price. The Company carries all these securities at their estimated fair value on its consolidated statements of financial condition.

For the nine months ended September 30, 2007, changes in timing of assumed credit loss and prepayments on seven CMBS required an impairment charge totaling \$4,468. The Company also increased its underlying loss expectations for one below investment grade European CMBS during the nine months ended September 30, 2007, resulting in an additional impairment charge of \$1,321. In addition, the Company incurred a charge of \$1,247 related to the mark to market of its remaining high credit quality securities because similar securities were sold at a loss during the third quarter of 2007. During the quarter ended September 30, 2007, 65 of the Company's Controlling Class CMBS with an aggregate adjusted purchase price of \$356,646 experienced a weighted average yield increase of 40 basis points, and 17 Controlling Class CMBS with an aggregate adjusted purchase price of \$117,093 experienced a weighted average yield decrease of one basis point.

For the nine months ended September 30, 2006, the Company had nine CMBS that required an impairment charge of \$5,795, of which \$4,572 was attributed to higher prepayment rates on a pool of Small Business Administration commercial mortgages. The decline in the updated yields that caused the remaining impairment charge of \$1,223 is not related to increases in losses but rather accelerated prepayments and changes in the timing of credit losses.

### Note 5 COMMERCIAL MORTGAGE LOAN POOLS

During the second quarter of 2004, the Company acquired subordinated CMBS in a trust establishing a Controlling Class interest. The Company obtained a greater degree of influence over the disposition of the commercial mortgage loans than is typically granted to the special servicer. As a result of this expanded influence, the trust was not a QSPE and FIN 46R required the Company to consolidate the net assets and results of operations of the trust.

Approximately 45% of the par amount of the commercial mortgage loan pool is comprised of investment grade loans and the remaining 55% are unrated. For income recognition purposes, the Company considers the investment grade and unrated commercial mortgage loans in the pool as single assets reflecting the credit assumptions made in establishing loss adjusted yields for Controlling Class

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## Note 7 EQUITY INVESTMENTS

The following table is a summary of the Company's equity investments for the nine months ended September 30, 2007:

| BlackRock                          |          |           |                           |          |                               |                   |            |           |                 |            |
|------------------------------------|----------|-----------|---------------------------|----------|-------------------------------|-------------------|------------|-----------|-----------------|------------|
| Diamond Fund IV*                   | Carbon I | Carbon II | Dynamic India             |          |                               |                   |            |           |                 |            |
| Total Balance at December 31, 2006 |          |           | \$ 105,894                | \$ 3,144 | \$ 69,259                     | \$ 3,850          | \$ 182,147 |           |                 |            |
| Contributions to Investments       | 7,397    | —         | 28,958                    | 2,200    | 38,555                        | Return of capital | (100,000)  | (1,403)   |                 |            |
| ) — — (101,403)                    |          |           | Distributions of earnings | (32,081) | —                             | (9,345)           | —          | (41,426)  | Equity earnings |            |
| 18,790                             | 812      | 9,380     | —                         | 28,982   | Balance at September 30, 2007 | \$ —              | \$ 2,553   | \$ 98,252 | \$ 6,050        | \$ 106,855 |

\* The Company neither controls nor has significant influence over the Dynamic India Fund IV and accounts for this investment using the cost method of accounting.

The Company had a \$100,000 commitment to acquire shares of BlackRock Diamond Property Fund, Inc. ("BlackRock Diamond"). The Company redeemed \$25,000 of its investment in BlackRock Diamond on June 30, 2007. The remaining \$75,000 was redeemed at its September 30, 2007 net asset value of \$104,476, the proceeds from which were received in October 2007. The Company recorded \$18,790 of income related to its ownership in BlackRock Diamond for the nine months ended September 30, 2007, as reported by BlackRock Diamond. BlackRock Diamond is a private real REIT managed by BlackRock Realty Advisors, Inc., a subsidiary of the Company's Manager.

At September 30, 2007, the Company owned approximately 20% of Carbon Capital, Inc. ("Carbon I"). The Company also owned approximately 26% of Carbon Capital II, Inc. ("Carbon II", and collectively with Carbon I, the "Carbon Capital Funds") at September 30, 2007. Collectively, the Carbon Capital Funds are private commercial real estate income opportunity funds managed by the Manager (see Note 12 of the consolidated financial statements).

The Company entered into a \$50,000 commitment on July 20, 2001 to acquire shares of Carbon I. On July 12, 2005, the investment period expired and as repayments occur, capital will be returned to investors. The Company's investment in Carbon I at September 30, 2007 was \$2,554.

The Company entered into an aggregate commitment of \$100,000 to acquire shares of Carbon II. The final obligation to fund capital of \$13,346 was called on July 13, 2007. The Company's investment in Carbon II at September 30, 2007 was \$98,252.

One of the investments held by Carbon II, of which the Company owns 26%, includes a \$24,546 commercial real estate mezzanine loan which defaulted during July 2006 and was subsequently cured. The underlying property is a hotel located in the South Beach area of Miami, Florida. In the second quarter of 2006, Carbon II purchased the controlling class position of the senior loan. This position is senior in the capital structure to Carbon II's existing investment and provides Carbon II with the ability to direct the workout process of the senior loan. Both loans matured in March 2007, and the borrower failed to repay, triggering a maturity default. The borrower has reached a settlement agreement that allows the borrower a specified period of time to obtain a purchaser for the hotel. Based on the credit analysis performed for this property, the loan to value of this loan is approximately 80% and Carbon II

believes a loan loss reserve is not necessary at September 30, 2007.

Two other loans held by Carbon II have defaulted. The aggregate carrying value of the two loans on Carbon II's consolidated financial statements is \$24,000 (\$12,000 per loan). The underlying properties, located in Orlando and Boynton Beach, Florida, are multi-family assets. Regarding the 336-unit property in Orlando, Carbon II has concluded a workout arrangement with the borrower, whereby Carbon II will forebear from taking title and will make all advances necessary to operate the property and service the first mortgage. The borrower continues to hold title and implement its sales strategy. Since its implementation in March 2007, 233 units have been sold and closed. An additional

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20 units are under contract with deposits and 36 contracts are being prepared. Based on credit analysis performed for this property, Carbon II believes a loan loss reserve is not necessary at September 30, 2007.

Regarding the 216-unit property in Boynton Beach, the borrower was not able to achieve sufficient condominium sales to complete the condominium conversion. The borrower defaulted on its loan. Carbon II has taken title to the property and is operating it as a rental property. During 2006, Carbon II established a loss reserve of \$5,180, of which the Company's share is \$1,361. Carbon II determined that no change to the carrying value of the property was necessary at September 30, 2007. All other commercial real estate loans in the Carbon Capital Funds are performing as expected.

On December 22, 2005, the Company entered into an \$11,000 commitment to acquire shares of Dynamic India Fund IV. At September 30, 2007, the Company's capital committed was \$11,000 of which \$6,050 had been drawn.

Note 8 REAL ESTATE, HELD-FOR-SALE

SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets specifies that long-lived assets to be disposed by sale, which meet certain criteria, should be classified as real estate held-for-sale and measured at the lower of its carrying amount or fair value less costs of sale. In addition, depreciation is not recorded for real estate held-for-sale.

On March 6, 2006, the Company purchased a defaulted loan from a Controlling Class CMBS trust. The loan was secured by a first mortgage on a multi-family property in Texas. Subsequent to the loan purchase, the property was acquired by the Company at foreclosure. The Company sold the property during the second quarter of 2006 and recorded a gain from discontinued operations of \$1,366 on the consolidated statement of operations.

Note 9 BORROWINGS

The Company's borrowings consist of reverse repurchase agreements, credit facilities, CDOs, senior unsecured notes, senior convertible debt, junior unsecured notes, trust preferred securities, and commercial mortgage loan pools.

Certain information with respect to the Company's borrowings at September 30, 2007 is summarized as follows:

| Borrowing Type                        | Outstanding | Weighted  | Weighted  | Estimated                      | Estimated         | Estimated              | Estimated | Estimated | Estimated |
|---------------------------------------|-------------|-----------|-----------|--------------------------------|-------------------|------------------------|-----------|-----------|-----------|
| average                               | average     | average   | maturity  | fair value                     | of assets         |                        |           |           |           |
| pledged Reverse Repurchase Agreements | \$ 110,113  | 5.36 %    | 5.1 years | \$ 139,528                     | Credit Facilities |                        |           |           |           |
| 574,162                               | 6.25        | 114 days  | 776,430   | Commercial Mortgage Loan Pools | 1,225,085         | 3.99                   | 5.4 years |           |           |
| 1,246,494                             | CDOs        | 1,814,231 | 5.84      | 6.2 years                      | 2,020,169         | Senior Unsecured Notes | 162,500   | 7.59      | 6.9       |

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|            |   |                        |              |       |            |   |                            |              |        |
|------------|---|------------------------|--------------|-------|------------|---|----------------------------|--------------|--------|
| years      | — | Junior Unsecured Notes | 71,107       | 6.56  | 14.6 years | — | Trust Preferred Securities | 180,477      | 7.64   |
| 28.3 years | — | Convertible Debt       | 80,000       | 11.75 | 19.9 years | — | Total Borrowings*          | \$ 4,217,675 | 5.61 % |
| 6.5 years  |   |                        | \$ 4,182,621 |       |            |   |                            |              |        |

\* Also included in total borrowings on the Consolidated Statement of Financial Condition is \$50,000 of borrowings secured by the Company's interest in BlackRock Diamond. The borrowings bear interest at a rate of 6.63% and matured on October 19, 2007.

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Amount Total

Borrowings Unused

Borrowing

|                                   |                        |            |            |            |                             |         |            |            |    |
|-----------------------------------|------------------------|------------|------------|------------|-----------------------------|---------|------------|------------|----|
| Capacity Bank of America, N.A.(1) | 9/18/09                | \$ 275,000 | \$ 149,664 | \$ 125,336 | Deutsche Bank, AG(2)        |         |            |            |    |
| 12/20/07                          |                        | \$ 200,000 | \$ 154,750 | \$ 45,250  | Bank of America, N.A.(3)(4) | 9/17/08 | \$ 100,000 | \$ 85,544  | \$ |
| 14,456                            | Morgan Stanley Bank(3) | 2/16/08    | \$ 300,000 | \$ 184,204 | \$ 15,796                   |         | \$ 875,000 | \$ 574,162 | \$ |
| 300,838                           |                        |            |            |            |                             |         |            |            |    |

(1) USD

only (2) Multicurrency (3) Non-USD only (4) Can be increased up to \$15,000 based on the change in exchange rates of the non-U.S. dollar loans. However, any amounts drawn after this provision must be prepaid in ninety days.

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During the second quarter of 2007, the Company entered into a \$150,000 committed U.S. dollar and non- U.S. dollar credit facility with Lehman Commercial Paper, Inc. Outstanding borrowings bear interest at LIBOR-based variable rate. The facility matured and was fully repaid on August 23, 2007.

On July 20, 2007, the Company entered into a \$200,000 committed U.S. dollar facility with Bank of America, N.A. which matures in September 2009. Outstanding borrowings under this credit facility bear interest at a LIBOR-based variable rate. During the third quarter of 2007, the Company increased its commitment to \$275,000.

On July 20, 2007 the Company amended its \$200,000 committed non-U.S. dollar credit facility with Morgan Stanley Bank which matures in February 2008. The amendment increases the committed facility to \$300,000. The amendment also allows for borrowings in Japanese Yen to fund the Company's Yen asset acquisitions.

On August 27, 2007, the Company borrowed \$50,000 from KeyBank National Association. The loan was secured by a pledge of all of the Company's ownership interest in the redemption proceeds of BlackRock Diamond and was repaid in full in October 2007.

On October 22, 2007 the Company notified Deutsche Bank, AG that it had elected to extend the \$200,000 credit facility for one year. After the extension becomes effective, the new maturity date will be December 20, 2008.

The Company is subject to various covenants in its credit facilities, including maintaining a minimum net worth of \$520,416 plus an amount equal to 75% of any equity proceeds issued after September 30, 2007 in accordance with GAAP, a maximum recourse debt-to-equity of 3.0 to 1, and a minimum cash requirement of \$10,000 based upon certain debt-to-equity ratios. During the first quarter of 2007, the Company amended the debt service coverage ratio covenant on its committed debt facilities. The terms of the calculation were revised and the debt service coverage ratio was reduced from 1.75 to 1.20. The revised calculation better reflects the Company's ability to service debt on a cash basis. At September 30, 2007, the Company was in compliance with all covenants.

## Senior Unsecured Notes

During 2007, the Company issued \$87,500 of senior unsecured notes due in 2017. The notes bear interest at a weighted average fixed rate of 7.93% until July 2012 and thereafter at a rate equal to 3-month LIBOR plus 2.55%. The senior unsecured notes contain a covenant whereby total borrowings cannot exceed 95% of the sum of total borrowings plus stockholders' equity and the Company must maintain a minimum net worth of \$400,000. The senior unsecured notes can be redeemed in whole by the Company subject to certain provisions, which could include the payment of fees.

## Junior Unsecured Notes

During April 2007, the Company issued €50,000 junior subordinated notes due in 2022. The notes bear interest at a rate equal to 3-month Euribor plus 2.6%. The notes can be redeemed in whole by the Company subject to certain provisions. The Company has the option to redeem all or a portion of the notes at any time on or after April 30, 2012 at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest through but excluding the redemption date.

## Convertible Debt

On August 29, 2007 and September 10, 2007, the Company completed an offering of a total of \$80,000 aggregate principal amount of convertible senior notes due in 2027. The notes bear interest at a rate of 11.75% per annum and are convertible only under certain conditions, including a 20-day period of trading above \$14.02 per share, as adjusted. The initial conversion rate of 92.7085 shares of common stock per \$1,000 principal amount of notes (equal to an initial conversion price of approximately \$10.79 per share) represented a premium of 17.5% to the last reported sale price of Anthracite's common stock on August 23, 2007 of \$9.18.

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## Note 10 PREFERRED STOCK

On February 12, 2007, the Company authorized and issued 3,450,000 shares of Series D Preferred Stock, including 450,000 shares of Series D Preferred Stock issued pursuant to an option to purchase additional shares granted to the underwriters. The Series D Preferred Stock is perpetual, carries a 8.25% coupon and has a preference in liquidation of \$86,250. The aggregate net proceeds to the Company (after deducting underwriting fees and expenses) were approximately \$83,267.

## Note 11 COMMON STOCK

The following table summarizes Common Stock issued by the Company for the nine months ended September 30, 2007:

|                            |             |          |                              |           | Shares    | Net Proceeds       |
|----------------------------|-------------|----------|------------------------------|-----------|-----------|--------------------|
| Dividend Reinvestment Plan | 242,742     | \$ 2,410 | Sales agency agreement       | 147,700   | 1,770     | Incentive fees*    |
|                            | 143,876     | 1,780    | Incentive fee – stock based* | 289,155   | 3,470     | Follow-on offering |
| Share repurchase           | (1,307,189) | (12,000) | Total                        | 5,266,284 | \$ 59,869 |                    |

\* See

Note 12 of the consolidated financial statements, Transactions with Affiliates, for a further description of the Company's Management Agreement.

On June 12, 2007, the Company completed a follow-on offering of 5,750,000 shares of its common stock, par value \$0.001 per share, at a price of \$11.75, which included a 15% option to purchase additional shares exercised by the underwriter. Net proceeds (after deducting underwriting fees and expenses) were approximately \$62,439.

Utilizing a portion of the net proceeds from the convertible senior notes offering, the Company repurchased 1,307,189 shares of common stock with value of \$12,000 on August 29, 2007.

The following table summarizes the dividends declared by the Company during the nine months ended September 30, 2007:

| Date    | Record Date | Payable Date | Per Share Amount | March 6    | March 30 | April 30 | \$ 0.29 | May 22 | June 29 | Declaration |
|---------|-------------|--------------|------------------|------------|----------|----------|---------|--------|---------|-------------|
| July 31 | \$ 0.30     | September 5  | September 30     | October 31 | \$ 0.30  |          |         |        |         |             |

For U.S. federal income tax purposes, the dividends are expected to be ordinary income to the Company's stockholders.

## Note 12 TRANSACTIONS WITH AFFILIATES

The Company has a Management Agreement, an administrative services agreement and an accounting services agreement with the Manager, the employer of certain directors and all of the officers of the Company, under which the Manager and the Company's officers manage the Company's day-to-day investment operations, subject to the direction and oversight of the Company's Board of Directors. Pursuant to the Management Agreement and these other

agreements, the Manager and the Company's officers formulate investment strategies, arrange for the acquisition of assets, arrange for financing, monitor the performance of the Company's assets and provide certain other advisory, administrative and managerial services in connection with the operations of the Company. For performing certain of these services, the Company pays the Manager under the Management Agreement a base management fee equal to 2.0% of the quarterly average total stockholders' equity for the applicable quarter.

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To provide an incentive, the Manager is entitled to receive an incentive fee under the Management Agreement equal to 25% of the amount by which the rolling four-quarter GAAP net income before the incentive fee exceeds the greater of 8.5% or 400 basis points over the ten-year Treasury note multiplied by the adjusted per share issue price of the Company's Common Stock (\$11.41 per common share at September 30, 2007). Additionally, up to 30% of the incentive fees earned in 2006 or after may be paid in shares of the Company's Common Stock subject to certain provisions under a compensatory deferred stock plan approved by the stockholders of the Company in 2006. The Board of Directors also authorized a stock based incentive plan where one-half of one percent of common shares outstanding as of December 31st is paid to the Manager.

The Company's unaffiliated directors approved an extension of the Management Agreement to March 31, 2008 at the Board's March 2007 meeting.

The following is a summary of management and incentive fees incurred for the three and nine months ended September 30, 2007 and 2006:

| For the Three Months          |      | For the Nine Months |          |                            |                |           |          |           |          |
|-------------------------------|------|---------------------|----------|----------------------------|----------------|-----------|----------|-----------|----------|
| Ended September 30,           | 2007 | 2006                | 2007     | 2006                       | Management fee | \$ 3,473  | \$ 3,179 | \$ 10,862 | \$ 9,339 |
| Incentive fee                 | —    | 5,645               | 2,708    | Incentive fee- stock based | 497            | 997       | 2,145    | 1,853     | Total    |
| management and incentive fees |      | \$ 3,970            | \$ 4,176 |                            | \$ 18,652      | \$ 13,900 |          |           |          |

At September 30, 2007 and 2006, respectively, management and incentive fees of \$5,434 and \$2,979, remain payable to the Manager and are included on the accompanying consolidated statement of financial condition as a component of other liabilities. In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of \$184 and \$486 for certain expenses incurred on behalf of the Company during the three and nine months ended September 30, 2007, and \$100 and \$300 for the three and nine months ended September 30, 2006, respectively.

The Company also has administration and accounting services agreements with the Manager. Under the terms of the administration services agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. Under the terms of the accounting services agreement, the Manager provides investment accounting services to the Company. For the nine months ended September 30, 2007, and 2006, the Company recorded administration and investment accounting service fees of \$544 and \$175, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

The special servicer on 32 of the Company's 37 Controlling Class trusts is Midland Loan Services, Inc. ("Midland"), a wholly owned indirect subsidiary of The PNC Financial Services Group, Inc. ("PNC Bank"), and therefore a related party of the Manager. The Company's fees for Midland's services are at market rates.

The Company had a \$100,000 commitment to acquire shares of BlackRock Diamond Property Fund, Inc. ("BlackRock Diamond"). The Company redeemed \$25,000 of its investment in BlackRock Diamond on June 30, 2007. The remaining \$75,000 was redeemed at its September 30, 2007 net asset value of \$104,476, the proceeds from which were received in October 2007. The Company did not incur any additional management or incentive fees to the Manager or its affiliates related to its investment in BlackRock Diamond.

During 2001, the Company entered into a \$50,000 commitment to acquire shares of Carbon I, a private commercial real estate income opportunity fund managed by the Manager. The Carbon I investment period ended on July 12, 2004 and the Company's investment in Carbon I at September 30, 2007 was \$2,554. On September 30, 2007, Carbon I returned \$1,403 of capital. The Company does not incur any additional management or incentive fees to the Manager related to its investment in Carbon I. On September 30, 2007, the Company owned approximately 20% of the outstanding shares of Carbon I.

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The Company entered into an aggregate commitment of \$100,000 to acquire shares of Carbon II, a private commercial real estate income opportunity fund managed by the Manager. The final obligation to fund capital of \$13,346 was called on July 13, 2007. The Company's investment in Carbon II was \$98,252. The Company does not incur any additional management or incentive fees to the Manager related to its investment in Carbon II. On September 30, 2007, the Company owned approximately 26% of the outstanding shares of Carbon II.

The Company's unaffiliated directors approved the investments in BlackRock Diamond and the Carbon Capital Funds prior to the investments being made.

During 2000, the Company completed the acquisition of CORE Cap, Inc. At the time of the CORE Cap, Inc. acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) \$12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the Core Cap, Inc. assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. At September 30, 2007, the Installment Payment would be \$3,000 payable over three years. The Company does not accrue for this contingent liability because it is remote.

## Note 13 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company accounts for its derivative investments under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the consolidated statement of financial condition at estimated fair value. If the derivative is designated as a cash flow hedge, the effective portions of change in the estimated fair value of the derivative are recorded in other comprehensive income ("OCI") and are recognized in the consolidated statement of operations when the hedged item affects earnings. Ineffective portions of changes in the estimated fair value of cash flow hedges are recognized in earnings. If the derivative is designated as a fair value hedge, the changes in the estimated fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings.

The Company uses interest rate swaps to manage exposure to variable cash flows on portions of its borrowings under reverse repurchase agreements and the floating rate debt of its CDOs and as trading derivatives intended to offset changes in estimated fair value related to securities held as trading assets. On the date in which the derivative contract is entered, the Company designates the derivative as either a cash flow hedge or a trading derivative.

Occasionally, counterparties will require the Company, or the Company will require counterparties, to provide collateral for the interest rate swap agreements in the form of margin deposits. Net deposits are recorded as a component of either other assets, other liabilities or restricted cash equivalents. Should the counterparty fail to return deposits paid, the Company would be at risk for the estimated fair value of that asset. At September 30, 2007, the Company did not have any of these deposits.

During the third quarter, the Company sold a majority of its high credit quality, liquid securities. The sales of these securities resulted in a significant reduction in 90-day repurchase agreements. As a result of the reduction in the balance of 90-day repurchase agreements, certain interest rate swaps that were hedging 90-day repurchase agreements no longer qualified for hedge accounting. As a result, the

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Company recognized a gain of \$11,849 which is included in gain (loss) on sale of available-for-sale securities on the consolidated statement of operations. Of this amount, \$4,902 was previously recorded in OCI and was being reclassified to interest expense over the weighted average remaining term of the swaps at the time the swaps were closed. The balance of \$6,587 relates to gains associated with interest rate swaps that were closed in the third quarter of 2007.

At September 30, 2007, the Company had interest rate swaps with notional amounts aggregating \$1,132,070 designated as cash flow hedges of borrowings under reverse repurchase agreements and the floating rate debt of its CDOs. Cash flow hedges with an estimated fair value of \$13,758 are included in derivative assets on the consolidated statement of financial condition and cash flow hedges with an estimated fair value of \$20,331 are included in derivative liabilities on the consolidated statement of financial condition. For the nine months ended September 30, 2007, the net change in the estimated fair value of the interest rate swaps was a decrease of \$3,662, of which \$163 was deemed ineffective and is included as an increase of interest expense and \$3,649 was recorded as a reduction of OCI. At September 30, 2007, the \$1,132,070 notional of swaps designated as cash flow hedges had a weighted average remaining term of 6.7 years.

During the nine months ended September 30, 2007, the Company terminated 15 of its interest rate swaps with a notional amount of \$778,620 that were designated as cash flow hedge of borrowings under reverse repurchase agreements. The Company will reclassify the \$4,366 gain in value from OCI to interest expense over 7.58 years, which was the weighted average remaining term of the swaps at the time they were closed out. At September 30, 2007, the Company has, in aggregate, \$2,615 of net losses related to terminated swaps recorded in OCI. For the quarter ended September 30, 2007, \$165 was reclassified as an increase to interest expense and \$1,084 will be reclassified as an increase to interest expense for the next twelve months.

At September 30, 2007, the Company had interest rate swaps with notional amounts aggregating \$1,487,443 designated as trading derivatives. Trading derivatives with an estimated fair value of \$871 are included in derivative assets on the consolidated statement of financial condition and trading derivatives with an estimated fair value of \$851 are included in derivative liabilities on the consolidated statement of financial condition. For the nine months ended September 30, 2007, the change in estimated fair value for these trading derivatives was an increase of \$15 and is included as an increase of gain on securities held-for-trading on the consolidated statement of operations. At September 30, 2007, the \$1,487,443 notional of swaps designated as trading derivatives had a weighted average remaining term of 2.1 years.

At September 30, 2007, the Company had a forward LIBOR cap with a notional amount of \$85,000 and an estimated fair value at September 30, 2007, of \$189 which is included in derivative assets, and the change in estimated fair value related to this derivative is included as a component of gain (loss) in securities held-for-trading on the consolidated statement of operations.

Foreign Currency

Foreign currency agreements at September 30, 2007 consisted of the following:

|             |           |
|-------------|-----------|
|             | Estimated |
| Fair Value  |           |
| Unamortized |           |

Cost Average Remaining

Term Currency swaps \$ (4,848 ) — 7.9 years CDO currency swaps \$ 4,135 — 10.7 years Forwards \$ (5,385 ) — 17 days

The U.S. dollar is considered the functional currency for certain of the Company's international subsidiaries. Foreign currency transaction gains or losses are recognized in the period incurred and are included in foreign currency gain (loss) in the consolidated statement of operations. Gains and losses on foreign currency forward commitments are included in foreign currency gain (loss) in the consolidated statement of operations. The Company recorded foreign currency gains of \$775 and \$3,631 for the three and nine months ended September 30, 2007 and \$682 and \$997 for the three and nine months ended 2006, respectively.

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Consistent with SFAS No. 52, Foreign Currency Translation (“SFAS No. 52”), SFAS No. 133 allows hedging of the foreign currency risk of a net investment in a foreign operation. The Company primarily uses foreign currency forward contracts to manage the foreign exchange risk associated with the Company’s investment in its non-U.S. dollar functional currency foreign subsidiary. In accordance with SFAS No. 52, the Company records the change in the carrying amount of this investment in the cumulative translation adjustment account within accumulated OCI. Simultaneously, the effective portion of the hedge of this exposure is also recorded in the cumulative translation adjustment account and any ineffective portion of net investment hedges is recorded in income.

## Note 14 NET INTEREST INCOME

The following is a presentation of the Company’s net interest income for the three and nine months ended September 30, 2007 and 2006:

| For the Three Months        |                     | For the Nine Months                       |            |  |   |                          |         |         |  |
|-----------------------------|---------------------|---|------------|--|---|--------------------------|---------|---------|--|
| Ended September 30,         | 2007                | 2006                                      | 2007       | 2006   | Interest Income:                        | Interest from securities |         |         |  |
| available-for-sale          | \$ 49,176           | \$ 44,707                                 | \$ 144,923 | \$ 126,684                                   | Interest from commercial mortgage loans |                          |         |         |  |
| 20,494                      | 11,052              | 49,942                                    | 28,041     | Interest from commercial mortgage loan pools | 12,985                                  | 13,230                   |         |         |  |
| 39,119                      | 39,743              | Interest from securities held-for-trading | 384        | 1,750  | 2,272                                   | 5,522                    |         |         |  |
| and cash equivalents        | 1,784               | 828                                       | 3,648      | 1,746  | Total interest income                   | 84,823                   | 71,567  | 239,904 |  |
| 201,736                     | Interest Expense:   | Interest                                  |            | 62,525                                       | 54,185                                  | 176,976                  | 148,345 |         |  |
| securities held-for-trading | —                   | 1,875                                     | 1,474      | 5,597  | Total interest expense                  | 62,525                   | 56,060  | 178,450 |  |
| 153,942                     | Net interest income | \$ 22,298                                 | \$ 15,507  | \$ 61,454                                    | \$ 47,794                               |                          |         |         |  |

## Note 15 CURRENT AND SUBSEQUENT EVENTS IN THE CREDIT MARKETS

The current and continuing weaknesses in the sub-prime mortgage sector and in the broader mortgage market have resulted in reduced liquidity for mortgage-backed securities. Although this reduction in liquidity has been directly linked to sub-prime residential assets, to which Company continues to have no direct exposure, there has been an overall reduction in liquidity across the credit spectrum of commercial and residential mortgage products. Significant price declines may cause lenders to call in all or a portion of their loans to reflect the reduced value of the assets securing those loans. The Company’s strategy is to match-fund assets when economical and to maintain adequate cash to meet any margin calls on the remaining portfolio assets. At September 30, 2007, only 14% of the Company’s commercial mortgage-backed securities (“CMBS”) were not match-funded and approximately 40% of the Company’s recourse borrowings are unsecured term debt which does not permit lenders to call any portion of their loans.

In the event of a further reduction in market liquidity, the Company’s short-term (one year or less) liquidity needs will be met primarily with \$122,185 of cash and cash equivalents we held as of September 30, 2007. In addition, subsequent to September 30, 2007, the Company received \$104,476 from the redemption of its remaining investment in BlackRock Diamond. The Company used \$50,000 of the proceeds to repay a borrowing secured by the Company’s interest in BlackRock Diamond, thus increasing the Company’s cash position since quarter end by approximately \$54,000.



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ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

All currency figures expressed herein are expressed in thousands, except share and per share amounts.

I. General

Anthracite Capital, Inc., a Maryland corporation, and subsidiaries (collectively, the “Company”) is a specialty finance company that invests in commercial real estate assets on a global basis. The Company seeks to generate income from the spread between the interest income, gains and net operating income on its commercial real estate assets and the interest expense from borrowings to finance its investments. The Company’s primary activities are investing in high yielding commercial real estate debt and equity. The Company combines traditional real estate underwriting and capital markets expertise to maximize the opportunities arising from the continuing integration of these two disciplines. The Company focuses on acquiring pools of performing loans in the form of commercial mortgage-backed securities (“CMBS”), issuing secured debt backed by CMBS and providing strategic capital for the commercial real estate industry in the form of mezzanine loan financing. The Company also began investing in diversified portfolios of commercial real estate in the United States during December 2005. The Company commenced operations on March 24, 1998.

The Company’s common stock is traded on the New York Stock Exchange under the symbol “AHR”. The Company’s primary long-term objective is to distribute dividends supported by earnings. The Company establishes its dividend by analyzing the long-term sustainability of earnings given existing market conditions and the current composition of its portfolio. This includes an analysis of the Company’s credit loss assumptions, general level of interest rates and projected hedging costs.

The Company is managed by BlackRock Financial Management, Inc. (the “Manager”), a subsidiary of BlackRock, Inc., a publicly traded (NYSE:BLK) asset management company with approximately \$1.3 trillion of assets under management, including more than \$25 billion in real estate equity and debt, at September 30, 2007. The Manager provides an operating platform that incorporates significant asset origination, risk management, operational and property management capabilities.

The Company’s ongoing investment activities primarily encompass three core investment activities:

- |                                   |                    |
|-----------------------------------|--------------------|
| Commercial Real Estate Securities | 1)                 |
| Estate Loans                      | 2) Commercial Real |
| Estate Equity                     | 3) Commercial Real |

The commercial real estate securities portfolio provides diversification and high yields that are adjusted for anticipated losses over a period of time (typically, a ten-year weighted average life) and can be financed through the issuance of secured debt that matches the life of the investment. Commercial real estate loans provide attractive risk adjusted returns over shorter periods of time through strategic investments in specific property types or regions. The Company’s equity strategy is to invest in a diverse portfolio of commercial real estate with the objective of repositioning the property to maximize its value. The return objective is to provide strong returns over a medium term period of four to seven years through a combination of real estate operating income and capital gains. It is expected that, over the short term, current returns will fluctuate as gains and losses are reported based on a valuation process each quarter. The

Company believes that the combination of these activities will result in moderate income and dividend growth for its stockholders.

The Company's fixed income investment activity continues to be managed to maintain a positive, though controlled, exposure to both long- and short-term interest rates through its active hedging strategies. See "Item 3 — Quantitative and Qualitative Disclosures About Market Risk" for a discussion of interest rates and their effect on earnings and book value.

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The following table illustrates the mix of the Company's asset types at September 30, 2007 and December 31, 2006:

| Carrying Value at             | September 30, 2007 | December 31, 2006 | Amount                          | %                                      | Amount                              | %         | Commercial real estate |
|-------------------------------|--------------------|-------------------|---------------------------------|--|-------------------------------------|-----------|------------------------|
| securities                    | \$ 2,299,956       | 50.2 %            | \$ 2,494,099                    | 53.0 %                                 | Commercial mortgage loan pools(1)   | 1,246,494 |                        |
| 27.2 %                        | 1,271,014          | 27.0 %            | Commercial real estate loans(2) | 1,013,480                              | 22.2 %                              | 554,149   | 11.8 %                 |
| Commercial real estate equity | 6,050              | 0.1 %             | 109,744                         | 2.3 %                                  | Total commercial real estate assets |           |                        |
| 4,565,980                     | 99.7 %             | 4,429,006         | 94.1 %                          | Residential mortgage-backed securities | 10,997                              | 0.3 %     |                        |
| 276,344                       | 5.9 %              | Total             | \$ 4,576,977                    | 100.0 %                                | \$ 4,705,350                        | 100.0 %   |                        |

(1)

Represents a Controlling Class CMBS that is consolidated for accounting purposes. See Note 5 of the consolidated financial statements. (2) Includes Carbon Capital funds.

During the third quarter of 2007, the Company purchased \$226,778 of commercial real estate securities, including \$53,859 of non-U.S. dollar denominated securities.

During the three months ended September 30, 2007, the Company purchased a total of \$356,723 of commercial real estate assets, which included \$125,994 of non-U.S. dollar denominated assets. Commercial real estate assets purchased consisted of \$226,777 of commercial mortgage-backed securities ("CMBS") and \$129,946 of commercial real estate loans.

At June 30, 2007, the Company redeemed \$25,000 of its investment in BlackRock Diamond Property Fund, Inc. ("BlackRock Diamond"). At September 30, 2007, the Company redeemed its remaining investment in BlackRock Diamond based on the September 30, 2007 net asset value of \$104,476. The proceeds from this redemption were received in October 2007.

The Company sold the majority of its high credit quality, liquid securities during the third quarter of 2007. As a result of higher Treasury rates since the time of purchase, these sales generated a loss of \$13,352.

Summary of Commercial Real Estate Assets

A summary of the Company's commercial real estate assets with estimated fair values in local currencies at September 30, 2007 is as follows:

|                       |
|-----------------------|
| Commercial            |
| Real Estate           |
| Securities Commercial |
| Real Estate           |
| Loans(1) Commercial   |
| Real Estate           |
| Equity Commercial     |
| Mortgage Loan         |

Pools Total  
 Commercial  
 Real Estate  
 Assets Total  
 Commercial  
 Real Estate

|                  |         |               |             |        |              |              |              |              |                      |
|------------------|---------|---------------|-------------|--------|--------------|--------------|--------------|--------------|----------------------|
| Assets (USD)     | USD     | \$ 1,882,867  | \$ 419,603  | \$ —   | \$ 1,246,494 | \$ 3,548,964 | \$ 3,548,964 | GBP          | £ 36,977             |
|                  | £       | 46,997        | —           | —      | £ 83,974     | 171,085      | EURO         | € 139,004    | € 331,514            |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | € 470,518            |
|                  | 669,147 |               |             |        |              |              |              |              |                      |
| Canadian Dollars | C\$     | 104,157       | C\$ 6,250   | —      | —            | C\$ 110,407  | 111,107      | Japanese Yen | ¥ 4,514,357          |
|                  | —       | —             | ¥ 4,514,357 | 39,250 | Swiss Francs | —            | CHF 23,804   | —            | —                    |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | CHF 23,804           |
|                  | 20,377  | Indian Rupees | —           | —      | Rs 240,488   | —            | Rs 240,488   | 6,050        | Total USD Equivalent |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 2,299,955         |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 1,013,481         |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 6,050             |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 1,246,494         |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 4,565,980         |
|                  | —       | —             | —           | —      | —            | —            | —            | —            | \$ 4,565,980         |

(1)

Includes the Company's investments in the Carbon Capital Funds of \$100,806 at September 30, 2007.





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Price Adjusted

Purchase

Price Dollar

Price Expected

|  |  |                              |                               |                                       |                       |         |                        |               |        |
|--|--|------------------------------|-------------------------------|---------------------------------------|-----------------------|---------|------------------------|---------------|--------|
| Yield Commercial real estate securities outside CDOs | Investment grade CMBS                                | \$ 147,964                   | \$ 136,936                    | \$ 92.55                              |                       |         |                        |               |        |
| \$ 136,962   | 92.56  | 5.63 %                       | Investment grade REIT debt    | 28,000                                | 25,695                | 91.77   | 27,925                 | 99.73         |        |
| 5.45 %   | CMBS rated BB+ to B                                  | 473,657                      | 327,439                       | 69.13                                 | 379,714               | 80.17   | 8.37 %                 | CMBS rated B- |        |
| or lower   | 429,725  | 142,707                      | 33.21                         | 150,236                               | 34.96                 | 9.58 %  | CDO Investments        | 347,807       | 58,819 |
| 16.91  | 65,831   | 18.93                        | 20.45 %                       | CMBS Interest Only securities ("IOs") | 912,879               | 18,220  | 2.00                   |               |        |
| 17,195   | 1.88   | 7.90 %                       | Multifamily agency securities | 36,236                                | 37,239                | 102.77  | 37,260                 | 102.83        |        |
| 5.37 %   | Commercial mortgage loan pools                       | 1,187,066                    | 1,246,494                     | 105.01                                | 1,246,494             | 105.01  | 4.16 %                 |               |        |
| Total commercial real estate assets outside CDOs     | 3,563,334  | 1,993,549                    | 55.95                         | 2,061,617                             | 57.86                 |         |                        |               |        |
| 6.02 %   | Commercial real estate loans and equity outside CDOs | Commercial real estate loans | 526,273                       | 618,462                               |                       |         |                        |               |        |
| 4,561  | Commercial real estate                               | 6,050                        | 6,050                         | 3,452                                 | Total commercial real |         |                        |               |        |
| estate loans and equity outside CDOs                 | 4,095,657  | 2,618,061                    | 2,069,630                     | Commercial real estate                |                       |         |                        |               |        |
| assets included in CDOs                              | Investment grade CMBS                                | 806,513                      | 767,594                       | 95.17                                 | 762,065               | 94.49   | 7.06 %                 |               |        |
| Investment grade REIT debt                           | 218,445  | 221,210                      | 101.27                        | 219,808                               | 100.62                | 5.93 %  | CMBS rated BB+         |               |        |
| to B   | 615,410  | 473,872                      | 77.00                         | 476,106                               | 77.36                 | 9.73 %  | CMBS rated B- or lower | 198,667       |        |
| 66,106   | 33.27  | 73,769                       | 37.13                         | 15.01 %                               | Credit tenant lease   | 23,378  | 24,118                 | 103.17        | 23,999 |
| 102.66   | 5.66 %   | Commercial real estate loans | 408,038                       | 395,019                               | 96.81                 | 374,272 | 91.72                  | 8.53 %        |        |
| Total commercial real estate assets included in CDOs | 2,270,451  | 1,947,919                    | 85.79                         | 1,930,019                             | 85.01                 |         |                        |               |        |
| 8.16 %   | Total commercial real estate assets                  | \$ 6,366,108                 | \$ 4,565,980                  | \$ 3,999,649                          |                       |         |                        |               |        |

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The following table details the par, carrying value, adjusted purchase price and expected yield of the Company's commercial real estate assets included in as well as outside of the Company's CDOs at December 31, 2006:

| Value     | Par    | Carrying | Price   | Adjusted | Yield | Commercial real estate securities outside CDOs | Investment grade CMBS | Investment grade REIT debt | CMBS rated BB+ to B or lower | CMBS IOs | CMBS rated B- or lower | CDO Investments | Commercial mortgage loan pools | Total commercial real estate assets outside CDOs | Commercial real estate loans and equity outside CDOs | Commercial real estate loans | Total commercial real estate assets included in CDOs | Investment grade CMBS | Investment grade REIT debt | CMBS rated BB+ to B or lower | Credit tenant lease | Commercial real estate loans | Total commercial real estate assets included in CDOs | Total commercial real estate assets |        |      |        |      |        |                                |           |           |        |           |        |        |  |           |           |       |           |       |        |  |         |                        |        |         |        |  |         |         |         |  |         |         |       |         |       |        |                            |         |         |        |         |        |        |                              |         |         |       |         |       |        |                        |         |        |       |        |       |         |                     |        |        |        |                              |         |         |       |         |       |        |  |           |           |       |           |       |        |                                     |              |              |              |
|-----------|--------|----------|---------|----------|-------|--|-----------------------|----------------------------|------------------------------|----------|------------------------|-----------------|--------------------------------|--|--|------------------------------|--|-----------------------|----------------------------|------------------------------|---------------------|------------------------------|--|-------------------------------------|--------|------|--------|------|--------|--------------------------------|-----------|-----------|--------|-----------|--------|--------|--|-----------|-----------|-------|-----------|-------|--------|--|---------|------------------------|--------|---------|--------|--|---------|---------|---------|--|---------|---------|-------|---------|-------|--------|----------------------------|---------|---------|--------|---------|--------|--------|------------------------------|---------|---------|-------|---------|-------|--------|------------------------|---------|--------|-------|--------|-------|---------|---------------------|--------|--------|--------|------------------------------|---------|---------|-------|---------|-------|--------|--|-----------|-----------|-------|-----------|-------|--------|-------------------------------------|--------------|--------------|--------------|
| Dollar    | Dollar | Dollar   | Dollar  | Dollar   | %     |  |                       |                            |                              |          |                        |                 |                                |  |  |                              |  |                       |                            |                              |                     |                              |  |                                     |        |      |        |      |        |                                |           |           |        |           |        |        |  |           |           |       |           |       |        |  |         |                        |        |         |        |  |         |         |         |  |         |         |       |         |       |        |                            |         |         |        |         |        |        |                              |         |         |       |         |       |        |                        |         |        |       |        |       |         |                     |        |        |        |                              |         |         |       |         |       |        |  |           |           |       |           |       |        |                                     |              |              |              |
| \$ 21,753 | 103.64 | 5.51 %   |         |          |       |  | \$ 20,989             | \$ 21,426                  | 102.09                       |          |                        |                 |                                |  |  |                              |  |                       |                            |                              |                     |                              |  |                                     |        |      |        |      |        |                                |           |           |        |           |        |        |  |           |           |       |           |       |        |  |         |                        |        |         |        |  |         |         |         |  |         |         |       |         |       |        |                            |         |         |        |         |        |        |                              |         |         |       |         |       |        |                        |         |        |       |        |       |         |                     |        |        |        |                              |         |         |       |         |       |        |  |           |           |       |           |       |        |                                     |              |              |              |
| 5.49 %    |        |          | 106,979 | 86,677   | 81.02 | 87,486   | 81.78                 | 8.01 %                     | CMBS rated B- or lower       | 147,465  | 50,165                 | 34.02           | 46,043                         | 31.22  | 9.06 %   | CDO Investments              | 406,605  | 117,246               | 28.84                      | 114,482                      | 28.16               | 14.19 %                      | CMBS IOs   | 2,980,467                           | 69,352 | 2.33 | 69,183 | 2.32 | 7.36 % | Commercial mortgage loan pools | 1,207,212 | 1,271,014 | 105.29 | 1,271,014 | 105.29 | 4.14 % | Total commercial real estate assets outside CDOs | 5,340,029 | 2,087,273 | 39.06 | 2,085,715 | 39.06 | 5.30 % | Commercial real estate loans and equity outside CDOs | 141,951 | Commercial real estate | 96,453 | 109,744 | 96,453 | Total commercial real estate loans and equity outside CDOs | 165,636 | 250,729 | 238,404 | Commercial real estate assets included in CDOs | 797,678 | 794,622 | 99.62 | 750,662 | 94.11 | 7.00 % | Investment grade REIT debt | 223,324 | 227,678 | 101.95 | 224,964 | 100.73 | 5.92 % | CMBS rated BB+ to B or lower | 650,202 | 554,185 | 85.23 | 508,908 | 78.27 | 9.31 % | CMBS rated B- or lower | 193,236 | 77,038 | 39.87 | 70,727 | 36.60 | 14.87 % | Credit tenant lease | 24,439 | 102.71 | 5.67 % | Commercial real estate loans | 424,973 | 413,163 | 97.22 | 400,559 | 94.25 | 8.36 % | Total commercial real estate assets included in CDOs | 2,313,206 | 2,091,004 | 90.39 | 1,980,259 | 85.61 | 8.01 % | Total commercial real estate assets | \$ 7,818,871 | \$ 4,429,006 | \$ 4,304,378 |

The Company's CDO offerings allow the Company to match fund its commercial real estate portfolio by issuing long-term debt to finance long-term assets. The CDO debt is non-recourse to the Company; therefore, the Company's losses are limited to its equity investment in the CDO. The CDO debt is also hedged to protect the Company from an increase in short-term interest rates. At September 30, 2007, over 51% of the estimated fair value of the Company's subordinated CMBS was match funded in the Company's CDOs in this manner. The Company retained 100% of the equity of CDOs I, II, III, HY3 and Euro (each as defined below) and recorded the transactions on its consolidated financial statements as secured financing.

The table below summarizes the Company's CDO collateral and debt at September 30, 2007.

| Collateral at September 30, 2007 | Debt at September 30, 2007 | Adjusted |
|----------------------------------|----------------------------|----------|
| Purchase Price                   | Loss                       | Adjusted |
| Yield                            | Adjusted                   |          |
| Issue Price                      | Weighted                   |          |

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Average Cost  
of Funds\* Net

|              |            |              |            |              |          |         |         |         |
|--------------|------------|--------------|------------|--------------|----------|---------|---------|---------|
| Spread CDO I | \$ 430,086 | 8.19 %       | \$ 396,383 | 7.37 %       | 0.82 %   | CDO II  | 327,682 | 7.63 %  |
| 292,482      | 6.26 %     | 1.37 %       | CDO III    | 383,510      | 7.16 %   | 377,045 | 5.14 %  | 2.03 %  |
| 415,573      | 9.84 %     | 373,584      | 6.35 %     | 3.49 %       | Euro CDO | 412,229 | 7.76 %  | 374,737 |
| 2.73 %       | Total**    | \$ 1,969,080 | 8.15 %     | \$ 1,814,231 | 6.03 %   | 2.12 %  |         |         |

\*

Weighted Average Cost of Funds is the current cost of funds plus hedging expenses. \*\* The Company chose not to sell \$12,500 of par of Euro CDO debt rated BB.

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Real Estate Credit Profile of Below Investment Grade CMBS

The Company views its below investment grade CMBS investment activity as two portfolios: Controlling Class CMBS and other below investment grade CMBS. The Company considers the CMBS securities where it maintains the right to influence the foreclosure/workout process on the underlying loans its controlling class CMBS (“Controlling Class”). The distinction between the two is in the rights the Company obtains with its investment in Controlling Class CMBS. Controlling Class rights allow the Company to influence the workout and/or disposition of defaults that occur in the underlying loans. These securities absorb the first losses realized in the underlying loan pools. The coupon payment on the non-rated security also can be reduced for special servicer fees charged to the trust. The next highest rated security in the structure then generally will be downgraded to non-rated and become the first to absorb losses and expenses from that point on. At September 30, 2007, the Company owned 37 trusts where it is in the first loss position and is designated as the controlling class representative by owning the lowest rated or non-rated CMBS class. The total par of the loans underlying these securities was \$58,615,416. At September 30, 2007, subordinated Controlling Class CMBS with a par of \$1,433,716 were included on the Company’s consolidated statement of financial condition and subordinated Controlling Class CMBS with a par of \$762,549 were held as collateral for CDO HY1 and CDO HY2 (each as defined below).

The Company’s other below investment grade CMBS have more limited rights associated with its ownership to influence the workout and/or disposition of underlying loan defaults. The total par of the Company’s other below investment grade CMBS at September 30, 2007 was \$2,555,339; the average credit protection, or subordination level, of this portfolio is 0.96%.

The Company’s investment in its subordinated Controlling Class CMBS securities by credit rating category at September 30, 2007 was as follows:

|                       | Par        | Estimated  |           |            |         |           |           |              |            |        |          |
|-----------------------|------------|------------|-----------|------------|---------|-----------|-----------|--------------|------------|--------|----------|
| Fair Value            | Dollar     |            |           |            |         |           |           |              |            |        |          |
| Price                 | Adjusted   |            |           |            |         |           |           |              |            |        |          |
| Purchase Price        | Dollar     |            |           |            |         |           |           |              |            |        |          |
| Price                 | Weighted   |            |           |            |         |           |           |              |            |        |          |
| Average Subordination |            |            |           |            |         |           |           |              |            |        |          |
| Level BB+             | \$ 255,729 | \$ 195,546 | 76.47     | \$ 213,352 | 83.43   | 3.49% BB  | 175,896   | 121,110      | 68.85      |        |          |
|                       | 144,966    | 82.42      | 2.55% BB- | 179,731    | 123,051 | 68.46     | 130,471   | 72.59        | 3.25% B+   | 90,994 |          |
|                       | 57,305     | 62.98      | 60,622    | 66.62      | 2.14% B | 129,231   | 76,997    | 59.58        | 79,341     | 61.39  | 1.79% B- |
|                       | 113,662    | 54,641     | 48.07     | 60,260     | 53.02   | 1.29% CCC | 22,314    | 6,691        | 29.98      | 7,964  | 35.69    |
|                       | 0.88% NR   | 466,159    | 123,164   | 26.42      | 131,369 | 28.18     | n/a Total | \$ 1,433,716 | \$ 758,505 | 52.90  |          |
|                       | \$ 828,345 | 57.78      |           |            |         |           |           |              |            |        |          |

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The Company's investment in its subordinated Controlling Class CMBS securities by credit rating category at December 31, 2006 was as follows:

|                                      | Par        | Estimated  |           |            |         |           |           |            |            |        |          |
|--------------------------------------|------------|------------|-----------|------------|---------|-----------|-----------|------------|------------|--------|----------|
| Fair Value                           |            |            |           |            |         |           |           |            |            |        |          |
| Price Adjusted Purchase              |            |            |           |            |         |           |           |            |            |        |          |
| Price Dollar                         |            |            |           |            |         |           |           |            |            |        |          |
| Price Weighted Average Subordination |            |            |           |            |         |           |           |            |            |        |          |
| Level BB+                            | \$ 158,220 | \$ 142,415 | 90.01     | \$ 130,966 | 82.77   | 3.51% BB  | 135,874   | 116,085    | 85.44      |        |          |
|                                      | 111,000    | 81.69      | 2.81% BB- | 120,226    | 94,256  | 78.40     | 86,317    | 71.80      | 3.13% B+   | 71,277 |          |
|                                      | 51,030     | 71.59      | 47,861    | 67.15      | 2.05% B | 88,217    | 60,237    | 68.28      | 52,988     | 60.07  | 1.88% B- |
|                                      | 66,160     | 37,680     | 56.95     | 35,001     | 52.90   | 1.28% CCC | 9,671     | 3,823      | 39.53      | 3,596  | 37.19    |
|                                      | 0.88% NR   | 260,332    | 81,480    | 31.30      | 73,842  | 28.36     | n/a Total | \$ 909,977 | \$ 587,006 | 64.51  | \$       |
|                                      | 541,571    | 59.54      |           |            |         |           |           |            |            |        |          |

Future delinquencies and losses may cause the par reductions and cause the Company to conclude that a change in loss adjusted yield is required along with a write-down of the adjusted purchase price through the income statement as required by EITF 99-20. During the nine months ended September 30, 2007, the loan pools were paid down by \$1,200,077. Pay down proceeds are distributed to the highest rated CMBS class first and reduce the percent of total underlying collateral represented by each rating category.

As the portfolio matures and expected losses occur, subordination levels of the lower rated classes of a CMBS investment will be reduced. This may cause the lower rated classes to be downgraded, which would negatively affect their estimated fair value and therefore the Company's net asset value. Reduced estimated fair value would negatively affect the Company's ability to finance any such securities that are not financed through a CDO or similar matched funding vehicle. In some cases, securities held by the Company may be upgraded to reflect seasoning of the underlying collateral and thus would increase the estimated fair value of the securities. During the nine months ended September 30, 2007, eleven securities in six of the Company's Controlling Class CMBS were upgraded by at least one rating agency and one was downgraded. Additionally, at least one rating agency downgraded seven of the Company's non-Controlling Class commercial real estate securities.

As part of its underwriting process, the Company assumes a certain amount of loans will incur losses over time. In performing continuing credit reviews on the 37 Controlling Class trusts, the Company estimates that specific losses totaling \$724,728 related to principal of the underlying loans will not be recoverable, of which \$304,115 is expected to occur over the next five years. The total loss estimate of \$724,728 represents 1.24% of the total underlying loan pools. Due to falling delinquency rates in the CMBS market, the Company no longer assumes an additional layer of unassigned losses. Previously, the Company assumed ten to forty basis points of additional defaults would occur with a 35% loss severity and a one-year recovery period. This change reduced total losses assumed by 15 to 62 basis points, depending on the transaction.



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The Company considers delinquency information from the Lehman Brothers Conduit Guide to be the most relevant benchmark to measure credit performance and market conditions applicable to its Controlling Class CMBS holdings. The year of issuance, or vintage year, is important, as older loan pools will tend to have more delinquencies than newly underwritten loans. The Company owns Controlling Class CMBS issued in 1998, 1999, and 2001 through 2007. Comparable delinquency statistics referenced by vintage year as a percentage of par outstanding at September 30, 2007 are shown in the table below:

|                             |      |              |        |        |       |               |        |         |      | Vintage Year |
|-----------------------------|------|--------------|--------|--------|-------|---------------|--------|---------|------|--------------|
| Underlying                  |      |              |        |        |       |               |        |         |      |              |
| Collateral Delinquencies    |      |              |        |        |       |               |        |         |      |              |
| Outstanding Lehman Brothers |      |              |        |        |       |               |        |         |      |              |
| Conduit Guide               | 1998 | \$ 4,447,223 | 0.99 % | 0.94 % | 1999  | 538,981       | 2.05 % | 0.82 %  | 2001 | 817,031      |
|                             | 2002 | 974,074      | 0.00 % | 0.56 % | 2003  | 2,060,251     | 0.76 % | 0.31 %  | 2004 |              |
|                             | 2005 | 12,028,391   | 0.44 % | 0.34 % | 2006  | 13,766,152    | 0.20 % | 0.22 %  | 2007 |              |
|                             | 2007 | 17,595,038   | 0.16 % | 0.05 % | Total | \$ 58,615,416 | 0.33 % | 0.27 %* |      |              |

\*

Weighted average based on current principal balance.

Delinquencies on the Company's CMBS collateral as a percent of principal are in line with expectations and are consistent with comparable data provided in the Lehman Brothers Conduit Guide. These seasoning criteria generally will adjust for the lower delinquencies that occur in newly originated collateral. See "Item 7A — Quantitative and Qualitative Disclosures About Market Risks" for a detailed discussion of how delinquencies and loan losses affect the Company.

The following table sets forth certain information relating to the aggregate principal balance and payment status of delinquent commercial mortgage loans underlying the Controlling Class CMBS held by the Company at September 30, 2007:

|             |                             |           |     |                  |                             |        |        |                          |                          | September |
|-------------|-----------------------------|-----------|-----|------------------|-----------------------------|--------|--------|--------------------------|--------------------------|-----------|
| 30, 2007    |                             |           |     |                  |                             |        |        |                          |                          |           |
| Principal   |                             |           |     |                  |                             |        |        |                          |                          |           |
| Loans       |                             |           |     |                  |                             |        |        |                          |                          |           |
| % of        |                             |           |     |                  |                             |        |        |                          |                          |           |
| Collateral  | Past due 30 days to 60 days | \$ 63,375 | 8   | 0.11 %           | Past due 60 days to 90 days | 50,500 | 12     | 0.09 %                   | Past due 90 days or more | 33,029    |
|             |                             |           | 10  | 0.06 %           | Real Estate owned           | 40,351 | 13     | 0.07 %                   |                          |           |
| Foreclosure | —                           | —         | n/a | Total Delinquent | \$ 187,255                  | 43     | 0.32 % | Total Collateral Balance | \$ 58,615,416            |           |

Of the 43 delinquent loans at September 30, 2007, 13 loans were real estate owned and being marketed for sale, no loans were in foreclosure and the remaining 30 loans were in some form of workout negotiations. The Controlling Class CMBS owned by the Company have a delinquency rate of 0.32%, which is consistent with industry averages. During 2007, the underlying collateral experienced early payoffs of \$1,200,077 representing 2.05% of the year-end pool balance. These loans were paid off at par with no loss. Aggregate losses related to the underlying collateral of \$14,442,782 were realized during nine months ended September 30, 2007. This brings cumulative realized losses to \$123,891, which is 17.1% of total estimated losses. These losses include special servicer and other workout expenses. This experience to date is in line with the Company's loss expectations. Realized losses and special servicer expenses



are expected to increase on the underlying loans as the portfolio matures. Special servicer expenses are also expected to increase as portfolios mature.

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To the extent that realized losses differ from the Company’s original loss estimates, it may be necessary to reduce or increase the projected yield on the applicable CMBS investment to better reflect such investment’s expected earnings net of expected losses, from the date of purchase. While realized losses on individual assets may be higher or lower than original estimates, the Company currently believes its aggregate loss estimates and yields remain appropriate.

The Company manages its credit risk through disciplined underwriting, diversification, active monitoring of loan performance and exercise of its right to influence the workout process for delinquent loans as early as possible. The Company maintains diversification of credit exposures through its underwriting process and can shift its focus in future investments by adjusting the mix of loans in subsequent acquisitions. The comparative profiles of the loans underlying the Company’s CMBS by property type at September 30, 2007 and December 31, 2006 were as follows:

September 30, 2007

Exposure December 31, 2006  
 Exposure Property Type Collateral  
 Balance % of  
 Total Collateral  
 Balance % of

|                  |               |         |               |        |               |            |               |            |
|------------------|---------------|---------|---------------|--------|---------------|------------|---------------|------------|
| Total Office     | \$ 19,377,734 | 33.1 %  | \$ 13,415,671 | 31.6 % | Retail        | 16,549,972 | 28.2          | 13,217,676 |
| 31.2 Multifamily | 13,567,969    | 23.2    | 8,978,823     | 21.2   | Industrial    | 4,347,832  | 7.4           | 3,332,194  |
| Lodging          | 3,894,702     | 6.6     | 2,726,441     | 6.4    | Healthcare    | 407,339    | 0.7           | 305,612    |
| 469,868          | 0.8           | 422,284 | 1.0           | Total  | \$ 58,615,416 | 100 %      | \$ 42,398,701 | 100 %      |

At September 30, 2007, the estimated fair value of the Company’s holdings of subordinated Controlling Class CMBS is \$69,840 lower than the adjusted cost for these securities which consists of a gross unrealized gain of \$33,990 and a gross unrealized loss of \$103,830. The adjusted purchase price of the Company’s subordinated Controlling Class CMBS portfolio at September 30, 2007 represents approximately 58.7% of its par amount. The estimated fair value of the Company’s subordinated Controlling Class CMBS portfolio at September 30, 2007 represents approximately 52.9% of its par amount. As the portfolio matures, the Company expects to recoup the \$103,830 of unrealized loss, provided that the credit losses experienced are not greater than the credit losses assumed in the projected cash flow analysis. At September 30, 2007, the Company believed there has been no material deterioration in the credit quality of its portfolio below current expectations.

The Company’s interest income calculated in accordance with EITF 99-20 for its CMBS is computed based upon a yield, which assumes credit losses will occur. The yield to compute the Company’s taxable income does not assume there would be credit losses, as a loss can only be deducted for tax purposes when it has occurred. This is the primary difference between the Company’s income in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and taxable income. As a result, for the years 1998 through 2007, the Company’s GAAP income was approximately \$56,511 lower than its taxable income.

Commercial Real Estate Loan Activity

The Company’s commercial real estate loan portfolio generally emphasizes larger transactions located in metropolitan markets located in the United States and Europe, as compared to the typical loan in the CMBS portfolio.



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The following table summarizes the Company's commercial real estate loan portfolio by property type at September 30, 2007 and December 31, 2006:

| Average Yield | Loan Outstanding   |                   | Weighted |     | Property Type   | Amount     | %       | Amount     | %       | 2007  | 2006 U.S. |
|---------------|--------------------|-------------------|----------|-----|-----------------|------------|---------|------------|---------|-------|-----------|
|               | September 30, 2007 | December 31, 2006 |          |     |                 |            |         |            |         |       |           |
| 5.0           | 65,812             | 13.6              | 10.3     | 8.5 | Retail          | \$ 52,119  | 5.7 %   | \$ 51,553  | 10.7 %  | 9.6 % | 9.6 %     |
|               |                    |                   |          |     | Office          |            |         |            |         |       | 45,635    |
|               |                    |                   |          |     | Multifamily     | 147,474    | 16.3    | 51,368     | 10.7    | 10.0  | 11.1      |
|               |                    |                   |          |     | Land            | 25,000     | 2.7     | —          | —       | 9.8   | —         |
|               |                    |                   |          |     | Hotel           |            |         |            |         |       |           |
|               |                    |                   |          |     | Other Mixed Use | 3,983      | 0.4     | 3,983      | 0.8     | 8.5   | 9.1       |
|               |                    |                   |          |     | Total U.S.      | 318,796    | 35.0    | 238,369    | 49.5    | 9.9   | 9.6       |
|               |                    |                   |          |     | Non-U.S.        |            |         |            |         |       | Retail    |
|               |                    |                   |          |     | Office          | 197,441    | 21.6    | 64,204     | 13.3    | 8.3   | 8.0       |
|               |                    |                   |          |     | Multifamily     | 39,310     | 4.3     | 6,550      | 1.4     | 8.0   | 7.3       |
|               |                    |                   |          |     | Storage         | 52,424     | 5.7     | 1,384      | 0.3     | 9.2   |           |
|               |                    |                   |          |     | Industrial      | 20,879     | 2.3     | 19,317     | 4.0     | 10.1  | 9.1       |
|               |                    |                   |          |     | Hotel           | 5,115      | 0.6     | 5,870      | 1.2     | 10.1  |           |
|               |                    |                   |          |     | Other Mixed Use | 3,554      | 0.4     | 2,666      | 0.6     | 8.0   | 8.2       |
|               |                    |                   |          |     | Total Non-U.S.  | 593,879    | 65.0    |            |         |       |           |
|               |                    |                   |          |     | Total           | \$ 912,675 | 100.0 % | \$ 481,745 | 100.0 % | 8.4 % | 8.6 %     |

The Company finances its non-U.S. dollar denominated loans by borrowing in the applicable local currency and hedging the un-financed portion.

During the three months ended September 30, 2007, the Company purchased \$129,946 of commercial real estate loans. These purchases were comprised of six Euro denominated commercial real estate loans with a total cost of €47,434 and a principal balance totaling €51,870, and fourteen Canadian dollar denominated loan with a cost of C\$6,250 (and a principal balance of C\$6,576. During the quarter ended September 30, 2007, the Company received repayments of commercial real estate loans in the aggregate amount of \$119,954.

The Company's investments in Carbon Capital Funds also invest in commercial real estate loans. For the three and nine months ended September 30, 2007, the Company recorded \$2,222 and \$10,191 of income for the Carbon Capital Funds. Carbon II increased its investment in U.S. commercial real estate loans by originating four loans for a total investment of \$178,660 during the third quarter of 2007. Paydowns in Carbon Capital Funds during the quarter totaled \$83,806. As loans are repaid or sold, Carbon II has redeployed capital into acquisitions of additional loans for the portfolio. The Carbon I investment period has expired and no new portfolio additions are expected.

The Company's investments in the Carbon Capital Funds are as follows:

|                            | September 30, 2007 |           |
|----------------------------|--------------------|-----------|
| December 31, 2006 Carbon I | \$ 2,554           | \$ 3,144  |
| Carbon II                  | 98,252             | 69,259    |
|                            | \$ 100,806         | \$ 72,403 |

An investments held by Carbon II, of which the Company owns 26%, includes a \$24,546 commercial real estate mezzanine loan which defaulted during July 2006 and was subsequently cured. The underlying property is a hotel located in the South Beach area of Miami, Florida. In the



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second quarter of 2006, Carbon II purchased the controlling class position of the senior loan. This position is senior in the capital structure to Carbon II's existing investment and provides Carbon II with the ability to direct the workout process of the senior loan. Both loans matured in March 2007, and the borrower failed to repay triggering a maturity default. The borrower has reached a settlement agreement that allows the borrower a specified period of time to obtain a purchaser for the hotel. Based on the credit analysis performed for this property, the loan to value of this loan is approximately 80% and Carbon II believes a loan loss reserve is not necessary at September 30, 2007.

Two other loans held by Carbon II have defaulted. The aggregate carrying value of the two loans on Carbon II's consolidated financial statements is \$24,000 (\$12,000 per loan). The underlying properties, located in Orlando and Boynton Beach, Florida, are multi-family assets. Regarding the 336-unit property in Orlando, Carbon II has concluded a workout arrangement with the borrower, whereby Carbon II will forebear from taking title and will make all advances necessary to operate the property and service the first mortgage. The borrower continues to hold title and implement its sales strategy. Since its implementation in March 2007, 233 units have been sold and closed. An additional 20 units are under contract with deposits and 36 contracts are being prepared. Based on credit analysis performed for this property, Carbon II believes a loan loss reserve is not necessary at September 30, 2007.

Regarding the 216-unit property in Boynton Beach, the borrower was not able to achieve sufficient condominium sales to complete the condominium conversion. The borrower defaulted on its loan. Carbon II has taken title to the property and is operating it as a rental property. During 2006, Carbon II established a loss reserve of \$5,180, of which the Company's share is \$1,361. Carbon II determined that no change to the carrying value of the property was necessary at September 30, 2007. All other commercial real estate loans in the Carbon Capital Funds are performing as expected.

## Commercial Real Estate

The Company had a \$100,000 commitment to acquire shares of BlackRock Diamond which was fully funded in January 2007. The Company redeemed \$25,000 of its investment in BlackRock Diamond on June 30, 2007 and redeemed the remaining \$104,476 as of September 30, 2007. BlackRock Diamond is a private real estate investment trust ("REIT") managed by BlackRock Realty Advisors, Inc., a subsidiary of the Company's Manager.

BlackRock Diamond's investment objective is to seek a high risk adjusted return through "value-added" capital appreciation and current income on properties throughout the United States. This means that BlackRock Diamond focuses on operating properties that will be repositioned, renovated, or expanded to achieve maximum returns. Part of the investment strategy includes a budgeted amount of capital expenditures that are used to improve the value of the investment and realize the full value potential of a given property. BlackRock Diamond relies on its manager's extensive relationships in the real estate markets to source opportunities. BlackRock Diamond focuses on large urban locations where it believes the real estate equity markets will outperform.

BlackRock Diamond is an open-end fund. As such, it may allow shares to be redeemed at a price equal to its quarter-end net asset value upon 60 days' notice. The assets are subject to quarterly valuations with one independent appraisal done annually. The Company does not pay a separate management or incentive fee to the Manager or its affiliates for management services associated with its investment in BlackRock Diamond.

For the three and nine months ended September 30, 2007, respectively, the Company recorded \$4,390 and \$18,790 of income related to BlackRock Diamond. All financial information relating to this investment was reported by BlackRock Diamond.

The Company has an indirect investment in a commercial real estate development fund located in India. At September 30, 2007, the Company's capital committed was \$11,000 of which \$6,050 had been drawn. The entity conducts its operations in the local currency, Indian Rupees.

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## Operations

## II. Results of

Interest Income: The following tables set forth information regarding interest income from certain of the Company's interest-earning assets.

## For the Three Months Ended

| September 30, Variance                 | 2007      | 2006                           | Amount                            | % U.S. dollar | denominated income           |          |                |
|--|-----------|--------------------------------|-----------------------------------|---------------|------------------------------|----------|----------------|
| Commercial real estate securities      | \$ 43,016 | \$ 41,306                      | \$ 1,710                          | 4.1 %         | Commercial real estate loans | 8,933    |                |
| 5,952                                  | 2,981     | 50.1 %                         | Commercial mortgage loan pools    | 12,985        | 13,230                       | (245)    | (1.9) %        |
| Residential mortgage-backed securities | 128       | 2,960                          | (2,832)                           | (95.7) %      | Cash and cash equivalents    | 1,242    |                |
| 828                                    | 414       | 50.0 %                         | Total U.S. interest income        | \$ 66,304     | \$ 64,276                    | \$ 2,028 | 3.2 %          |
| denominated income                     |           |                                | Commercial real estate securities | \$ 6,415      | \$ 2,191                     | \$ 4,224 | 192.8          |
| % Commercial real estate loans         | 11,562    | 5,100                          | 6,462                             | 126.7 %       | Cash and cash equivalents    | 542      | —              |
| 542                                    | 100.0 %   | Total Non-U.S. interest income | \$ 18,519                         | \$ 7,291      | \$ 11,228                    | 154.0 %  | Total Interest |
| Income                                 | \$ 84,823 | \$ 71,567                      | \$ 13,256                         | 18.5 %        |                              |          |                |

## For the Nine Months Ended

| September 30, Variance                 | 2007                  | 2006                         | Amount                            | % U.S. dollar              | denominated income             |           |               |
|--|-----------------------|------------------------------|-----------------------------------|----------------------------|--------------------------------|-----------|---------------|
| Commercial real estate securities      | \$ 128,999            | \$ 119,151                   | \$ 9,848                          | 8.3 %                      | Commercial real estate loans   | 22,530    |               |
| 16,808                                 | 5,722                 | 34.0 %                       | Commercial mortgage loan pools    | 39,119                     | 39,743                         | (624)     | (1.6) %       |
| Residential mortgage-backed securities | 3,869                 | 9,070                        | (5,201)                           | (57.3) %                   | Cash and cash equivalents      | 2,316     |               |
| 2,316                                  | 1,746                 | 570                          | 32.6 %                            | Total U.S. interest income | \$ 196,833                     | 186,518   | \$ 10,315     |
| Non-U.S. dollar denominated income     |                       |                              | Commercial real estate securities | \$ 14,326                  | \$ 3,984                       | \$        |               |
| 10,342                                 | 259.6 %               | Commercial real estate loans | 27,413                            | 11,234                     | 16,179                         | 144.0 %   | Cash and cash |
| equivalents                            | 1,332                 | —                            | 1,332                             | 100.0 %                    | Total Non-U.S. interest income | \$ 43,071 | \$ 15,218     |
| 183.0 %                                | Total Interest Income | \$ 239,904                   | \$ 201,736                        | \$ 38,168                  | 18.9 %                         |           |               |

The following table reconciles interest income and total income for the three and nine months ended September 30, 2007 and 2006.

## For the Three Months Ended

| September 30, Variance            | 2007      | 2006      | Amount                  | % Interest Income | \$ 84,823              | \$ 71,567 | \$ 13,256 | 18.5         |
|-----------------------------------|-----------|-----------|-------------------------|-------------------|------------------------|-----------|-----------|--------------|
| % Earnings from BlackRock Diamond | 4,390     | 660       | 3,730                   | 565.2 %           | Earnings from Carbon I | (47)      |           |              |
| 94                                | (141)     | (150.0) % | Earnings from Carbon II | 2,268             | 2,232                  | 36        | 1.6 %     | Total Income |
| \$ 74,553                         | \$ 16,881 | 22.6 %    |                         |                   |                        |           |           | \$ 91,434    |



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## For the Nine Months Ended

|  |        |        |        |        |                        |            |            |           |
|--|--------|--------|--------|--------|------------------------|------------|------------|-----------|
| September 30, Variance                 | 2007   | 2006   | Amount | %      | Interest Income        | \$ 239,904 | \$ 201,736 | \$ 38,168 |
| 18.9 % Earnings from BlackRock Diamond | 18,790 | 12,357 | 6,433  | 52.1 % | Earnings from Carbon I | 812        | 807        | 5         |
| 0.6 % Earnings from Carbon II          | 9,380  | 8,837  | 543    | 6.1 %  | Total Income           | \$ 223,737 | \$ 45,149  | 20.2 %    |

U.S. dollar denominated income

For the three and nine months ended September 30, 2007 versus 2006, interest income from US assets increased \$2,028 or 3.2% and \$10,315 or 5.5%, respectively. The Company has continued to acquire commercial real estate securities and loan throughout the year which has offset the decline in interest income resulting in the sale of residential mortgage-back securities. Income from BlackRock Diamond was \$4,390 and \$18,790 for the three and nine months ended September 30, 2007. The Company redeemed its interest in BlackRock Diamond as of September 30, 2007.

## Non-U.S. dollar denominated income

For the three and nine months ended September 30, 2007 versus 2006, interest income from non-U.S. assets increased \$11,288 or 154.0% and \$27,853 or 183.0%, respectively. The Company continues to increase its investment in non-U.S. dollar assets resulting in higher interest income from non-U.S. commercial real estate securities and loans.

Interest Expense: The following table sets forth information regarding the total amount of interest expense from certain of the Company's borrowings and cash flow hedges.

## For the Three Months Ended

|   |           |           |          |            |  |           |           |            |
|---|-----------|-----------|----------|------------|--|-----------|-----------|------------|
| September 30, Variance                              | 2007      | 2006      | Amount   | %          | U.S. dollar denominated interest expense |           |           |            |
| Collateralized debt obligations                     | \$ 22,905 | \$ 22,889 | \$ 16    | 0.07 %     | Commercial real estate securities        | 6,021     | 9,731     | (3,710)    |
| (38.1)% Commercial real estate loans                | 1,625     | 187       | 1,438    | 768.9 %    | Commercial mortgage loan pools           | 12,353    | 12,594    | (241)      |
| (1.9)% Residential mortgage-backed securities       | 778       | 3,878     | (3,100)  | (79.9)%    | Convertible debt                         | 794       | —         | 794        |
| 100.0 % Senior unsecured notes                      | 3,226     | —         | 3,226    | 100.0 %    | Junior unsecured notes                   | 3,396     | 3,440     | (44)       |
| (1.3)% Cash flow hedges                             | (181)     | (9)       | (172)    | (1,911.1)% | Hedge ineffectiveness*                   | 106       | 174       | (68)       |
| (39.1)% Other                                       | 331       | —         | 331      | 100.0 %    | Total U.S. Interest Expense              | \$ 51,354 | \$ 52,884 | \$ (1,530) |
| (2.9)% Non-U.S. dollar denominated interest expense |           |           |          |            | Euro CDO                                 | \$ 4,950  | —         | \$ 4,950   |
| 100.0 % Commercial real estate securities           | 1,971     | 1,130     | 841      | 74.4 %     | Commercial real estate loans             | 3,055     | 2,042     | 1,013      |
| 49.6 % Junior subordinated notes                    | 1,195     | —         | 1,195    | 100.0 %    | Total Non-U.S. Interest Expense          | \$ 11,171 | \$ 3,172  | \$ 7,999   |
| 252.2 % Total Interest Expense                      | \$ 62,525 | \$ 56,056 | \$ 6,469 | 11.5 %     |  |           |           |            |

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| For the Nine Months Ended                    |           |           |                           |                              |                        |  |            |                         |                        |
|--|-----------|-----------|---------------------------|------------------------------|------------------------|--|------------|-------------------------|------------------------|
| September 30,                                | Variance  | 2007      | 2006                      | Amount                       | % U.S. dollar          | denominated interest expense           |            |                         |                        |
| Collateralized debt obligations              |           | \$ 68,238 | \$ 57,603                 | \$ 10,635                    | 18.46 %                | Commercial real estate securities      |            |                         |                        |
| 22,983                                       | 26,161    | (3,178)   | (12.1)%                   | Commercial real estate loans | 3,636                  | 3,888                                  | (252)      | (6.5)%                  |                        |
| Commercial mortgage loan pools               |           | 37,233    | 37,871                    | (638)                        | (1.7)%                 | Residential mortgage-backed securities |            |                         |                        |
| 5,841  | 11,221    | (5,380)   | (47.9)%                   | Convertible debt             | 794                    | —                                      | 794        | 100.0%                  | Senior unsecured       |
| notes  | 6,432     | —         | 6,432                     | 100.0%                       | Junior unsecured notes | 10,115                                 | 9,103      | 1,012                   | 11.1%                  |
| hedges                                       | (1,040)   | 2,110     | (3,150)                   | (149.3)%                     | Other                  | 331                                    | —          | 331                     | 100.0%                 |
| 163  | (401)     | 564       | (140.6)%                  | Total U.S. Interest Expense  | \$ 154,726             | \$ 147,556                             | \$ 7,170   | 4.9%                    | Hedge ineffectiveness* |
| Non-U.S. dollar denominated interest expense |           |           |                           | Euro CDO                     | 13,041                 | —                                      | \$ 13,041  | 100.0%                  |                        |
| Commercial real estate securities            |           | 2,857     | 2,057                     | 800                          | 38.9%                  | Commercial real estate loans           |            |                         |                        |
| 4,329  | 1,355     | 31.3%     | Junior subordinated notes | 2,142                        | —                      | 2,142                                  | 100.0%     | Total Non-U.S. Interest |                        |
| Expense                                      | \$ 23,724 | \$ 6,386  | \$ 17,338                 | 271.5%                       | Total Interest Expense | \$ 178,450                             | \$ 153,942 | \$                      |                        |
| 24,508                                       | 15.9%     |           |                           |                              |                        |  |            |                         |                        |

\* See

Note 14 of the consolidated financial statements, Derivative Instruments and Hedging Activities, for a further description of the Company's hedge ineffectiveness.

## U.S. dollar denominate interest expense

For the three and nine months ended September 30, 2007 versus 2006, U.S. dollar interest expense decreased \$1,534 or 2.9% and increased \$7,170 or 4.9%, respectively. The three month decrease and nine month increase was due to the sale of residential mortgage-backed securities during 2007, offset by the issuance of convertible debt, senior notes, and junior notes.

## Non-U.S. dollar denominated interest expense

For the three and nine months ended September 30, 2007 versus 2006. Non-dollar interest expense increased \$3,172 or 68.9% and \$8,386 or 182.9%, respectively. The Euro CDO was issued in December 2006 and as a result, is the major contributing factor for the three month and nine month increase.

**Net Interest Margin and Net Interest Spread from the Portfolio:** The Company considers its interest generating portfolio to consist of its securities available-for-sale, securities held-for-trading, commercial mortgage loans, and cash and cash equivalents because these assets relate to its core strategy of acquiring and originating high yield loans and securities backed by commercial real estate, while at the same time maintaining a portfolio of investment grade securities to enhance the Company's liquidity. The Company's equity investments, which include the Carbon Capital Funds and BlackRock Diamond through September 30, 2007, also generate a significant portion of the Company's income.

The Company believes interest income and expense related to these assets excluding the effects of hedge ineffectiveness and the consolidation of a VIE better reflect the Company's net interest margin and net interest spread from its portfolio. Adjusted interest income and adjusted interest expense are better indicators for both management and investors of the Company's financial performance over time.





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## For the Three Months Ended

September 30, For the Nine Months Ended

| September 30, 2007 | 2006 | 2007 | 2006 | Adjusted interest income                        | \$ 72,564 | \$ 59,036 | \$ 202,937 | \$         |
|--------------------|------|------|------|---|-----------|-----------|------------|------------|
| 164,009            |      |      |      | Adjusted interest expense                       | \$ 50,159 | \$ 43,355 | \$ 141,320 | \$ 116,616 |
|                    |      |      |      | Adjusted net interest income ratios             |           |           |            |            |
|                    |      |      |      | Net interest margin                             | 2.5 %     | 2.0 %     | 2.4 %      | 2.1 %      |
|                    |      |      |      | Average yield                                   | 8.2 %     | 7.5 %     |            |            |
|                    |      |      |      | Cost of funds                                   | 6.1 %     | 6.1 %     | 6.0 %      | 6.1 %      |
|                    |      |      |      | Net interest spread                             | 2.1 %     | 1.4 %     |            |            |
|                    |      |      |      | Ratios including income from equity investments |           |           |            |            |
|                    |      |      |      | Net interest margin                             | 3.1 %     |           |            |            |
|                    |      |      |      | Average yield                                   | 8.5 %     | 7.5 %     | 8.5 %      | 7.4 %      |
|                    |      |      |      | Cost of funds                                   | 6.1 %     | 6.1 %     |            |            |
|                    |      |      |      | Net interest spread                             | 2.5 %     | 1.5 %     | 2.4 %      | 1.3 %      |

The average yield increased from 7.5% to 8.2% as the sales of high credit quality liquid securities were offset with higher yielding commercial real estate securities.

**Other Expenses:** Expenses other than interest expense consist primarily of management fees, incentive fees and general and administrative expenses. The table below summarizes those expenses for the three and nine months ended September 30, 2007 and 2006, respectively.

## For the Three Months Ended

| September 30, 2007                 | Variance | 2006  | Amount | %    | Management fee              | \$ 3,473 | \$ 3,179 | \$ 294 | 9.3 %  |
|------------------------------------|----------|-------|--------|------|-----------------------------|----------|----------|--------|--------|
| Incentive fee                      | —        | —     | —      | —    | Incentive fee – stock based | 497      | 997      | (500)  | (50.2) |
| General and administrative expense | 1,624    | 1,144 | 480    | 41.9 | Total other expenses        | \$ 5,594 | \$ 5,320 | \$ 274 | 5.2 %  |

## For the Nine Months Ended

| September 30, 2007                 | Variance | 2006  | Amount | %     | Management fee              | \$ 10,862 | \$ 9,339  | \$ 1,523 | 16.3 % |
|------------------------------------|----------|-------|--------|-------|-----------------------------|-----------|-----------|----------|--------|
| Incentive fee                      | 5,645    | 2,708 | 2,937  | 108.4 | Incentive fee – stock based | 2,145     | 1,853     | 292      | 15.8   |
| General and administrative expense | 4,448    | 3,382 | 1,066  | 31.5  | Total other expenses        | \$ 23,100 | \$ 17,282 | \$ 5,818 | 33.7 % |

Management fees are based on 2% of average quarterly stockholders' equity. The increase of \$294, or 9.3%, and \$1,523, or 16.3%, is due to the increase in the Company's stockholders' equity. The Manager earned an incentive fee of \$0 and \$4,150 for the three and nine month period ended September 30, 2007, 30% of which was paid in Common Stock, as the Company achieved the necessary performance goals specified in the Management Agreement. The decrease in incentive fee – stock based of \$500 is due to the decline in the market price of the common stock. The fee is based on the number of common shares outstanding as of year end. The Company accrues the incentive fee – stock based expense each quarter based on the shares outstanding at the end of the quarter.

General and administrative expense is comprised of accounting agent fees, custodial agent fees, directors' fees, fees for professional services, insurance premiums, broken deal expenses, and due diligence costs. The increase in general and administrative expense for the quarter ended

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September 30, 2007 is primarily attributable to costs associated with the Company's global expansion and the Company's new investment accounting system.

Other Gains (Losses): Gains (losses) on securities available-for-sale were \$(1,331) and \$5,576 for the three and nine months ended September 30, 2007 and \$446 and \$386 for the three and nine months ended September 30, 2006. Gains (losses) on securities held-for-trading were \$(4,435) and \$(4,063) for the three and nine months ended September 30, 2007, and \$(18) and \$2,297 for the three and nine months ended September 30, 2007. Foreign currency gains were \$775 and \$3,631 for the three and nine months ended September 30, 2007 and \$682 and \$997 for the three and nine months ended September 30, 2006. This represents the net impact of the Company's foreign currency exposure for the applicable periods. The losses on impairment of assets of \$2,938 and 7,036 and \$361 and \$5,795, for the three and nine month periods ended September 30, 2007 and 2006, respectively, were related to the Company's write down of certain CMBS as required by EITF 99-20.

Dividends Declared: On March 6, 2007, the Company declared distributions to its stockholders of \$0.29 per share, which were paid on April 30, 2007 to stockholders of record on March 30, 2007.

On May 22, 2007, the Company declared distributions to its stockholders of \$0.30 per share, which were paid on July 31, 2007 to stockholders of record on June 29, 2007.

On September 5, 2007, the Company declared distributions to its stockholders of \$0.30 per share, which were paid on October 31, 2007 to stockholders of record on September 30, 2007.

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## Changes in Financial Condition

Securities available-for-sale: The Company's securities available-for-sale, which are carried at estimated fair value, included the following at September 30, 2007 and December 31, 2006:

| September 30,<br>2007 Estimated                           |   | December 31,<br>2006 Estimated                              |  |
|---|---|---|--|
| Fair Value  | Percentage  | Fair Value  | Percentage   |
| U.S. dollar denominated securities available-for-sale     |   |   |  |
| Commercial mortgage-backed securities:                    |   |   |  |
| CMBS IOs  | \$ 18,220 0.8 %   | \$ 69,352 2.7 %   | Investment grade CMBS                              |
| 740,573 32.3 %  | 738,766 28.2 %  | Non-investment grade rated subordinated securities          | 632,367 27.6 %                                     |
| 562,748 21.5 %  | Non-rated subordinated securities                               | 105,988 4.6 %   | 78,619 3.0 %                                       |
| 24,118 1.1 %  | 24,318 0.9 %  | Investment grade REIT debt                                  | 246,905 10.8 %                                     |
| 24,118 1.1 %  | 24,318 0.9 %  | 249,244 9.5 %   | Multifamily agency securities                      |
| 117,246 4.5 %   | 37,240 1.6 %  | 449,827 17.2 %  | CDO investments                                    |
| 117,246 4.5 %   | Total CMBS  | 1,864,230 81.4 %  | 2,290,120 87.5 %                                   |
| Commercial mortgage-backed securities:                    |   |   |  |
| Agency adjustable rate securities                         | 1,235 0.0 %   | 1,774 0.1 %   | Residential CMOs                                   |
| 201 0.0 %   | 130,850 5.0 %   | Hybrid adjustable rate mortgages ("ARMs")                   | 8,648 0.4 %  |
| 11,516 0.4 %  | Total RMBS  | 10,084 0.4 %  | 144,140 5.5 %                                      |
| \$ 1,874,314 81.8 %                                       | \$ 2,434,260 93.1 %   | Total U.S. dollar denominated securities available-for-sale |  |
| Non-U.S. dollar denominated securities available-for-sale |   |   |  |
| Commercial mortgage-backed securities:                    |   |   |  |
| Investment grade CMBS                                     | 146,916 6.4 %   | 56,778 2.2 %  | Non-investment grade rated subordinated securities |
| 233,564 10.2 %  | 123,271 4.7 %   | Non-rated subordinated securities                           | 36,608 1.6 %                                       |
| 1,547 0.1 %   | Total Non-U.S. dollar denominated securities available-for-sale | 417,088 18.2 %  | 181,597 6.9 %                                      |
| 2,291,402 100.0 %   | \$ 2,615,856 100.0 %  | Total securities available-for-sale                         | \$ 2,615,856                                       |

Borrowings: As of September 30, 2007 and December 31, 2006, the Company's debt consisted of reverse repurchase agreements, credit facilities, CDOs, senior unsecured notes, senior convertible debt, junior unsecured notes, trust preferred securities, and commercial mortgage loans pools collateralized by a pledge of most of the Company's securities available-for-sale, securities held-for-trading, and its commercial mortgage loans. The Company's financial flexibility is affected by its ability to renew or replace on a continuous basis its maturing short-term borrowings. At September 30, 2007 and December 31, 2006, the Company obtained financing in amounts and at interest rates consistent with the Company's short-term financing objectives.

Under the credit facilities and reverse repurchase agreements the lender retains the right to mark the underlying collateral to its estimated fair value. A reduction in the value of its pledged assets would require the Company to provide additional collateral or fund margin calls. From time to time, the Company expects that it will be required to provide such additional collateral or fund margin calls.





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|        |        |        |        |                 |         |        |          |        |        |        |     |
|--------|--------|--------|--------|-----------------|---------|--------|----------|--------|--------|--------|-----|
| — %    | — %    | — %    | 5.76 % | Effective Yield |         |        |          |        | Fixed  | — %    | — % |
| 7.30 % | 3.99 % | 7.64 % | 7.59 % | 6.56 %          | 11.75 % | 6.14 % | Floating | 5.36 % | 6.25 % | 5.63 % |     |
| %      | — %    | — %    | — %    | — %             | — %     | 5.76 % |          |        |        |        |     |

Hedging Instruments: The Company may modify its exposure to market interest rates by entering into various financial instruments that adjust portfolio duration. These financial instruments are intended to mitigate the effect of changes in interest rates on the value of the Company’s assets and the cost of borrowing.

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Interest rate hedging instruments at September 30, 2007 and December 31, 2006 consisted of the following:

|                       |                  |            |             |     |     |                      |         |     |   |
|-----------------------|------------------|------------|-------------|-----|-----|----------------------|---------|-----|---|
| At September 30, 2007 | Notional         |            |             |     |     |                      |         |     |   |
| Value                 | Estimated        |            |             |     |     |                      |         |     |   |
| Fair Value            | Unamortized      |            |             |     |     |                      |         |     |   |
| Cost                  | Average          |            |             |     |     |                      |         |     |   |
| Remaining             |                  |            |             |     |     |                      |         |     |   |
| Term (years)          | Cash flow hedges | \$ 244,500 | \$ (6,700 ) | —   | 7.4 | CDO cash flow hedges | 887,570 | 127 | — |
| 6.5                   | Trading swaps    | 1,206,076  | (192 )      | —   | 1.4 | CDO timing swaps     | 281,267 | 211 | — |
| LIBOR cap             | 85,000           | 189        | —           | 5.7 |     |                      |         |     |   |

|                      |                  |            |          |     |     |                      |         |       |   |
|----------------------|------------------|------------|----------|-----|-----|----------------------|---------|-------|---|
| At December 31, 2006 | Notional         |            |          |     |     |                      |         |       |   |
| Value                | Estimated        |            |          |     |     |                      |         |       |   |
| Fair Value           | Unamortized      |            |          |     |     |                      |         |       |   |
| Cost                 | Average          |            |          |     |     |                      |         |       |   |
| Remaining            |                  |            |          |     |     |                      |         |       |   |
| Term (years)         | Cash flow hedges | \$ 644,200 | \$ 5,048 | —   | 7.9 | CDO cash flow hedges | 895,499 | 8,230 | — |
| 7.2                  | Trading swaps    | 1,220,000  | 2,033    | —   | 2.1 | CDO timing swaps     | 223,445 | 212   | — |
| LIBOR cap            | 85,000           | (38 )      | \$ 1,407 | 6.4 |     |                      |         |       |   |

Foreign currency agreements at September 30, 2007 and December 31, 2006 consisted of the following:

|                    |                |             |      |     |       |                    |       |   |          |
|--------------------|----------------|-------------|------|-----|-------|--------------------|-------|---|----------|
|                    |                |             |      |     |       |                    |       |   | At       |
| September 30, 2007 | Estimated      |             |      |     |       |                    |       |   |          |
| Fair Value         | Unamortized    |             |      |     |       |                    |       |   |          |
| Cost               | Average        |             |      |     |       |                    |       |   |          |
| Remaining          |                |             |      |     |       |                    |       |   |          |
| Term               | Currency swaps | \$ (4,848 ) | —    | 7.9 | years | CDO currency swaps | 4,135 | — | 10.7     |
| (5,385 )           | —              | 17          | days |     |       |                    |       |   | Forwards |

|                                 |                |          |      |      |       |                    |          |   |          |
|---------------------------------|----------------|----------|------|------|-------|--------------------|----------|---|----------|
|                                 |                |          |      |      |       |                    |          |   | At       |
| December 31, 2006               | Estimated      |          |      |      |       |                    |          |   |          |
| Fair Value                      | Unamortized    |          |      |      |       |                    |          |   |          |
| Cost                            | Average        |          |      |      |       |                    |          |   |          |
| Remaining                       |                |          |      |      |       |                    |          |   |          |
| Term                            | Currency swaps | \$ 1,179 | —    | 12.5 | years | CDO currency swaps | (1,418 ) | — | 12.5     |
| (2,659 )                        | —              | 10       | days |      |       |                    |          |   | Forwards |
| Capital Resources and Liquidity |                |          |      |      |       |                    |          |   |          |

The current weaknesses in the sub-prime mortgage sector and in the broader mortgage market have resulted in reduced liquidity for mortgage-backed securities. Although this reduction in liquidity has been directly linked to sub-prime residential assets, to which the Company continues to have no direct exposure, there has been an overall

reduction in liquidity across the credit spectrum of commercial and residential mortgage products. The Company has been closely managing its liquidity and believes it has sufficient access to capital resources to fund its investment activities and operating expenses. The Company's current strategy is to match-fund assets when economical and to maintain adequate cash to meet any margin calls on the remaining portfolio assets.

The aforementioned market factors could adversely affect one or more of the Company's repurchase counterparties providing funding for the Company's portfolio and could cause one or more of the Company's counterparties to be unwilling or unable to provide the Company with additional financing. This could potentially increase the Company's financing costs and reduce the Company's liquidity. If one or more major market participants fails or decides to withdraw from the market, it

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could negatively impact the marketability of all fixed income securities, and this could negatively impact the value of the securities in the Company's portfolio, thus reducing the Company's net book value. Furthermore, if many of the Company's counterparties are unwilling or unable to provide the Company with additional financing, the Company could be forced to sell its investments at a time when prices are depressed. If this were to occur, it could potentially have a negative impact on the Company's compliance with the REIT asset and income tests necessary to fulfill the Company's REIT qualification requirements.

In addition, the Company's liquidity may also be adversely affected by margin calls under the Company's repurchase agreements and credit facilities that are dependent in part on the valuation of the collateral to secure the financing. The Company's repurchase agreements and credit facilities allow the lender, to varying degrees, to revalue the collateral to values that the lender considers to reflect market. If a counterparty determines that the value of the collateral has decreased, it may initiate a margin call requiring the Company to post additional collateral to cover the decrease. When subject to such a margin call, the Company repays a portion of the outstanding borrowing with minimal notice. The Company has hedged a significant amount of its portfolio to offset market value declines due to changes in interest rates but is exposed to market value fluctuations due to spread widening. A significant increase in margin calls as a result of spread widening could harm the Company's liquidity, results of operations, financial condition, and business prospects. Additionally, in order to obtain cash to satisfy a margin call, the Company may be required to liquidate assets at a disadvantageous time, which could cause the Company to incur further losses and consequently adversely affect its results of operations and financial condition.

To date, the credit performance of the Company's investments remains consistent both with the Company's expectations and with the broader commercial real estate finance industry experience; nevertheless, subsequent to September 30, 2007, the capital markets have been marking down the value of all credit sensitive securities regardless of performance. In the event of further reduction in market liquidity, the Company's near-term liquidity needs will be met primarily with \$122,185 of cash and cash equivalents held by the Company as of September 30, 2007, along with \$104,476 of cash that was received in October 2007 related to the redemption of the investment in BlackRock Diamond. The Company used \$50,000 of the proceeds to repay a borrowing secured by its interest in BlackRock Diamond, thus increasing the Company's cash position since quarter end by approximately \$54,000.

The distribution requirements under the REIT provisions of the Code limit the Company's ability to retain earnings and thereby replenish or increase capital committed to its operations. However, the Company believes that its access to capital resources and financing will enable the Company to meet current and anticipated capital requirements.

The Company believes that its existing sources of funds will be adequate for purposes of meeting its short- and long-term (i.e., beyond one year) liquidity needs. The Company's ability to meet its long-term liquidity requirements is subject to obtaining additional debt and equity financing. Any decision by the Company's lenders and investors to provide the Company with financing will depend upon a number of factors, such as the Company's compliance with the terms of its existing credit arrangements, the Company's financial performance, industry or market trends, the general availability of and rates applicable to financing transactions, such lenders' and investors' resources and policies concerning the terms under which they make capital commitments and the relative attractiveness of alternative investment or lending opportunities.

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Certain information with respect to the Company's borrowings at September 30, 2007 is summarized as follows:

| Borrowing Type                 | Outstanding borrowings | Weighted average borrowing rate | Weighted average remaining maturity | Estimated fair value of assets pledged |
|--------------------------------|------------------------|---------------------------------|-------------------------------------|--|
| Reverse Repurchase Agreements  | \$ 110,113             | 5.36 %                          | 5.1 years                           | \$ 139,528                             |
| Credit Facilities              | 574,162                | 6.25                            | 114 days                            | 776,430                                |
| Commercial Mortgage Loan Pools | 1,225,085              | 3.99                            | 5.4 years                           | 1,246,494                              |
| CDOs                           | 1,814,231              | 5.84                            | 6.2 years                           | 2,020,169                              |
| Senior Unsecured Notes         | 162,500                | 7.59                            | 6.9 years                           | —                                      |
| Junior Unsecured Notes         | 71,107                 | 6.56                            | 14.6 years                          | —                                      |
| Trust Preferred Securities     | 180,477                | 7.64                            | 28.3 years                          | —                                      |
| Convertible Debt               | 80,000                 | 11.75                           | 19.9 years                          | —                                      |
| Total Borrowings (*)           | \$ 4,217,675           | 5.61 %                          | 6.5 yrs                             | \$ 4,182,621                           |

(\*) Also included in total borrowings on the Consolidated Statement of Financial Condition is \$50,000 of borrowings secured by the Company's interest in BlackRock Diamond. The borrowings bear interest at a rate of 6.63% and matured on October 19, 2007.

At September 30, 2007, the Company's borrowings had the following remaining maturities:

| Borrowing Type                 | Within 30 days | 31 to 59 days | 60 days to less than 1 year | 1 year to 3 years | 3 years to 5 years | Over 5 years | Total      |
|--------------------------------|----------------|---------------|-----------------------------|-------------------|--------------------|--------------|------------|
| Reverse Repurchase Agreements  | \$ 91,276      | \$ 18,837     | \$ —                        | \$ —              | \$ —               | \$ —         | \$ 110,113 |
| Credit Facilities              | 254,977        | —             | 319,185                     | —                 | —                  | —            | 574,162    |
| Commercial Mortgage Loan Pools | —              | —             | —                           | —                 | —                  | —            | —          |
| CDOs                           | —              | 1,225,085     | 1,225,085                   | 243               | 247                | 45,148       | 110,206    |
| Senior Unsecured Notes         | —              | —             | —                           | —                 | —                  | 162,500      | 162,500    |
| Junior Unsecured Notes         | —              | —             | —                           | —                 | —                  | —            | —          |
| Trust Preferred Securities     | —              | —             | —                           | —                 | —                  | 180,477      | 180,477    |
| Convertible Debt               | —              | —             | —                           | —                 | —                  | 80,000       | 80,000     |
| Total Borrowings               | \$ 470,035     | \$ 2,907,521  | \$ 4,217,675                | \$ 346,496        | \$ 19,084          | \$ 364,333   | \$ 110,206 |

\* At September 30, 2007, CDOs are comprised of \$396,383 of CDO debt with a weighted average remaining maturity of 4.5 years, \$292,482 of CDO debt with a weighted average remaining maturity of 4.6 years, \$377,045 of CDO debt with a weighted average remaining maturity of 5.6 years, \$373,584 of CDO debt with a weighted average remaining maturity of 8.9 years and \$374,737 of CDO debt with a weighted average remaining maturity of 7.0 years.

Reverse Repurchase Agreements and Credit Facilities

Reverse repurchase agreements are secured loans generally with a term of 90 days. The interest rate is based on 90-day LIBOR plus a spread that is determined based on the asset pledged as security. The terms include a daily mark to market provision that requires the posting of additional collateral if the value of the pledged asset declines. After the 90-day period expires, there is no obligation for the lender to extend credit for an additional period. This type of financing generally is available only for more liquid securities. The interest rate charged on reverse repurchase agreements is usually the lowest relative to the alternatives due to the lower risk inherent in these transactions.

Committed financing facilities represent multi-year agreements to provide secured financing for a specific asset class. These facilities include a mark to market provision requiring the Company to repay borrowings if the value of the pledged asset declines in excess of a threshold amount. A

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significant difference between committed financing facilities and reverse repurchase agreements is the term of the financing. A committed facility provider generally is required to provide financing for the full term of the agreement, usually two to three years, rather than ninety days as generally used in the reverse repurchase market. This longer term makes the financing of less liquid assets viable.

During the second quarter of 2007, the Company entered into a \$150,000 committed U.S. dollar and non- U.S. dollar credit facility with Lehman Commercial Paper, Inc. Outstanding borrowings bear interest at LIBOR-based variable rate. The facility matured on August 23, 2007.

On July 20, 2007, the Company entered into a \$200,000 committed U.S. dollar facility with Bank of America, N.A. which matures in September 2009. Outstanding borrowings under this credit facility bear interest at a LIBOR-based variable rate. During the third quarter of 2007, the Company increased it's commitment to \$275,000

On July 20, 2007 the Company amended its \$200,000 committed non-U.S. dollar credit facility with Morgan Stanley Bank which matures in February 2008. The amendment increases the committed facility to \$300,000. The amendment also allows for borrowings in Japanese Yen to fund the Company's Yen asset acquisitions.

On August 27, 2007, the Company borrowed \$50,000 from KeyBank National Association. The loan was secured by a pledge of all of the Company's ownership interest in the redemption proceeds of BlackRock Diamond and was repaid in full in October 2007.

On October 22, 2007 the Company notified Deutsche Bank, AG that it had elected to extend the \$200,000 credit facility for one year. After the extension becomes effective, the new maturity date will be December 20, 2008.

## CDOs

Issuance of secured term debt is generally done through a CDO offering in a private placement. This entails creating a special purpose entity that holds assets used to secure the payments required of the debt issued. Asset cash flows generally are matched with the debt service requirements over their respective lives and an interest rate swap is used to match the fixed or floating rate nature of the coupon payments where necessary. This type of transaction is usually referred to as "match funding" or "term financing" the assets. There is no mark to market requirement in this structure and the debt cannot be called or terminated by the bondholders. Furthermore, the debt issued is non-recourse to the issuer; and therefore permanent reductions in asset value do not affect the liquidity of the Company. However, since the Company expects to earn a positive spread between the income generated by the assets and the expense of the debt issued, a permanent impairment of any of the assets would negatively affect the spread over time.

## Senior Unsecured Notes

During June 2007, the Company issued \$37,500 of senior unsecured notes due in 2017. The notes bear interest at a fixed rate of 8.13% until July 2012 and thereafter at a rate equal to 3-month LIBOR plus 2.55%. Total borrowings cannot exceed 95% of the sum of total borrowings plus stockholders' equity and the Company must maintain a minimum net worth of \$400,000. The senior unsecured notes can be redeemed in whole by the Company subject to certain provisions, which could include the payment of fees.

## Junior Unsecured Notes

During April 2007, the Company issued €50,000 junior subordinated notes due in 2022. The notes bear interest at a rate equal to 3-month Euribor plus 2.6%. The notes can be redeemed in whole by the Company subject to certain provisions. The Company has the option to redeem all or a portion of the notes at any time on or after April 30, 2012 at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest through but excluding the redemption date.

#### Convertible Debt

On August 29, 2007 and September 10, 2007, the Company completed an offering of a total of \$80,000 aggregate principal amount of convertible senior notes due in 2027. The notes bear interest at



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a rate of 11.75% per annum and are convertible only under certain conditions, including a 20-day period of trading above \$14.02 per share, as adjusted. The initial conversion rate of 92.7085 shares of common stock per \$1,000 principal amount of notes (equal to an initial conversion price of approximately \$10.79 per share), subject to adjustment, represented a premium of 17.5% to the last reported sale price of Anthracite's common stock on August 23, 2007 of \$9.18.

## Preferred Equity Issuances

The Company may issue preferred stock from time to time as a source of long-term or permanent capital. Preferred stock generally has a fixed coupon and may have a fixed term in the form of a maturity date or other redemption or conversion features. The preferred stockholder typically has the right to a preferential distribution for dividends and any liquidity proceeds.

On February 12, 2007, the Company issued \$86,250 of Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock"), including \$11,250 of Series D Preferred Stock sold to underwriters pursuant to an option to purchase additional shares. The Series D Preferred Stock pays an annual dividend of 8.25%.

## Common Equity Issuances

Another source of permanent capital is the issuance of common stock through a follow-on offering. This allows investors to purchase a large block of common stock in one transaction. A common stock issuance can be accretive to the Company's book value per share if the issue price per share exceeds the Company's book value per share. It also can be accretive to earnings per share if the Company deploys the new capital into assets that generate a risk adjusted return that exceeds the return of the Company's existing assets. Furthermore, earnings accretion also can be achieved at reinvestment rates that are lower than the return on existing assets if common stock is issued at a premium to book value.

On June 12, 2007, the Company completed a follow-on offering of 5,750,000 shares of its common stock, par value \$0.001 per share, at a price of \$11.75, which included a 15% option to purchase additional shares exercised by the underwriter. Net proceeds (after deducting underwriting fees and expenses) were approximately \$64,033.

The Company utilized a portion of the net proceeds from the convertible senior notes offering to repurchase 1,307,189 shares of its common stock with value of \$12,000.

The Company continuously evaluates the market for follow-on common stock offerings as well as the available opportunities to deploy new capital on an accretive basis. For the nine months ended September 30, 2007, the Company issued 242,742 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company under the Dividend Reinvestment Plan were approximately \$2,410.

For the nine months ended September 30, 2007, the Company issued 147,700 shares of Common Stock in connection with a sales agency agreement with Brinson Patrick Securities Corporation. Net proceeds to the Company were approximately \$1,770.

## Off-Balance Sheet Arrangements

The Company's ownership of the subordinated classes of CMBS from a single issuer gives it the right to influence the foreclosure/workout process on the underlying loans ("Controlling Class CMBS"). FASB Staff Position FIN 46(R)-5,

Implicit Variable Interests under FASB Interpretation No. 46 (“FIN 46(R)-5”) has certain scope exceptions, one of which provides that an enterprise that holds a variable interest in a QSPE does not consolidate that entity unless that enterprise has the unilateral ability to cause the entity to liquidate. SFAS No. 140 provides the requirements for an entity to be considered a QSPE. To maintain the QSPE exception, the trust must continue to meet the QSPE criteria both initially and in subsequent periods. A trust’s QSPE status can be impacted in future periods by activities by its transferors or other involved parties, including the manner in which certain

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servicing activities are performed. To the extent its CMBS investments were issued by a trust that meets the requirements to be considered a QSPE, the Company records the investments at the purchase price paid. To the extent the underlying trusts are not QSPEs the Company follows the guidance set forth in FIN 46(R)-5 as the trusts would be considered VIEs.

The Company has analyzed the governing pooling and servicing agreements for each of its Controlling Class CMBS and believes that the terms are consistent with the QSPE criteria and are industry standard. However, there is uncertainty with respect to QSPE treatment due to ongoing review by accounting standard setters, potential actions by various parties involved with the QSPE, as discussed above, as well as varying and evolving interpretations of the QSPE criteria under SFAS No. 140. Additionally, the standard setters continue to review the FIN 46(R)-5 provisions related to the computations used to determine the primary beneficiary of a VIE. Future guidance from the standard setters may require the Company to consolidate CMBS trusts in which the Company has invested.

At September 30, 2007, the Company owned securities of 37 Controlling Class CMBS trusts with a par of \$1,779,484. The total par amount of CMBS issued by the 37 trusts was \$64,640,982. One of the Company's 37 Controlling Class trusts does not qualify as a QSPE and has been consolidated by the Company.

The Company's maximum exposure to loss as a result of its investment in these VIEs totaled \$1,144,751 and \$762,567 at September 30, 2007 and December 31, 2006, respectively.

In addition, the Company has completed two securitizations that qualify as QSPE's under SFAS No. 140. Through CDO HY1 and CDO HY2 the Company issued non-recourse liabilities secured by commercial related assets including portions of 17 Controlling Class CMBS. Should future guidance from the standard setters determine that Controlling Class CMBS are not QSPE's, the Company would be required to consolidate the assets, liabilities, income and expense of CDO HY1 and CDO HY2.

The Company's total maximum exposure to loss as a result of its investment in CDO HY1 and CDO HY2 at September 30 2007 and December 31, 2006, respectively, was \$63,104 and \$111,076.

The Company also owns non-investment grade debt and preferred securities in LEAFs CMBS I Ltd ("Leaf"), a QSPE under SFAS No. 140. Leaf issued non-recourse liabilities secured by investment grade commercial real estate securities. At September 30, 2007 and December 31, 2006, the Company's total maximum exposure to loss as a result of its investment in Leaf was \$6,186 and \$6,796, respectively.

## Cash Flows

Cash provided by operating activities is net income adjusted for certain non-cash items and changes in assets and liabilities including the Company's trading securities. Operating activities provided cash flows of \$174,224 and \$95,662 for the nine months ending September 30, 2007, and 2006, respectively. Operating cash flow is affected by the purchase and sale of fixed income securities classified as trading securities.

The Company's investing cash flow consists primarily of the purchase, sale and repayments on securities activities available-for-sale, commercial loan pools, commercial mortgage loans and equity investments. The Company's investing activities used cash flows of \$236,557 and \$710,694 during the nine months ended September 30, 2007 and 2006, respectively.

Net cash flow provided by financing activities was \$118,130 and \$606,122 for the nine months ended September 30, 2007 and 2006, respectively. During the nine months ended September 30, 2007, net cash provided by financing activities primarily represented the issuance of preferred stock. During the nine months ended September 30, 2006, net cash provided by financing activities primarily represented the issuance of junior subordinated notes and significant borrowings under reverse repurchase agreements and credit facilities. Partially offsetting these cash inflows during the nine months ended September 30, 2007 and 2006 were repayments under reverse repurchase agreements and credit facilities and dividends payments.

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## Transactions with Affiliates

The Company has a Management Agreement with the Manager, the employer of certain directors and all of the officers of the Company, under which the Manager manages the Company's day-to-day operations, subject to the direction and oversight of the Company's Board of Directors. Pursuant to the Management Agreement, the Manager formulates investment strategies, arranges for the acquisition of assets, arranges for financing, monitors the performance of the Company's assets and provides certain other advisory and managerial services in connection with the operations of the Company. For performing these services, the Company pays the Manager a base management fee equal to 2.0% of the quarterly average total stockholders' equity for the applicable quarter.

To provide an incentive, the Manager is entitled to receive a quarterly incentive fee equal to 25% of the amount by which the rolling four-quarter GAAP net income before the incentive fee exceeds the greater of 8.5% or 400 basis points over the ten-year Treasury note multiplied by the adjusted per share issue price of the common stock (\$11.41 per common share at September 30, 2007). Additionally, pursuant to a resolution of the Company's Board of Directors adopted at the February 2006 meeting, 30% of the incentive fees earned in 2005 or after may be paid in shares of the Company's common stock subject to certain provisions. The Board of Directors also authorized a stock based incentive plan where one-half of one percent of common shares outstanding at December 31st is paid to the Manager.

The Company's unaffiliated directors approved an extension of the Management Agreement to March 31, 2008 at the Board's March 2007 meeting.

The following is a summary of management and incentive fees incurred for the three and nine months ended September 30, 2007 and 2006:

## For the Three Months

|                               | Ended September 30, 2007 |   | For the Nine Months Ended September 30, 2006 |          | 2007      |           | 2006  |       | Management fee |          | Incentive fee |          | Total |  |
|-------------------------------|--------------------------|---|--|----------|-----------|-----------|-------|-------|----------------|----------|---------------|----------|-------|--|
| Incentive fee                 | —                        | — | 5,645  | 2,708    | 497       | 997       | 2,145 | 1,853 | \$ 3,473       | \$ 3,179 | \$ 10,862     | \$ 9,339 |       |  |
| management and incentive fees |                          |   | \$ 3,970                                     | \$ 4,176 | \$ 18,652 | \$ 13,900 |       |       |                |          |               |          |       |  |

At September 30, 2007 and 2006, respectively, management and incentive fees of \$5,434 and \$2,979 remain payable to the Manager and are included on the accompanying consolidated statements of financial condition as a component of other liabilities.

In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of \$184 and \$486 for certain expenses incurred on behalf of the Company during the three and nine months ended September 30, 2007, and \$100 and \$300 for the three and nine months ended September 30, 2006, respectively.

The Company has administration and accounting services agreements with the Manager. Under the terms of the administration services agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. Under the terms of the accounting services agreement, the Manager provides investment accounting services to the Company. For the nine months ended September 30, 2007 and 2006, the Company recorded administration and investment accounting fees of \$544 and \$175, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

The special servicer on 32 of the Company's 37 Controlling Class trusts is Midland Loan Services, Inc. ("Midland"), a wholly owned indirect subsidiary of PNC Bank. Midland therefore may be presumed to be an affiliate of the Manager. The Company's fees for Midland's services are at market rates.

The Company had a \$100,000 commitment to acquire shares of BlackRock Diamond. The Company redeemed \$25,000 of its investment in BlackRock Diamond on June 30, 2007. The

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remaining \$75,000 was redeemed at its September 30, 2007 net asset value of \$104,476, the proceeds from which were received in October 2007. The Company did not incur any additional management or incentive fees to the Manager or its affiliates related to its investment in BlackRock Diamond.

During 2001, the Company entered into a \$50,000 commitment to acquire shares of Carbon I, a private commercial real estate income opportunity fund managed by the Manager. The Carbon I investment period ended on July 12, 2004 and the Company's investment in Carbon I at September 30, 2007 was \$2,554. The Company does not incur any additional management or incentive fees to the Manager related to its investment in Carbon I. On September 30, 2007, the Company owned approximately 20% of the outstanding shares of Carbon I.

The Company entered into an aggregate commitment of \$100,000 to acquire shares of Carbon II, a private commercial real estate income opportunity fund managed by the Manager. The final obligation to fund capital of \$13,346 was called on July 13, 2007. The Company's investment in Carbon II was \$98,252. The Company does not incur any additional management or incentive fees to the Manager related to its investment in Carbon II. On September 30, 2007, the Company owned approximately 26% of the outstanding shares of Carbon II.

**REIT Status:** The Company has elected to be taxed as a REIT and therefore must comply with the provisions of the Code with respect thereto. Accordingly, the Company generally will not be subject to U.S. federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company may, however, be subject to tax at corporate rates or at excise tax rates on net income or capital gains not distributed.

During the first quarter of 2006, the Company and certain subsidiaries elected to have the subsidiaries treated as taxable REIT subsidiaries. This election permits the subsidiaries to enter into activities related to foreign investments that may not have constituted qualifying assets generating qualifying income for the REIT tests.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**Market Risk:** Market risk includes the exposure to loss resulting from changes in interest rates, credit curve spreads, foreign currency exchange rates, commodity prices and equity prices. The primary market risks to which the Company is exposed are interest rate risk, credit curve risk and foreign currency risk. Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond the control of the Company. Credit curve risk is highly sensitive to the dynamics of the markets for commercial real estate securities and other loans and securities held by the Company. Excessive supply of these assets combined with reduced demand will cause the market to require a higher yield. This demand for higher yield will cause the market to use a higher spread over the U.S. Treasury securities yield curve, or other benchmark interest rates, to value these assets. Changes in the general level of the U.S. Treasury yield curve can have significant effects on the estimated fair value of the Company's portfolio.

The majority of the Company's assets are fixed rate securities valued based on a market credit spread to U.S. Treasuries. As U.S. Treasury securities are priced to a higher yield and/or the spread to U.S. Treasuries used to price the Company's assets is increased, the estimated fair value of the Company's portfolio may decline. Conversely, as U.S. Treasury securities are priced to a lower yield and/or the spread to U.S. Treasuries used to price the Company's assets is decreased, the estimated fair value of the Company's portfolio may increase. Changes in the estimated fair value of the Company's portfolio may affect the Company's net income or cash flow directly through their impact on unrealized gains or losses on securities held-for-trading or indirectly through their impact on the Company's ability to borrow. Changes in the level of the U.S. Treasury yield curve can also affect, among other things, the prepayment assumptions used to value certain of the Company's securities and the Company's ability to realize gains from the sale of such assets. In addition, changes in the general level of the LIBOR money market rates can affect the Company's net interest income. At September 30, 2007, all of the Company's short-term collateralized liabilities outside of the CDOs were floating rate based on a market spread to LIBOR. As the level of LIBOR increases or decreases, the Company's interest expense will move in the same direction.

The Company may utilize a variety of financial instruments, including interest rate swaps, caps, floors and other interest rate exchange contracts, in order to limit the effects of fluctuations in interest rates on its operations. The use of these types of derivatives to hedge interest-earning assets and/or interest-bearing liabilities carries certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of securities and that such losses may exceed the amount invested in such instruments. A hedge may not perform its intended purpose of offsetting losses or rising interest rates. Moreover, with respect to certain of the instruments used as hedges, the Company is exposed to the risk that the counterparties with which the Company trades may cease making markets and quoting prices in such instruments, which may render the Company unable to enter into an offsetting transaction with respect to an open position. If the Company anticipates that the income from any such hedging transaction will not be qualifying income for REIT income purposes, the Company may conduct part or all of its hedging activities through a to-be-formed corporate subsidiary that is fully subject to Federal corporate income taxation. The profitability of the Company may be adversely affected during any period as a result of changing interest rates.

The Company monitors and manages interest rate risk based on a method that takes into consideration the interest rate sensitivity of the Company's assets and liabilities, including preferred stock. The Company's objective is to acquire assets and match fund the purchase so that interest rate risk associated with financing these assets is reduced or eliminated. The primary risks associated with acquiring and financing these assets under short-term repurchase agreements and committed borrowing facilities are mark-to-market risk and short-term rate risk. Certain secured financing arrangements provide for an advance rate based upon a percentage of the estimated fair value of the asset



being financed. Market movements that cause asset values to decline would require a margin call or a cash payment to maintain the relationship between asset value and amount borrowed. A cash flow based CDO is an example of a secured financing vehicle that does not require a mark-to-market to establish or maintain a level of financing. When financed assets are subject to a mark-to-market

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margin call, the Company carefully monitors the interest rate sensitivity of those assets. The duration of the assets financed which are subject to a mark-to-market margin call was 2.9 years based on net asset value at September 30, 2007. This means that a 100 basis point increase in interest rates would cause a margin call of approximately \$17,000.

Net interest income sensitivity to changes in interest rates is analyzed using the assumptions that interest rates, as defined by the LIBOR curve, increase or decrease and that the yield curves of the LIBOR rate shocks will be parallel to each other.

Regarding the table below, all changes in net interest income are measured as percentage changes from the respective values calculated in the scenario labeled as "Base Case." The base interest rate scenario assumes interest rates at September 30, 2007. Actual results could differ significantly from these estimates.

## Projected Percentage Change In Earnings

| Per Share Given LIBOR Movements | Change in LIBOR,    |            |      |            |     |            |           |     |         |      |         |
|---------------------------------|---------------------|------------|------|------------|-----|------------|-----------|-----|---------|------|---------|
| +/- Basis Points                | Projected Change in |            |      |            |     |            |           |     |         |      |         |
| Earnings per Share              | -200                | \$ (0.06 ) | -100 | \$ (0.03 ) | -50 | \$ (0.01 ) | Base Case | +50 | \$ 0.01 | +100 | \$ 0.03 |
|                                 | +200                | \$ 0.06    |      |            |     |            |           |     |         |      |         |

The Company's GAAP book value incorporates the estimated fair value of the Company's interest bearing assets but it does not incorporate the estimated fair value of the Company's interest bearing fixed rate liabilities and preferred stock. The fixed rate liabilities and preferred stock generally will reduce the actual interest rate risk of the Company from an economic perspective even though changes in the estimated fair value of these liabilities are not reflected in the Company's reported book value. The Company focuses on economic risk in managing its sensitivity to interest rates and maintains an economic duration within a band of 2.0 to 5.0 years. At September 30, 2007, economic duration for the Company's entire portfolio was 3.0 years. This implies that for each 100 basis points of change in interest rates the Company's economic value will change by approximately 3.0%. At September 30, 2007 the Company estimates its economic value, or net asset value of its common stock to be \$722,027, or \$11.44 per share.

A reconciliation of the economic duration of the Company to the duration of the reported book value of the Company's common stock is as follows:

|                    |     | Duration – GAAP book value at |  |
|--------------------|-----|-------------------------------|--|
| September 30, 2007 | 9.3 | Less:                         | Duration contribution of CDO I liabilities (0.9)         |
|                    |     |                               | Duration contribution of CDO II liabilities (0.8)        |
|                    |     |                               | Duration contribution of CDO III liabilities (0.5)       |
|                    |     |                               | Duration contribution of CDO HY3 liabilities (0.5)       |
|                    |     |                               | Duration contribution of Euro CDO liabilities (0.1)      |
|                    |     |                               | Duration contribution of Series C Preferred Stock (0.5)  |
|                    |     |                               | Duration contribution of Series D Preferred Stock (0.3)  |
|                    |     |                               | Duration contribution of senior unsecured notes (1.2)    |
|                    |     |                               | Duration contribution of senior convertible debt (0.5)   |
|                    |     |                               | Duration contribution of junior unsecured notes —        |
|                    |     |                               | Duration contribution of junior subordinated notes (1.0) |
| September 30, 2007 | 3.0 |                               | Economic duration at                                     |

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The GAAP book value of the Company's common stock is \$7.13 per share. As indicated in the table above a 100 basis point change in interest rates will change reported book value by approximately 9.3%, or \$55,000. However, the duration of the Company's portfolio not financed with match funded debt is 2.9. This means that a 100 basis point increase in interest rates or credit spreads would cause a margin call of approximately \$17,000.

**Credit Risk:** The Company's portfolios of commercial real estate assets are subject to a high degree of credit risk. Credit risk is the exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply/demand factors, construction trends, consumer behavior, regional economics, interest rates, the strength of the U.S. economy, and other factors beyond the control of the Company.

All loans are subject to a certain probability of default. Before acquiring a Controlling Class security, the Company will perform an analysis of the quality of all of the loans proposed. As a result of this analysis, loans with unacceptable risk profiles are either removed from the proposed pool or the Company receives a price adjustment. The Company underwrites its Controlling Class CMBS investments assuming the underlying loans will suffer a certain dollar amount of defaults and these defaults will lead to some level of realized losses. Loss adjusted yields are computed based on these assumptions and applied to each class of security supported by the cash flow on the underlying loans. The most significant variables affecting loss adjusted yields include, but are not limited to, the number of defaults, the severity of loss that occurs subsequent to a default and the timing of the actual loss. The different rating levels of CMBS will react differently to changes in these assumptions. The lowest rated securities (B- or lower) are generally more sensitive to changes in timing of actual losses. The higher rated securities (B or higher) are more sensitive to the severity of losses and timing of cash flows.

The Company generally assumes that all of the principal of a non-rated security and a significant portion, if not all, of CCC and a portion of B- rated securities will not be recoverable over time. The loss adjusted yields of these classes reflect that assumption; therefore, the timing of when the total loss of principal occurs is the most important assumption in determining value. The interest coupon generated by a security will cease when there is a total loss of its principal regardless of whether that principal is paid. Therefore, timing is of paramount importance because the longer the principal balance remains outstanding, the more interest coupon the holder receives; which results in a larger economic return. Alternatively, if principal is lost faster than originally assumed, there is less opportunity to receive interest coupon; which results in a lower or possibly negative return.

If actual principal losses on the underlying loans exceed estimated loss assumptions, the higher rated securities will be affected more significantly as a loss of principal may not have been assumed. The Company generally assumes that all principal will be recovered by classes rated B or higher. The Company manages credit risk through the underwriting process, establishing loss assumptions and careful monitoring of loan performance. After the securities have been acquired, the Company monitors the performance of the loans, as well as external factors that may affect their value.

Factors that indicate a higher loss severity or acceleration of the timing of an expected loss will cause a reduction in the expected yield and therefore reduce the earnings of the Company. Furthermore, the Company may be required to write-down a portion of the adjusted purchase price of the affected assets through its consolidated statements of operations.

For purposes of illustration, a doubling of the losses in the Company's Controlling Class CMBS, without a significant acceleration of those losses, would reduce GAAP income by approximately \$0.97 per share of Common Stock per year and cause a significant write-down at the time the loss assumption is changed. The amount of the write-down depends on several factors, including which securities are most affected at the time of the write-down, but is estimated

to be in the range of \$1.98 to \$2.08 per share based on a doubling of expected losses. A significant acceleration of the timing of these losses would cause the Company's net income to decrease. The Company's exposure to a write-down is mitigated by the fact that most of these assets are financed on a non-recourse basis in the Company's CDOs, where a significant portion of the risk of loss is transferred to the CDO bondholders. At September 30, 2007, securities with a total estimated fair value of \$2,024,831 are

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collateralizing the CDO borrowings of \$1,814,231; therefore, the Company's preferred equity interest in the five CDOs is \$210,600 (\$3.34 per share).

**Asset and Liability Management:** Asset and liability management is concerned with the timing and magnitude of the re-pricing and/or maturing of assets and liabilities. It is the Company's objective to attempt to control risks associated with interest rate movements. In general, management's strategy is to match the term of the Company's liabilities as closely as possible with the expected holding period of the Company's assets. This is less important for those assets in the Company's portfolio considered liquid, as there is a very stable market for the financing of these securities.

Other methods for evaluating interest rate risk, such as interest rate sensitivity "gap" (defined as the difference between interest-earning assets and interest-bearing liabilities maturing or re-pricing within a given time period), are used but are considered of lesser significance in the daily management of the Company's portfolio. Management considers this relationship when reviewing the Company's hedging strategies. Because different types of assets and liabilities with the same or similar maturities react differently to changes in overall market rates or conditions, changes in interest rates may affect the Company's net interest income positively or negatively even if the Company were to be perfectly matched in each maturity category.

**Currency Risk:** The Company has foreign currency rate exposures related to certain CMBS and commercial real estate loans. The Company's principal currency exposures are to the Euro and British pound. Changes in currency rates can adversely impact the fair values and earnings of the Company's non-U.S. holdings. The Company mitigates this impact by utilizing local currency-denominated financings on its foreign investments and foreign currency forward commitments and swaps to hedge the net exposure.

ITEM 4.

CONTROLS AND PROCEDURES

The Company, under the direction and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at September 30, 2007.

No change in internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during the quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II — OTHER INFORMATION

Item 1. Legal Proceedings

At September 30, 2007, there were no pending legal proceedings in which the Company was a defendant or of which any of its property was subject.

Item 1A. Risk Factors

Certain factors may have a material adverse effect on the Company's business, financial condition and results of operations. For discussion of the Company's potential risks, refer to Part I, "Item 1A, Risk Factors", included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the U.S. Securities and Exchange Commission on March 16, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the nine months ended September 30, 2007, the Company issued 433,031 shares of unregistered common stock with an aggregate value of \$5,250. Pursuant to the Management Agreement which authorizes that a portion of incentive fees earned by the Manager may be paid in shares of the Company's common stock, the Company issued 143,876 shares to the Manager as payment of a portion of the Manager's incentive fees. Pursuant to the portion of the Management Agreement which authorizes that a stock based incentive plan where one-half of one percent of common shares outstanding as of December 31st be paid to the Manager, 289,155 shares were issued in March 2007. The issuances of common stock were made in reliance upon the exemption from registration under Section 4(2) of the Securities Act.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

|   | Exhibit No. |
|---|-------------|
| Description 31 .1 Certification of Chief Executive Officer 31 .2 Certification of Chief Financial Officer 32 .1 Section 1350 Certification of Chief Executive Officer and Chief Financial Officer |             |
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SIGNATURES

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

ANTHRACITE CAPITAL, INC. Dated: November 9, 2007 By: /s/ Christopher A. Milner Name: Christopher A. Milner

Title: Chief Executive Officer Dated: November 9, 2007 By: /s/ James J. Lillis Name: James J. Lillis

Title: Chief Financial Officer

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