

IMPAC MORTGAGE HOLDINGS INC

Form 10-Q/A

October 20, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended March 31, 2004

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: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

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

1401 Dove Street, Newport Beach, California 92660

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(Address of principal executive offices)

(949) 475-3600

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) Yes x No "

There were 62,670,695 shares of common stock outstanding as of April 29, 2004.

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IMPAC MORTGAGE HOLDINGS, INC.

2004 FORM 10-Q/A QUARTERLY REPORT

EXPLANATORY NOTE

This document includes a restatement of our consolidated financial statements. The restatements were necessary to conform with accounting principles generally accepted in the United States of America (GAAP) and reflect the following:

the correction of our revenue recognition policy with respect to the cash sale of mortgage loan servicing rights (MSR) to unrelated third parties when the mortgage loans are retained. Previously, we recognized gains in the period in which the mortgage servicing rights were sold for the amount of cash proceeds received. We now allocate a portion of the accounting basis of the mortgage loans to the mortgage servicing rights, which results in a discount to the mortgage loans retained. That discount is accreted as an adjustment to yield on mortgage assets over the life of the related mortgage loans;

the correction of our accounting for derivative financial instruments (derivatives) and interest rate risk management activities related to the variability in expected future cash flows associated with a financing obligation or future liability (a cash flow hedge). Upon review, we now believe that the documentation of our cash flow hedge accounting relationships were deficient as to the specificity of the underlying hedged transaction in order to assess hedge effectiveness and measurement of ineffectiveness as required by the stringent applicable accounting standards. As such, we made the determination that it was not appropriate to apply cash flow hedge accounting for purposes of our GAAP financial statements. In addition, we determined that certain forward purchase commitments on mortgage loans meet the definition of a derivative and now need to be accounted for as such in the financial statements;

the reclassification of certain derivative gains and losses to mark-to-market gain (loss) derivative instruments as opposed to an adjustment to the yield on mortgage assets as a result of the elimination of cash flow hedge accounting, as stated above; and

the elimination of certain inter-company balance sheet and income statement items, principally finance receivables and the related interest income and expense, with Impac Funding Corporation, our mortgage operations, prior to its consolidation on July 1, 2003.

Although these corrections have an effect on net earnings, these corrections and reclassifications have no effect on taxable income, which is an important factor in determining the amount of dividends paid to our stockholders. In addition, beginning and ending cash and cash equivalents for all reporting periods remain unchanged.

This report on Form 10-Q/A for the three months ended March 31, 2004 reflects corrections and restatements of the following unaudited financial statements: (a) consolidated balance sheets as of March 31, 2004 and December 31, 2003; (b) consolidated statements of operations and comprehensive earnings for the three months ended March 31, 2004 and 2003; and (c) consolidated statements of cash flows for the three months ended March 31, 2004 and 2003. For a more detailed description of the restatements and reclassifications, see Note A.2. Restatement of Consolidated Financial Statements to the accompanying notes to the consolidated financial statements and Restatement of Consolidated Financial Statements in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this report on Form 10-Q/A. This report on Form 10-Q/A restates certain financial information for the applicable periods set forth in notes to consolidated financial statements: Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Item 3. Quantitative and Qualitative Disclosures About Market Risk and Item 4. Controls and Procedures. Other items included in this report on Form 10-Q/A are not affected by the restatements and reclassifications and appear unchanged from our original Form 10-Q for the quarterly period ended March 31, 2004. The financial statements and related financial information for the affected periods contained in our prior Quarterly Report on Form 10-Q

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for the three months ended March 31, 2004 should no longer be relied upon. We will not amend any Annual Reports on Form 10-K for fiscal years prior to December 31, 2003 or Quarterly Reports on Form 10-Q for quarterly periods prior to the three months ended March 31, 2004.

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IMPAC MORTGAGE HOLDINGS, INC.

FORM 10-Q/A QUARTERLY REPORT

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(dollar amounts in thousands, except per share data)

(unaudited)

| | March 31, 2004 | December 31, 2003 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| | (as restated) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 193,638 | \$ 127,381 |
| CMO collateral | 11,158,627 | 8,639,014 |
| Finance receivables | 526,396 | 630,030 |
| Mortgages held-for-investment | 136,707 | 652,814 |
| Allowance for loan losses | (46,299) | (38,596) |
| Mortgages held-for-sale | 611,072 | 397,618 |
| Accrued interest receivable | 47,839 | 39,347 |
| Other assets | 308,341 | 130,349 |
| | <u> </u> | <u> </u> |
| Total assets | \$ 12,936,321 | \$ 10,577,957 |
| | <u> </u> | <u> </u> |
| LIABILITIES | | |
| CMO borrowings | \$ 11,139,069 | \$ 8,489,853 |
| Reverse repurchase agreements | 1,117,944 | 1,568,807 |
| Accumulated dividends payable | 40,723 | |
| Other liabilities | 77,010 | 46,510 |
| | <u> </u> | <u> </u> |
| Total liabilities | 12,374,746 | 10,105,170 |
| | <u> </u> | <u> </u> |
| Commitments and contingencies | | |
| STOCKHOLDERS EQUITY | | |
| Preferred stock; \$0.01 par value; 7,500,000 shares authorized; none issued and outstanding as of March 31, 2004 and December 31, 2003, respectively | | |
| Series A junior participating preferred stock, \$0.01 par value; 2,500,000 shares authorized; none outstanding as of March 31, 2004 and December 31, 2003 | | |
| Common stock, \$0.01 par value; 200,000,000 shares authorized and 62,650,696 and 56,368,368 shares issued and outstanding as of March 31, 2004 and December 31, 2003, respectively | 627 | 564 |
| Additional paid-in capital | 749,878 | 629,662 |
| Accumulated other comprehensive gain | 4,216 | 4,356 |
| Net accumulated deficit: | | |
| Cumulative dividends declared | (347,754) | (307,031) |

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| | | |
|--------------------------------------------|---------------|------------|
| Retained earnings | 154,608 | 145,236 |
| Net accumulated deficit | (193,146) | (161,795) |
| Total stockholders' equity | 561,575 | 472,787 |
| Total liabilities and stockholders' equity | \$ 12,936,321 | 10,577,957 |

See accompanying notes to consolidated financial statements.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE EARNINGS**

(in thousands, except per share data)

(unaudited)

| | For the Three Months Ended March 31, | |
|----------------------------------------------------------|-------------------------------------------------|----------------|
| | 2004 | 2003 |
| | (as restated) | |
| INTEREST INCOME: | | |
| Mortgage assets | \$ 134,267 | \$ 82,216 |
| Other interest income | 440 | 154 |
| | <u>134,707</u> | <u>82,370</u> |
| INTEREST EXPENSE: | | |
| CMO borrowings | 51,994 | 38,294 |
| Reverse repurchase agreements | 9,554 | 6,790 |
| Other borrowings | 66 | 632 |
| | <u>61,614</u> | <u>45,716</u> |
| Total interest expense | 61,614 | 45,716 |
| Net interest income | 73,093 | 36,654 |
| Provision for loan losses | 9,725 | 6,484 |
| | <u>63,368</u> | <u>30,170</u> |
| Net interest income after provision for loan losses | 63,368 | 30,170 |
| NON-INTEREST INCOME: | | |
| Gain on sale of loans | 2,502 | 1,616 |
| Equity in net earnings of Impac Funding Corporation | | 1,293 |
| Mark-to-market loss derivative instruments | (36,630) | (7,118) |
| Other income | 315 | 692 |
| | <u>(33,813)</u> | <u>(3,517)</u> |
| Total non-interest income | (33,813) | (3,517) |
| NON-INTEREST EXPENSE: | | |
| Personnel expense | 13,668 | 686 |
| General and administrative and other expense | 3,175 | 434 |
| Professional services | 1,831 | 385 |
| Amortization and impairment of mortgage servicing rights | 1,080 | |
| Occupancy expense | 841 | 61 |
| Data processing expense | 805 | 109 |
| Equipment expense | 784 | 79 |
| Reversal of prior period provision for repurchases | (1,183) | |
| (Gain) loss on disposition of other real estate owned | (503) | 90 |
| | <u>20,498</u> | <u>1,844</u> |
| Total non-interest expense | 20,498 | 1,844 |

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| | | |
|-----------------------------------------------------------------------|-----------------|------------------|
| Net earnings before income taxes | 9,057 | 24,809 |
| Income taxes | (315) | |
| Net earnings | <u>\$ 9,372</u> | <u>\$ 24,809</u> |
| OTHER COMPREHENSIVE EARNINGS: | | |
| Unrealized holding (losses) gains on securities arising during period | (1,382) | 64 |
| Less: Reclassification of losses included in net earnings | 1,242 | 522 |
| Net unrealized (losses) gains arising during period | <u>(140)</u> | <u>586</u> |
| Other comprehensive earnings | <u>\$ 9,232</u> | <u>\$ 25,395</u> |
| NET EARNINGS PER SHARE: | | |
| Basic | <u>\$ 0.16</u> | <u>\$ 0.53</u> |
| Diluted | <u>\$ 0.15</u> | <u>\$ 0.52</u> |
| DIVIDENDS DECLARED PER COMMON SHARE | <u>\$ 0.65</u> | <u>\$ 0.50</u> |

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| | For the Three Months Ended March 31, | |
|-------------------------------------------------------------------------------------|-----------------------------------------|------------------|
| | 2004 | 2003 |
| | (as restated) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings | \$ 9,372 | \$ 24,809 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Equity in net earnings of Impac Funding Corporation | | (1,293) |
| Provision for loan losses | 9,725 | 6,484 |
| Amortization of CMO premiums and deferred securitization costs | 24,055 | 14,299 |
| (Gain) loss on sale of other real estate owned | (503) | 90 |
| Gain on sale of loans | (2,502) | (1,616) |
| Unrealized mark-to-market loss derivative instruments | 24,308 | (3,525) |
| Purchase of mortgages held-for-sale | (3,469,082) | |
| Sale and principal reductions on mortgages held-for-sale | 3,258,130 | |
| Net change in investment in and advances to Impac Funding Corporation | | 155,050 |
| Net change in deferred taxes | (6,814) | |
| Gain on sale of investment securities available-for-sale | (291) | (122) |
| Depreciation and amortization | 755 | |
| Amortization and impairment of mortgage servicing rights | 1,080 | |
| Net change in accrued interest receivable | (8,492) | (1,478) |
| Net change in other assets and liabilities | (129,039) | (25,509) |
| | <u>(288,298)</u> | <u>167,189</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net change in CMO collateral | (2,545,512) | (1,100,439) |
| Net change in finance receivables | 103,634 | 148,787 |
| Purchase of premises and equipment | (839) | |
| Net change in mortgages held-for-investment | 513,841 | (17,355) |
| Net change in mortgage servicing rights | 355 | |
| Net principal reductions on investment securities available-for-sale | 627 | 1,562 |
| Proceeds from the sale of other real estate owned, net | 9,737 | 5,319 |
| | <u>(1,918,157)</u> | <u>(962,126)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net change in reverse repurchase agreements and other borrowings | (450,863) | (312,393) |
| Proceeds from CMO borrowings | 3,356,924 | 1,483,605 |
| Repayments of CMO borrowings | (751,003) | (396,637) |
| Dividends paid | | (21,754) |

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| | | |
|----------------------------------------------------------------------|-------------------|-------------------|
| Proceeds from sale of common stock | 106,280 | 37,778 |
| Proceeds from sale of common stock via equity distribution agreement | 10,729 | 4,083 |
| Proceeds from exercise of stock options | 645 | 442 |
| | <u> </u> | <u> </u> |
| Net cash provided by financing activities | 2,272,712 | 795,124 |
| | <u> </u> | <u> </u> |
| Net change in cash and cash equivalents | 66,257 | 187 |
| Cash and cash equivalents at beginning of period | 127,381 | 113,345 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | \$ 193,638 | \$ 113,532 |
| | <u> </u> | <u> </u> |
| SUPPLEMENTARY INFORMATION: | | |
| Interest paid | \$ 57,900 | \$ 48,485 |
| Taxes paid | 797 | |
| NON-CASH TRANSACTIONS: | | |
| Transfer of mortgages to other real estate owned | \$ 9,169 | \$ 8,436 |
| Dividends declared and unpaid | 40,723 | 24,598 |
| Net change in other comprehensive earnings | (140) | 586 |

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(unaudited)

Note A Summary of Business and Significant Accounting Policies

1. Financial Statement Presentation and Business Summary

Unless the context otherwise requires, the terms Company, we, us, and our refer to Impac Mortgage Holdings, Inc. (IMH), a Maryland corporation incorporated in August 1995, and its subsidiaries, IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG), Impac Multifamily Capital Corporation (IMCC) and Impac Funding Corporation (IFC), together with its wholly-owned subsidiaries Impac Secured Assets Corp. (ISAC) and Novelle Financial Services, Inc. (Novelle).

The accompanying unaudited consolidated financial statements of IMH and our subsidiaries (as defined above) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The results of operations for the three months ended March 31, 2004 reflect the consolidation of IFC on July 1, 2003. On July 1, 2003, IMH entered into a stock purchase agreement with Joseph R. Tomkinson, our Chairman, Chief Executive Officer and a director, William S. Ashmore, our Chief Operating Officer, President and a director, and the Johnson Revocable Living Trust, of which Richard J. Johnson, our Executive Vice President and Chief Financial Officer is trustee, whereby IMH purchased all of the outstanding shares of voting common stock of IFC for aggregate consideration of \$750 thousand. Messrs. Tomkinson and Ashmore and the Johnson Revocable Living Trust each owned one-third of the outstanding common stock of IFC. Mr. Tomkinson elected to receive \$125 thousand worth of his consideration for the sale of his IFC shares of common stock in the form of 7,687 shares of IMH common stock. The fairness opinion related to the purchase price of IFC, as rendered by an independent financial advisor, and the subsequent transaction was approved by our board of directors. As a result of acquiring 100% of IFC's common stock on July 1, 2003, IMH owns all of the common stock and preferred stock of IFC and began to consolidate IFC as of that date. As such, the consolidated financial statements for the three months ended March 31, 2004 (consolidation period) reflect the results of operations of IFC on a consolidated basis. The consolidated financial statements for the three months ended March 31, 2003 (non-consolidation period) include the results of operations of IFC as equity in net earnings of IFC. The presentation of prior periods' consolidated financial statements conform to the restatements referred to in Note A.2. Restatement of Consolidated Financial Statements below.

All significant inter-company balances and transactions have been eliminated in consolidation or under the equity method of accounting regarding transactions involving the mortgage operations prior to its consolidation. Certain amounts in the prior periods' consolidated financial statements have been reclassified to conform to the current presentation.

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Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these financial statements in conformity with GAAP. Actual results could differ from those estimates.

We are a mortgage real estate investment trust (REIT) that is a nationwide acquirer, originator, seller and securitizer of non-conforming Alt-A mortgages (Alt-A mortgages). Alt-A mortgages are primarily first lien mortgages made to borrowers whose credit is generally within typical Fannie Mae and Freddie Mac guidelines, but have loan characteristics that make them non-conforming under those guidelines. Some of the principal differences between mortgages purchased by Fannie Mae and Freddie Mac and Alt-A mortgages are as follows:

credit and income histories of the mortgagor; and

documentation required for approval of the mortgagor.

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We operate three core businesses:

long-term investment operations that is conducted by IMH, IMH Assets and IMCC;

mortgage operations that is conducted by IFC, ISAC and Novelle; and

warehouse lending operations that is conducted by IWLG.

The long-term investment operations primarily invest in adjustable rate and fixed rate Alt-A mortgages that are acquired and originated by the mortgage operations. The long-term investment operations also originate small-balance, multi-family residential mortgages (multi-family mortgages). Mortgage balances generally range from \$250 thousand to \$3.0 million. Multi-family mortgages have interest rate floors, which is the initial start rate, and prepayment penalty periods of 3, 5 and 7 years. Multi-family mortgages provide greater asset diversification on our balance sheet as multi-family mortgage borrowers typically have higher credit scores and multi-family mortgages generally have lower loan-to-value ratios (LTV ratios) and longer lives than Alt-A mortgages. This business primarily generates net interest income on mortgages held-for-investment and mortgages held as CMO collateral (long-term mortgage portfolio). Investment in Alt-A and multi-family mortgages is financed with collateralized mortgage obligations (CMO) financing, warehouse facilities and proceeds from the sale of capital stock.

The mortgage operations, a taxable REIT subsidiary (TRS), acquire, originate, sell and securitize primarily adjustable rate and fixed rate Alt-A mortgages and, to a lesser extent, sub-prime mortgages (B/C mortgages) from correspondents, mortgage brokers and retail customers. The mortgage operations acquire Alt-A mortgages from its network of third party correspondents (Impac Alt-A mortgages). Correspondents originate and close mortgages under its mortgage programs on a flow (loan-by-loan) basis or through bulk sale commitments. Correspondents include savings and loan associations, commercial banks and mortgage bankers. The mortgage operations acts as an intermediary between the originators of mortgages that do not meet the guidelines for purchase by Fannie Mae and Freddie Mac and permanent investors in mortgage-backed securities secured by or representing an ownership interest in mortgages. The mortgage operations also acquire non-conforming Alt-A mortgages on a bulk basis that are underwritten to guidelines substantially similar, but not specific, to those of the mortgage operations (non-Impac Alt-A mortgages). Non-Impac mortgage borrowers generally have higher credit scores than Impac Alt-A mortgage borrowers. The mortgage operations generate income by securitizing and selling mortgages to permanent investors. This business also earns revenue from fees associated with mortgage servicing rights (MSR), master servicing agreements and interest income earned on mortgages held-for-sale. The mortgage operations use warehouse facilities provided by the warehouse lending operations to finance the acquisition and origination of mortgages.

The warehouse lending operations provide short-term financing to mortgage loan originators, including the mortgage operations, by funding mortgages from their closing date until they are sold to pre-approved investors. This business earns fees from warehouse transactions as well as net interest income from the difference between its cost of borrowings and the interest earned on warehouse advances.

2. Restatement of Consolidated Financial Statements

The unaudited consolidated balance sheets as of March 31, 2004 and December 31, 2003 and the unaudited consolidated statements of operations and comprehensive earnings and unaudited consolidated statements of cash flows for the three-month periods ended March 31, 2004 and 2003 have been restated. The effect of this restatement on net earnings for the three-month periods ended March 31, 2004 and 2003 was a decrease of \$36.7 million and \$0.7 million, respectively. The following are the principal reasons for the restatement:

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Correct our revenue recognition policy with respect to the cash sale of mortgage servicing rights to unrelated third parties when the mortgage loans are retained. Previously, we recognized gains in the period in which the mortgage servicing rights were sold for the amount of cash proceeds received. We now allocate a portion of the accounting basis of the mortgage loans to the mortgage servicing rights, which results in a discount to the mortgage loans retained. That discount is accreted as an adjustment to yield on mortgage assets over the life of the related mortgages. Historically, when IFC sold mortgages, on a servicing retained basis, to IMH, IFC capitalized the portion of the price received on mortgages that was deemed to represent the value of MSR as deferred income, which was amortized over the life of the mortgages. Subsequently, when IFC sold the MSR to third party investors, IFC would recognize the sale of MSR as gain on sale of loans and the remaining related amount of deferred income would be reduced accordingly. During the period when IFC was either a consolidated subsidiary

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or a 99% equity method investee of IMH, such related party loan sales between IFC and IMH are not sales for financial reporting purposes and, therefore, no gain should be recorded until MSR's are sold to unrelated third parties. The restated financial statements reflect IFC's sales of MSR's to third parties appropriately accounted for consistent with the provisions in AICPA Statement of Position 01-6, Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities with Others (SOP 01-6). Under SOP 01-6 for sales of MSR's with the loans being retained, the carrying value of the loan is allocated between the loan basis and the MSR basis consistent with the relative fair value method prescribed in SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). As a result, only a nominal gain is realized from the sale of MSR's and a discount is recorded on the mortgage loans retained. The consolidated financial statements have been restated to reflect the reversal of previously recorded gains on sale of loans upon the sale of MSR's and the corresponding accretion of the discount as an adjustment to the yield on the mortgage loans retained;

Correct our accounting for derivative financial instruments and hedging activities. We enter into forward purchase commitments on mortgage loans both to be held for sale and held for investment, in addition to our origination pipeline. Previously, certain purchase commitments were not accounted for as derivatives. In accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133) and Statement of Financial Accounting Standards No. 149 Amendment of FASB Statement No. 133 on Derivatives and Hedging Activities (SFAS 149), we believe that such instruments met the definition of a derivative and as such, they should have been carried at their fair value with changes in fair value recognized in earnings. In addition, we enter into derivative contracts to manage the various risks associated with certain specific liabilities. On the date we enter into these derivative contracts, the derivatives were designated as a hedge of the variability in expected future cash flows associated with a financing obligation or future liability (a cash flow hedge). Any change in value associated with a cash flow hedge derivative was previously recorded as an increase or decrease in accumulated other comprehensive income. Upon our review, we now believe that the documentation of cash flow hedge accounting relationships was deficient as to the specificity of the underlying hedged transaction in order to assess hedge effectiveness and the measurement of ineffectiveness as required by the stringent applicable accounting standard, SFAS 133. As such, we made the determination that it is not appropriate to apply cash flow hedge accounting in accordance with SFAS 133 for purposes of GAAP financial statements. However, we will continue to apply hedge accounting for purposes of preparing our tax returns and managing our REIT tests, for which the standards are different to achieve hedge accounting. This correction resulted in our recording all changes in fair value of hedge derivatives as a current period expense or revenue and not as an adjustment to accumulated other comprehensive income;

Change our classification of certain interest rate derivative gains and losses to non-interest income as opposed to an adjustment to the interest yield on mortgages held for long-term investment as a result of the elimination of cash flow hedging, as stated above. We purchase derivatives to manage our exposure to the variability of one-month LIBOR, which is the underlying index of our adjustable rate CMO and warehouse borrowings, as changing interest rates affect cash flows on CMO and warehouse borrowings. Historically, cash payments received and made on derivatives were recorded as an adjustment to the interest yield on mortgages held for long-term investment on the consolidated financial statements. Due to the restatement discussed above relating to derivatives, rather than the Company reclassifying cash payments received and made on derivatives as an adjustment to the interest yield on CMO and warehouse borrowings, we have now recorded the total change in fair value of the derivatives (cash payments plus unrealized gains and losses) as mark-to-market gains (losses) - derivative instruments in the statements of operations; and

Correct our accounting for certain inter-company transactions. Prior to the consolidation of IFC on July 1, 2003, certain significant inter-company balance sheet and income statement items of the mortgage operations were presented on an unconsolidated basis. The significant transactions primarily include advances made to the mortgage operations in the form of finance receivables, which have now been reclassified to investment in and advances to IFC in prior period financial statements. In addition, inter-company balance sheet and income statement eliminations include other interest income and expense as a result of inter-company borrowings, non-interest income as a result of inter-company fees associated with finance receivables and inter-company expense allocations, which were all eliminated through equity in net earnings of IFC, which also changes amounts reported in Investment in and advances to Impac Funding Corporation on the consolidated financial statements. These elimination entries have no effect on total stockholders equity or net earnings.

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A summary of the impact of the restatements on net earnings follows:

| | For the three months ended March 31, | |
|----------------------------------------------------------------------------------------|-------------------------------------------------|------------------|
| | 2004 | 2003 |
| Net earnings, as previously reported | \$ 46,046 | \$ 25,545 |
| Restatement for sale of mortgage servicing rights when the mortgage loans are retained | (12,116) | (4,983) |
| Restatement for derivatives and cessation of cash flow hedge accounting | (24,558) | 4,247 |
| Net earnings, as restated | \$ 9,372 | \$ 24,809 |

The aforementioned restatement adjustments have been tax affected to the extent attributable to activities of the taxable REIT subsidiary. Note B. Reconciliation of Net Earnings Per Share, Note C. Segment Reporting, Note D. Mortgages Held-for-Sale, Note E. CMO Collateral and Note F. CMO Borrowings have been amended for the impact of the aforementioned restatements.

The following tables present the consolidated balance sheets as of March 31, 2004 and December 31, 2003 and the consolidated statements of operations and comprehensive earnings and statements of cash flows for the three-month periods ended March 31, 2004 and 2003 that were affected by the correction and reclassification entries:

Consolidated Balance Sheets

| | As of March 31, 2004 | | As of December 31, 2003 | |
|---------------------------------------------------|-----------------------------|-----------------------------------|--------------------------------|-----------------------------------|
| | As Restated | As Previously Reported | As Restated | As Previously Reported |
| CMO collateral | \$ 11,158,627 | \$ 11,252,373 | \$ 8,639,014 | \$ 8,735,434 |
| Mortgages held-for-sale | 611,072 | 611,068 | 397,618 | 395,090 |
| Other assets | 308,341 | 280,960 | 130,349 | 109,678 |
| Total assets | 12,936,321 | 13,024,809 | 10,577,957 | 10,674,657 |
| CMO borrowings | 11,139,069 | 11,183,583 | 8,489,853 | 8,526,838 |
| Other liabilities | 77,010 | 73,789 | 46,510 | 70,522 |
| Total liabilities | 12,374,746 | 12,416,039 | 10,105,170 | 10,166,167 |
| Accumulated other comprehensive gain (loss) | 4,216 | (33,670) | 4,356 | (8,348) |
| Retained earnings | 154,608 | 239,689 | 145,236 | 193,643 |
| Net accumulated deficit | (193,146) | (108,065) | (161,795) | (113,388) |
| Total stockholders' equity | 561,575 | 608,770 | 472,787 | 508,490 |
| Total liabilities and stockholders' equity | 12,936,321 | 13,024,809 | 10,577,957 | 10,674,657 |

Table of Contents**Consolidated Statements of Operations and Comprehensive Earnings**

| | For the Three Months Ended March 31, | | | |
|-----------------------------------------------------|--------------------------------------|------------------------|-------------|------------------------|
| | 2004 | | 2003 | |
| | As Restated | As Previously Reported | As Restated | As Previously Reported |
| | As Restated | As Previously Reported | As Restated | As Previously Reported |
| Interest on mortgage assets | \$ 134,267 | \$ 115,833 | \$ 82,216 | \$ 75,478 |
| Total interest income | 134,707 | 116,273 | 82,370 | 76,159 |
| Interest on CMO borrowings | 51,994 | 54,060 | 38,294 | 41,684 |
| Interest on other borrowings | 66 | 66 | 632 | 883 |
| Total interest expense | 61,614 | 63,680 | 45,716 | 49,357 |
| Net interest income | 73,093 | 52,593 | 36,654 | 26,802 |
| Net interest income after provision for loan losses | 63,368 | 42,868 | 30,170 | 20,318 |
| Gain on sale of loans | 2,502 | 31,138 | 1,616 | 1,616 |
| Equity in net earnings of IFC | | | 1,293 | 5,167 |
| Mark-to-market loss derivative instruments | (36,630) | (1,280) | (7,118) | |
| Other income | 315 | 315 | 692 | 1,027 |
| Total non-interest income | (33,813) | 31,453 | (3,517) | 7,810 |
| Personnel expense | 13,668 | 13,668 | 686 | 692 |
| General and administrative and other expense | 3,175 | 3,173 | 434 | 435 |
| Professional services | 1,831 | 1,831 | 385 | 1,037 |
| Data processing expense | 805 | 805 | 109 | 189 |
| Total non-interest expense | 20,498 | 21,776 | 1,844 | 2,583 |
| Net earnings before income taxes | 9,057 | 52,545 | 24,809 | 25,545 |
| Income taxes | (315) | 6,499 | | |
| Net earnings | 9,372 | 46,046 | 24,809 | 25,545 |
| Comprehensive earnings | 9,232 | 20,724 | 25,395 | 29,656 |
| Net earnings per share: | | | | |
| Net earnings per share basic | \$ 0.16 | \$ 0.77 | \$ 0.53 | \$ 0.54 |
| Net earnings per share diluted | 0.15 | 0.76 | 0.52 | 0.53 |

Consolidated Statements of Cash Flows

| | For the Three Months Ended March 31, | | | |
|----------------------------------------------------------|--------------------------------------|------------------------|-------------|------------------------|
| | 2004 | | 2003 | |
| | As Restated | As Previously Reported | As Restated | As Previously Reported |
| | As Restated | As Previously Reported | As Restated | As Previously Reported |
| Net earnings | \$ 9,372 | \$ 46,046 | \$ 24,809 | \$ 25,545 |
| Equity in net earnings of IFC | | | (1,293) | (5,167) |
| Gain on sale of loans | (2,502) | (31,138) | (1,616) | (1,616) |
| Sale and principal reductions on mortgages held-for-sale | 3,258,130 | 3,283,978 | | |
| Unrealized mark-to-market loss derivative instruments | (24,308) | | (3,525) | |
| Net change in investment in and advances to IFC | | | 155,050 | |
| Net change in deferred taxes | (6,814) | 1,030 | | |

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| | | | | |
|--------------------------------------------------------|-------------|-------------|-------------|-------------|
| Net change in accrued interest receivable | (8,492) | (8,492) | (1,478) | (1,168) |
| Net change in other assets and other liabilities | (129,039) | (166,962) | (25,509) | (40,431) |
| Net cash provided by (used in) operating activities | (288,298) | (309,799) | 167,189 | (2,086) |
| Net change in CMO collateral | (2,545,512) | (2,574,835) | (1,100,439) | (1,117,985) |
| Net change in finance receivables | 103,634 | 103,634 | 148,787 | 308,622 |
| Dividend from IFC | | | | 4,455 |
| Net principal reductions on investment securities | 627 | 627 | 1,562 | 1,673 |
| Proceeds from the sale of other real estate owned, net | 9,737 | 9,737 | 5,319 | 5,410 |
| Net cash used in investing activities | (1,918,512) | (1,947,835) | (962,126) | (815,180) |
| Repayments of CMO borrowings | (751,003) | (700,179) | (396,637) | (374,308) |
| Net cash provided by financing activities | 2,273,067 | 2,323,891 | 795,124 | 817,453 |
| Net change in other comprehensive earnings | (140) | (25,322) | 586 | 4,111 |

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3. Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents consist of cash and money market mutual funds. Investments with maturities of three months or less at date of acquisition are considered to be cash equivalents.

4. Investment Securities Available-for-Sale

Investment securities are classified as held-to-maturity, available-for-sale, and/or trading securities. Held-to-maturity investment securities are reported at amortized cost, available-for-sale securities are reported at fair value with unrealized gains and losses as a separate component of stockholders' equity and trading securities are reported at fair value with unrealized gains and losses reported in earnings. Gains and losses recorded on sale of investment securities available-for-sale are based on the specific identification method. Premiums or discounts obtained on investment securities are accreted or amortized to interest income over the estimated life of the investment securities using the interest method. Investment securities may be subject to credit, interest rate and/or prepayment risk. As of March 31, 2004 and December 31, 2003, investment securities available-for-sale was \$12.9 million and \$13.4 million, respectively. There were no sale of investment securities available-for-sale and, therefore, no realized gains or losses during the three months ended March 31, 2004 and 2003. However, during the three months ended March 31, 2004 and 2003, we received \$291 thousand and \$122 thousand, respectively, of recoveries on investment securities available-for-sale that were written-off in prior periods.

5. Mortgages Held-for-Sale

Mortgages held for sale consist primarily of Alt-A mortgages, which are secured by one-to-four family residential real estate located throughout the United States. The mortgage operations acquire and originate mortgages generally with the intent to sell them in the secondary market or to the long-term investment operations. Mortgages held for sale are carried at the lower of aggregate cost, net of purchase discounts or premiums and deferred fees. We determine the fair value of mortgages held for sale using current secondary market prices for loans with similar coupons, maturities and credit quality.

SFAS 140 requires that a transfer of financial assets in which we surrender control over the assets be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. SFAS 140 requires a "true sale" analysis of the treatment of the transfer under law as if the Company was a debtor under the bankruptcy code. A "true sale" legal analysis includes several legally relevant factors, such as the nature and level of recourse to the transferor and the nature of retained servicing rights. Once the legal isolation test has been met under SFAS 140, other factors concerning the nature and extent of the transferor's control over the transferred assets are taken into account in order to determine whether de-recognition of assets is warranted, including whether the special-purpose entity (SPE) has complied with rules concerning qualifying special-purpose entities.

A legal opinion regarding legal isolation for each securitization has been obtained by the Company. The "true sale" opinion provides reasonable assurance the purchased assets would not be characterized as the property of the transferring Company's receivership or conservatorship estate in the event of insolvency and also states the transferor would not be required to substantively consolidate the assets and liabilities of the purchaser SPE with those of the transferor upon such event.

The securitization process involves the sale of the loans to one of our wholly-owned bankruptcy remote special-purpose entities which then sells the loans to a separate, transaction-specific securitization trust in exchange for cash and certain trust interests that we retain. The securitization trust issues and sells undivided interests to third party investors that entitle the investors to specified cash flows generated from the securitized loans. These undivided interests are usually represented by certificates with varying interest rates, and are secured by the payments on the loans

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acquired by the trust, and commonly include senior and subordinated classes. The senior class securities are usually rated AAA by at least two of the major independent rating agencies and have priority over the subordinated classes in the receipt of payments. We have no obligation to provide funding support to either the third party investors or the securitization trusts. The third party investors or the securitization trusts generally have no recourse to our assets or us and have no ability to require us to repurchase their securities other than the standard representations and warranties. We do make certain representations and warranties concerning the loans, such as lien status or mortgage insurance coverage, and if we are found to have breached a representation or warranty we may be required to repurchase the loan from the securitization trust. We do not guarantee any certificates issued by the securitization trusts. The securitization trusts represent qualified special-purpose entities under SFAS 140, and are therefore not consolidated for financial reporting purposes.

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In addition to the cash the securitization trust pays for the loans, we may have retained certain interests in the securitization trust as part of the trust's payment to us for the loans. These retained interests may include subordinated classes of securities, interest-only securities, residual securities and master servicing rights. These retained interests are included in securities available for sale and other assets on the consolidated balance sheets. Transaction costs associated with the securitizations are recognized as a component of the gain or loss at the time of sale.

Our recognition of gain or loss on the sale of loans from REMIC securitizations is accounted for in accordance with SFAS 140. At the closing of each securitization, mortgages held-for-sale are removed from the consolidated balance sheets and cash received and a portion of the mortgages retained from the securitizations (retained interests) is added to the balance sheet. The carrying value of the mortgages sold is allocated between the loans sold and the retained interests based on their relative fair values.

6. Master Servicing Rights

Master servicing rights on mortgages that we sell are generally retained and master servicing rights are retained on sales of mortgage servicing rights, when the mortgage loans are retained. Master servicing fees receivable represent the present value of the difference between (1) the interest rate on mortgages acquired or originated, and (2) the interest rate received by investors who purchase the securities backed by such loans in excess of the normal loan servicing fees charged by either the mortgage operations on loans acquired servicing released or correspondents who sold mortgages to the mortgage operations with servicing retained. Master servicing fees receivable have characteristics similar to interest-only securities. Accordingly, master servicing fees receivable have many of the same risks inherent in interest-only securities, including the risk that they will lose a substantial portion of their value as a result of rapid prepayments occasioned by declining interest rates. Accordingly, if the mortgage operations had to sell these receivables, the value received may be at or above the values at which the mortgage operations carried them on the balance sheet. In determining present value of future cash flows, management uses a market discount rate. Prepayment assumptions are based on recent evaluations of the actual prepayments of the mortgage operations servicing portfolio or on market prepayment rates on new portfolios and the interest rate environment at the time the master servicing fees receivable are created. We subcontract substantially all servicing obligations to independent third parties pursuant to sub-servicing agreements. However, master servicing rights on substantially all mortgage acquisitions and originations are retained. Master servicing fees are generally 0.03% per annum on the declining principal balances of the mortgages serviced. The value of master servicing fees is subject to prepayment and interest rate risks on the transferred financial assets.

7. CMO Collateral and Mortgages Held-for-Investment

The long-term investment operations invest in primarily adjustable rate and, to a lesser extent, fixed rate Alt-A mortgages to be held for long-term investment. CMO collateral and mortgages held-for-investment are recorded at cost, including adjustments for derivative gain or loss during the commitment period, as of the date of purchase. CMO collateral is recorded in IMH Assets, a special purpose financing subsidiary which is used to issue CMO financing. CMO collateral and mortgages held-for-investment include various types of adjustable rate and fixed rate mortgages secured by single-family residential real estate properties acquired and originated by the mortgage operations, multi-family residential real estate properties originated by IMCC and, to a lesser extent, fixed rate second trust deeds secured by single-family residential real estate properties. Any premiums and discounts, which may result from the acquisition of mortgages, derivative gain or loss during the commitment period or the sale of MSRs when the mortgages are retained, are amortized to interest income over their estimated lives using the interest method as an adjustment to the yield of the mortgage. CMO collateral and mortgages held-for-investment are continually evaluated for collectibility and, if appropriate, the mortgage may be placed on non-accrual status, generally when the mortgage is 90 days past due, and previously accrued interest is reversed from income.

8. Finance Receivables

Finance receivables represent transactions with customers, including affiliated companies, involving residential real estate lending. As a warehouse lender, the warehouse lending operations is a secured creditor of the mortgage bankers and brokers to which it extends credit and is

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subject to the risks inherent in that status including, the risk of borrower fraud, default and bankruptcy. Any claim of the warehouse lending operations as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay. Finance receivables represent warehouse lines of credit with mortgage bankers that are collateralized by mortgages on single-family residential real estate. Finance receivables are stated at the principal balance outstanding. Interest income is recorded on the accrual basis in accordance with the terms of the mortgages.

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9. Allowance for Loan Losses

An allowance is maintained for losses on mortgages held-for-investment, mortgages held as CMO collateral and finance receivables (loans provided for) at an amount that management believes provides for losses inherent in those loan portfolios. We have implemented a methodology designed to analyze the performance of various loan portfolios, based upon the relatively homogeneous nature within these loan portfolios. The allowance for losses is also analyzed using the following factors:

management's judgment of the net loss potential of mortgages in the long-term mortgage portfolio based on prior loan loss experience;

changes in the nature and volume of the long-term mortgage portfolio;

value of the collateral;

delinquency trends; and

current economic conditions that may affect the borrowers' ability to pay.

In evaluating the adequacy of the allowance for loan losses, a detailed analysis of historical loan performance data is accumulated and reviewed. This data is analyzed for loss performance and prepayment performance by product type, origination year and securitization issuance. The results of that analysis are then applied to the current mortgage portfolio and an estimate is created. We believe that pooling of mortgages with similar characteristics is an appropriate methodology in which to evaluate the allowance for loan losses. In addition, management provides an allowance for loan losses for Alt-A mortgages that are retained for long-term investment and which are not underwritten to our specific underwriting guidelines. These mortgages are acquired on a bulk basis by the mortgage operations from other mortgage originators that underwrite mortgages substantially similar, but not specific, to our mortgage underwriting guidelines, or non-Impac mortgages. Management also recognizes that there are qualitative factors that must be taken into consideration when evaluating and measuring inherent loss in our loan portfolios. These items include, but are not limited to, economic indicators that may affect the borrower's ability to pay, changes in value of collateral, political factors and industry statistics.

Additions to the allowance are provided through a charge to earnings. Specific valuation allowances may be established for loans that are deemed impaired, if default by the borrower is deemed probable, and if the fair value of the loan or the collateral is estimated to be less than the gross carrying value of the loan. Actual losses on loans are recorded as a reduction to the allowance through charge-offs. Subsequent recoveries of amounts previously charged off are credited to the allowance.

For loans on non-accrual status, cash receipts are applied, and interest income is recognized, on a cash basis. For all other impaired loans, cash receipts are applied to principal and interest in accordance with the contractual terms of the loan and interest income is recognized on the accrual basis. Generally, a loan may be returned to accrual status when all delinquent principal and interest are brought current in accordance with the terms of the loan agreement.

10. Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation or amortization. Depreciation on premises and equipment is recorded using the straight-line method over the estimated useful lives of individual assets, typically, three to twenty years.

11. CMO Borrowings

The decision to issue CMOs is based on our current and future investment needs, market conditions and other factors. CMOs, which are primarily secured by Alt-A mortgages on single-family and multi-family residential real properties, are issued as a means of financing our long-term mortgage portfolio. CMOs are carried at their outstanding principal balances, including accrued interest on such obligations. For accounting purposes, mortgages financed through the issuance of CMOs are treated as assets and the CMOs are treated as debt when the CMO qualifies as a financing arrangement. Each issue of CMOs is fully payable from the principal and interest payments on the underlying mortgages collateralizing such debt. CMOs typically are structured as one-month London Interbank Offered Rate (LIBOR) floaters and fixed rate securities

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with interest payable monthly. The maturity of each class of CMO is directly affected by the rate of principal prepayments on the related CMO collateral. Each CMO series is also subject to redemption according to specific terms of the respective indentures (clean-up calls). As a result, the actual maturity of any class of a CMO series is likely to occur earlier than the stated maturities of the underlying mortgages.

When we issue CMOs for financing purposes, we seek an investment grade rating for our CMOs by nationally recognized rating agencies. To secure such ratings, it is often necessary to pledge collateral in excess of the principal amount of the CMOs to be issued, or to obtain other forms of credit enhancement such as additional mortgage insurance. The need for additional collateral or other credit enhancements depends upon factors such as the type of collateral provided, the interest rates paid, the geographic concentration of the mortgaged property securing the collateral and other criteria established by the rating agencies. The pledge of additional collateral reduces our capacity to raise additional funds through short-term secured borrowings or additional CMOs and diminishes the potential expansion of our long-term mortgage portfolio. Our total loss exposure is limited to the net economic investment in CMOs at any point in time.

Certain CMO borrowings are guaranteed to certificate holders by a mortgage loan insurer, which give the CMOs the highest rating established by nationally recognized rating agencies. Each issue of CMOs is fully payable from the principal and interest payments on the underlying mortgages collateralizing such debt. Cash or other collateral is required to be pledged as a condition to receiving the desired rating on the debt. CMOs typically are structured as adjustable rate securities, which primarily are indexed to one-month LIBOR, and fixed rate securities with interest payable to certificate holders monthly.

12. Gain on Sale of MSRs

The long-term investment operations structures CMO securitizations as financing arrangements and recognizes no gain or loss on the transfer of mortgage assets. At the date of CMO securitizations, the mortgage operations sells the MSRs to third parties while IMH retains the mortgages on the balance sheet. Gains or losses on the sale of MSRs are recognized after allocating the previous carrying value of the mortgage between the MSRs sold and the mortgages retained by IMH, based on their relative fair values.

13. Income Taxes

We operate so as to qualify as a REIT under the requirements of the Internal Revenue Code (the Code). Requirements for qualification as a REIT include various restrictions on ownership of IMH's stock, requirements concerning distribution of taxable income and certain restrictions on the nature of assets and sources of income. A REIT must distribute at least 90% of its taxable income to its stockholders of which 85% must be distributed within the taxable year in order to avoid the imposition of an excise tax. The remaining balance may extend until timely filing of our tax return in the subsequent taxable year. Qualifying distributions of taxable income are deductible by a REIT in computing taxable income. If in any tax year IMH should not qualify as a REIT, we would be taxed as a corporation and distributions to stockholders would not be deductible in computing taxable income. If IMH were to fail to qualify as a REIT in any tax year, we would not be permitted to qualify for that year and the succeeding four years. As of December 31, 2003, we had estimated federal and state net operating loss tax carry-forwards of \$18.7 million that are available to offset future taxable income through 2020. We expect to file our 2003 federal and state tax returns in September of 2004 at which time federal and state net operating loss carry-forwards, if any, will be determined.

IFC is a taxable REIT subsidiary and is therefore subject to corporate income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

14. Net Earnings per Share

Basic net earnings per share are computed on the basis of the weighted average number of shares outstanding for the year divided into net earnings available to common stockholders for the year. Diluted net earnings per share are computed on the basis of the weighted average number of shares and dilutive common equivalent shares outstanding for the year divided by net earnings available to common stockholders for the year.

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Stock options and awards may be granted to the directors, officers and key employees. The exercise price for any qualified incentive stock options (ISOs) and non-qualified stock options (NQSOs) granted under our stock option plans may not be less than 100% (or 110% in the case of ISOs granted to an employee who is deemed to own in excess of 10% of the outstanding common stock) of the fair market value of the shares of common stock at the time the NQSO or ISO is granted. Grants under stock option plans are made and administered by the board of directors. We currently have a 1995 Stock Option, Deferred Stock and Restricted Stock Plan (1995 plan) and during 2001 the board of directors and stockholders approved a new Stock Option, Deferred Stock and Restricted Stock Plan (2001 plan), collectively, (the stock plans). Each stock plan provides for the grant of ISOs, NQSOs, deferred stock, and restricted stock, and, in the case of the 2001 plan, dividend equivalent rights and, in the case of the 1995 plan, stock appreciation rights and limited stock appreciation rights awards (awards).

In December 2002 the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148), an amendment of FASB Statement No. 123, Accounting for Stock-Based Compensation, (FASB 123). SFAS 148 amends FASB 123 to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements. On January 1, 2003, IMH adopted the disclosure requirements of SFAS 148. In November 1995, the FASB issued SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). This statement establishes financial accounting standards for stock-based employee compensation plans. SFAS 123 permits management to choose either a new fair value based method or the current APB 25 intrinsic value based method of accounting for its stock-based compensation arrangements. SFAS 123 requires pro forma disclosures of net earnings (loss) computed as if the fair value based method had been applied in financial statements of companies that continue to follow current practice in accounting for such arrangements under APB 25. SFAS 123 applies to all stock-based employee compensation plans in which an employer grants shares of its stock or other equity instruments to employees except for employee stock ownership plans. SFAS 123 also applies to plans in which the employer incurs liabilities to employees in amounts based on the price of the employer's stock, i.e., stock option plans, stock purchase plans, restricted stock plans and stock appreciation rights. The statement also specifies the accounting for transactions in which a company issues stock options or other equity instruments for services provided by non-employees or to acquire goods or services from outside suppliers or vendors.

The Company applies APB Opinion No. 25 in accounting for our stock plans. If compensation cost for our stock-based compensation plans had been determined consistent with SFAS 123, our net earnings and earnings per share would have been reduced to the pro forma amounts indicated below:

| | For the Three Months Ended March 31, | |
|-----------------------------------------------------------------------------------|-------------------------------------------------|------------------|
| | 2004 | 2003 |
| | (as restated) | |
| Net earnings as reported | \$ 9,372 | \$ 24,809 |
| Less: Total stock-based employee compensation expense using the fair value method | (290) | (289) |
| Pro forma net earnings | \$ 9,082 | \$ 24,520 |
| Net earnings per share as reported: | | |
| Basic | \$ 0.16 | \$ 0.53 |
| Diluted | \$ 0.15 | \$ 0.52 |
| Pro forma net earnings per share: | | |

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| | | |
|---------|---------|---------|
| Basic | \$ 0.15 | \$ 0.52 |
| Diluted | \$ 0.15 | \$ 0.51 |

During the periods in which the mortgage operations was accounted for under the equity method, grants of stock options by IMH to IFC employees were not accounted for under APB Opinion No. 25 but were accounted for at fair value consistent with the provisions specified under SFAS 123.

Table of Contents**16. Derivative Instruments**

In June 1998, FASB issued SFAS 133 as amended by SFAS No. 137 and SFAS No. 138, collectively, (SFAS 133). SFAS 133, subsequently amended by SFAS 149, establishes accounting and reporting standards for derivative instruments, including a number of derivative instruments embedded in other contracts and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If specific conditions are met, a derivative may be specifically designated as (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; (2) a hedge of the exposure to variable cash flows of a forecasted transaction; or (3) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available for sale security or a foreign-currency-denominated forecasted transaction. For derivatives that are accounted for as free standing derivatives, any change in fair value is recorded as expense or income in the current period.

Our primary objective is to limit the exposure to the variability in future cash flows attributable to the variability of one-month LIBOR, which is the underlying index of adjustable rate CMO and warehouse borrowings. We also monitor on an ongoing basis the prepayment risks that arise in fluctuating interest rate environments. Our interest rate risk management policies are formulated with the intent to offset the potential adverse effects of changing interest rates on CMO and warehouse borrowings.

To mitigate exposure to the effect of changing interest rates on cash flows on CMO and warehouse borrowings, we purchase derivative instruments in the form of interest rate cap agreements (caps), interest rate floor agreements (floors) and interest rate swap agreements (swaps). A cap or floor is a contractual agreement for which we may receive or pay a fee. If prevailing interest rates reach levels specified in the cap or floor agreement, we may either receive or pay cash. A swap is generally a contractual agreement that obligates one party to receive or make cash payments based on an adjustable rate index and the other party to receive or make cash payments based on a fixed rate. Swaps have the effect of fixing borrowing costs on a similar amount of debt and, as a result, can reduce the interest rate variability of borrowings. Our objective is to lock in a reliable stream of cash flows when interest rates fall below or rise above certain levels. For instance, when interest rates rise, borrowing costs may increase at greater speeds than the underlying collateral supporting the borrowings. These derivative instruments limit exposure to the variability of forecasted cash flows attributable to CMO and warehouse borrowings and protect net interest income by providing cash flows at certain triggers during changing interest rate environments. In all interest rate-hedging transactions, counter-parties must have a highly-rated credit rating as determined by various credit rating agencies.

Under SFAS 133, an entity that elects to apply hedge accounting is required to identify the hedged transaction and the hedging instrument and establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging relationships and the measurement and approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing interest rate risk. This statement was effective for all fiscal quarters of fiscal years beginning after June 15, 2000. We can expect high effectiveness of hedging relationships since the hedged items, CMO and warehouse borrowings, and the hedging derivative instrument are based on one-month LIBOR. As both instruments are tied to the same index, the hedge is expected to be highly effective at the time the hedge is designated and on an ongoing basis. While these relationships have not been formally documented as cash flow hedging relationships and, consequently, the derivatives have been accounted for as free-standing derivatives for accounting purposes, we believe that they are economic hedges that effectively manage interest rate risks associated with our borrowing costs. These derivatives are recorded at the fair value with changes in fair value reported as mark-to-market loss derivative instruments on the consolidated financial statements. The determination to treat these hedges as free-standing derivatives as opposed to cash flow hedges is primarily based upon the stringent documentation burden placed upon us to maintain cash flow hedge accounting. The accounting treatment has no effect on taxable income which is how we determine our dividend policy. In future periods we may choose to comply with such standards in order to achieve hedge accounting treatment.

We enter into commitments to make loans whereby the interest rate on the loan is set prior to funding (rate lock commitments). We also enter into commitments to purchase mortgage loans through our correspondent channel (purchase commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. In addition, purchase commitments for mortgage loans that are intended to be sold and those that will be held for investment purposes can qualify as derivatives. Both types of commitments to purchase loans are evaluated under the definition of a derivative to determine whether SFAS 133 is applicable. Rate lock and purchase commitments that are

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considered to be derivatives are recorded, at fair value, on the consolidated statements of financial condition with changes in fair value recorded in mark-to-market loss-derivative instruments on the consolidated statements of operations. In measuring the fair

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value of rate lock and purchase commitments, the amount of the expected servicing rights is not included in the valuation. This value is calculated and adjusted using an anticipated fallout factor for loan commitments that are not expected to be funded. This policy of recognizing the value of the derivative has the effect of recognizing a gain or loss on the related mortgage loans based on changes in the interest rate environment before the mortgage loans are funded and sold. As such, both rate lock and purchase commitments expose us to interest rate risk. We manage that risk by entering into various interest rate contracts that are also recorded at fair value with changes in fair value reported in mark-to-market loss-derivative instruments.

The mortgage operations also enter into forward commitments and derivative transactions to lock in the forecasted sale profitability of fixed rate mortgages held-for-sale. The mortgage operations generally sells calls or buys put options or enters into mandatory commitments on U.S. Treasury bonds and mortgage-backed securities to hedge against adverse movements of interest rates affecting the value of mortgages held-for-sale. The risk in writing a call option is that the mortgage operations gives up the opportunity for profit if the market price of the mortgage increases and the option is exercised. The mortgage operation also has the additional risk of not being able to enter into a closing transaction if a liquid secondary market for the mortgage loan does not exist. The risk of buying a put option is limited to the premium paid for the put option. These economic hedges are treated as free-standing derivatives under the provisions of SFAS 133 with the entire change in fair value of the hedges recorded through mark-to-market loss-derivative instruments in current earnings.

Included in other assets on the consolidated balance sheets as of March 31, 2004 and December 31, 2003 are \$29.2 million and \$33.6 million of derivative assets, respectively. Derivative assets include cash margin balances placed with third parties of \$15.5 million and \$18.2 million as of March 31, 2004 and December 31, 2003, respectively. Included in other liabilities on the consolidated balance sheets as of March 31, 2004 and December 31, 2003 are \$36.6 million and \$14.7 million of derivative liabilities, respectively.

17. Recent Accounting Pronouncements

FASB Interpretation 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46R), requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. Prior to FIN 46R, a company included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46R also requires disclosures about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest. The consolidated requirements of FIN 46R apply to all variable interest entities (VIEs) by the end of the first reporting period that ends after December 15, 2003. The provisions of FIN 46R for interests held by public entities in VIEs that are not qualified special purpose entities are required to be applied by the first reporting period that ends after March 15, 2004. In connection with our CMO transactions, mortgages are transferred into trusts that are classified as VIEs and are consolidated with the financial results of IMH and its subsidiaries.

Staff Accounting Bulletin No. 105, Application of Accounting Principles to Loan Commitments, (SAB 105), clarifies the SEC's position on the accounting and valuation for commitments to originate mortgage loans held-for-sale. Consistent with SFAS 149, SAB 105 states that loan commitments are treated as derivative instruments. SAB 105 requires that in valuing these loan commitments entities not include cash flows associated with servicing as to do so would result in the recognition of servicing assets prior to the sale or securitization of funded loans. This valuation methodology limits a company's ability to record an asset for its mortgage pipeline at the transaction date even when the total fair value may include servicing-related acquisition premium. Prior to the issuance of SAB 105, each reporting period the mortgage operations recorded the fair value of its mortgage pipeline, inclusive of changes in benchmark interest rates and acquisition premiums. Subsequent to SAB 105, as of April 1, 2004 we record the fair value change of the mortgage pipeline based solely on interest rate fluctuations from the date of rate-lock to the applicable reporting date.

Table of Contents**Note B Reconciliation of Earnings Per Share**

The following table presents the computation of basic and diluted net earnings per share available to common stockholders as if all stock options were outstanding for the periods indicated:

| | For the Three Months Ended March 31, | |
|--------------------------------------------------------------|-------------------------------------------------|-------------|
| | 2004 | 2003 |
| | (as restated) | |
| Numerator for earnings per share: | | |
| Net earnings | \$ 9,372 | \$ 24,809 |
| Denominator for earnings per share: | | |
| Basic weighted average number of common shares outstanding | 59,692 | 47,069 |
| Net effect of dilutive stock options | 1,120 | 827 |
| Diluted weighted average common and common equivalent shares | 60,812 | 47,896 |
| Net earnings per share: | | |
| Basic | \$ 0.16 | \$ 0.53 |
| Diluted | \$ 0.15 | \$ 0.52 |

The Company had none and 20,000 stock options during the three months ended March 31, 2004 and 2003, respectively, that were not considered in the calculation of diluted weighted average common and common equivalent shares as the exercise price of the stock options were greater than the average market price during the periods.

Note C Segment Reporting

Management internally reviews and analyzes its operating segments as follows:

long-term investment operations invest primarily in adjustable rate and, to a lesser extent, fixed rate Impac and non-Impac Alt-A mortgages and multi-family mortgages;

warehouse lending operations provide warehouse and repurchase financing to affiliated companies and to approved mortgage bankers and brokers, some of which are clients of the mortgage operations, to finance mortgages; and

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mortgage operations acquire and originate adjustable rate and fixed rate Impac and non-Impac Alt-A mortgages and, to a lesser extent, B/C mortgages from its network of third party correspondents, mortgage brokers and retail customers.

The following table presents business segments as of and for the three months ended March 31, 2004 (as restated):

| | Long-Term Investment Operations | Warehouse Lending Operations | Mortgage Operations | Inter- Company ⁽¹⁾ | Consolidated |
|--------------------------------------------------|------------------------------------------------|---------------------------------------------|--------------------------------|------------------------------------------|---------------------|
| Balance Sheet Items: | | | | | |
| CMO collateral and mortgages held-for-investment | \$ 11,384,789 | \$ | \$ | \$ (89,455) | \$ 11,295,334 |
| Mortgages held-for-sale | | | 611,072 | | 611,072 |
| Finance receivables | | 526,396 | | | 526,396 |
| Total assets | 12,300,573 | 1,240,748 | 730,676 | (1,335,676) | 12,936,321 |
| Total stockholders' equity | 956,034 | 122,144 | (18,262) | (498,341) | 561,575 |
| Income Statement Items: | | | | | |
| Net interest income | \$ 51,357 | \$ 8,417 | \$ 5,143 | \$ 8,176 | \$ 73,093 |
| Provision for loan losses | 4,285 | 5,440 | | | 9,725 |
| Non-interest income | (39,046) | 1,958 | 11,451 | (8,176) | (33,813) |
| Non-interest expense and income taxes | 1,745 | 1,521 | 16,917 | | 20,183 |
| Net earnings (loss) | \$ 6,281 | \$ 3,414 | \$ (323) | \$ | \$ 9,372 |

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The following table presents business segments as of and for the three months ended March 31, 2003 (as restated):

| | Long-Term Investment Operations | Warehouse Lending Operations | Inter - Company ⁽¹⁾ | Consolidated |
|--------------------------------------------------|------------------------------------------------|---------------------------------------------|-------------------------------------------|---------------------|
| Balance Sheet Items: | | | | |
| CMO collateral and mortgages held-for-investment | \$ 6,324,776 | \$ | \$ (48,448) | \$ 6,276,328 |
| Finance receivables | | 515,234 | | 515,234 |
| Total assets | 6,804,046 | 957,635 | (387,359) | 7,374,322 |
| Total stockholders' equity | 554,507 | 96,999 | (324,881) | 326,625 |
| Income Statement Items: | | | | |
| Net interest income | \$ 31,251 | \$ 6,070 | \$ (667) | \$ 36,654 |
| Provision for loan losses | 5,889 | 595 | | 6,484 |
| Non-interest income ⁽²⁾ | (5,712) | 1,360 | 835 | (3,517) |
| Non-interest expense | 1,485 | 1,097 | (738) | 1,844 |
| Net earnings | \$ 18,165 | \$ 5,738 | \$ 906 | \$ 24,809 |

⁽¹⁾ Elimination of inter-company balance sheet and income statement items.

⁽²⁾ Non-interest income in the inter-company eliminations column represents equity in net earnings of IFC, which was an unconsolidated qualified REIT subsidiary of IMH during the period and was accounted for using the equity method.

Note D Mortgages Held-for-Sale

Mortgages held-for-sale are primarily adjustable rate and fixed rate Impac Alt-A and non-Impac Alt-A mortgages and, to a lesser extent, B/C mortgages acquired and originated by the mortgage operations and secured by first and second liens on single-family residential real estate properties. As of March 31, 2004 and December 31, 2003, approximately 56% and 61%, respectively, of mortgages held-for-sale were collateralized by properties located in California. Mortgages held-for-sale consisted of the following:

| | At March 31, 2004 | At December 31, 2003 |
|-----------------------------------------------------|------------------------------|---------------------------------|
| | | (as restated) |
| Mortgages held-for-sale | \$ 598,054 | \$ 385,108 |
| Unamortized net premiums on mortgages held-for-sale | 13,018 | 12,510 |
| Total mortgages held-for-sale | \$ 611,072 | \$ 397,618 |

Included in other liabilities as of March 31, 2004 and December 31, 2003, was an allowance for mortgage repurchases of \$948 thousand and \$2.3 million, respectively. The allowance for mortgage repurchases is maintained for the purpose of purchasing previously sold mortgages for various reasons, including early payment defaults or breach of representations or warranties, which may be subsequently sold at a loss. In the

opinion of management, the potential exposure related to these representations and warranties will not have a material adverse effect on our financial condition and results of operations.

Note E CMO Collateral

CMO collateral includes various types of adjustable rate and fixed rate Impac Alt-A and non-Impac Alt-A mortgages secured by single-family residential and multi-family residential real estate properties and, to a lesser extent, fixed rate second trust deeds secured by single-family residential real estate properties. The long-term investment operations earns the net interest spread between interest income on mortgages securing CMOs and interest and other expenses associated with CMO financing. The net interest spread on CMOs may be directly impacted by mortgage prepayment levels and, to the extent each CMO class has variable rates of interest, by changes in short-term interest rates.

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CMO collateral for the periods indicated consisted of the following:

| | At March 31, 2004 | At December 31, 2003 |
|----------------------------------------------------------------------------------------|----------------------|-------------------------|
| | | (as restated) |
| Adjustable - and fixed rate mortgages secured by single-family residential real estate | \$ 10,782,213 | \$ 8,357,085 |
| Adjustable rate mortgages secured by multi-family residential real estate | 258,536 | 200,427 |
| Fixed rate second trust deeds secured by single-family residential real estate | 8,241 | 9,798 |
| Unamortized net premiums on mortgages | 109,637 | 71,704 |
| Total CMO collateral | \$ 11,158,627 | \$ 8,639,014 |

Note F Allowance for Loan Losses

Activity for allowance for loan losses for the periods shown was as follows:

| | For the Three Months Ended, | |
|------------------------------------------|-----------------------------|----------------------|
| | March 31, 2004 | December 31, 2003 |
| Beginning balance | \$ 38,596 | \$ 39,122 |
| Provision for loan losses ⁽¹⁾ | 9,725 | 3,490 |
| Charge-offs, net of recoveries | (2,022) | (4,016) |
| Ending balance | \$ 46,299 | \$ 38,596 |

⁽¹⁾ Includes estimated partial impairment on specific warehouse advances of \$6.0 million that we anticipate will be non-collectible.

At the end of the first quarter of 2004, we discovered that one client of the warehouse lending operations and certain of its officers had perpetrated a fraud pursuant to which they defrauded the warehouse lending operations into making advances pursuant to a warehouse line of credit. As of the date the fraud was discovered, an aggregate of \$12.6 million of fraudulent loan advances were outstanding. We immediately terminated the warehouse line of credit and have been cooperating with federal investigators in their ongoing investigation of the defrauding parties.

We retained an independent consultant to investigate the matter; the investigator reported that no principals of the warehouse lending operations had knowingly participated in the fraud. As a result of the fraud, during the first quarter of 2004 we established a specific allowance for loan losses in the amount of \$6.0 million to provide for anticipated losses on the fraudulent warehouse advances as we have deemed this amount to be non-collectible. Based on available information, we believe we will be able to recover the remaining \$6.6 million of related warehouse advances over time. To the extent that we believe that the actual losses will exceed the \$6.0 million allowance, we will make an additional allowance for loan losses when, or if, we determine it is appropriate to do so as events and circumstances dictate. However, we believe that this specific

allowance is adequate to provide for anticipated loan losses based on currently available information.

In the opinion of management and in accordance with the loan loss allowance methodology, the present allowance for loan losses is considered adequate to provide for losses inherent in the loan portfolios.

Note G CMO Borrowings

Certain CMO borrowings are guaranteed to certificate holders by a mortgage loan insurer, which give the CMOs the highest rating established by nationally recognized rating agencies. Each issue of CMOs is fully payable from the principal and interest payments on the underlying mortgages collateralizing such debt, any cash or other collateral required to be pledged as a condition to receiving the desired rating on the debt. CMOs typically are structured as adjustable rate securities, which primarily are indexed to one-month LIBOR, and fixed rate CMOs with interest payable to certificate holders monthly.

Interest rates on adjustable rate CMOs range from a low of 0.25% over one-month LIBOR, which was 1.09% as of March 31, 2004, or 1.34%, on AAA credit rated bonds to a high of 4.50% over one-month LIBOR, or 5.59%, on BBB credit rated bonds. Interest rates on fixed rate CMOs range from 4.34% to 12.75%, depending on the class of CMOs issued. We completed \$3.4 billion and \$905.9 million in CMOs during the three months ended March 31, 2004 and 2003, respectively, to finance the retention of \$2.9 billion and \$1.4 billion of mortgages acquired and originated by the mortgage operations. For the three months ended March 31, 2004 and 2003, interest expense on CMO borrowings was \$52.0 million and \$38.3 million, respectively.

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The following table presents CMOs issued, CMOs outstanding for the periods indicated and certain interest rate information on CMOs by year of issuance as indicated (dollars in millions):

| <u>Year of Issuance</u> | <u>Original Issuance Amount</u> | <u>CMOs Outstanding As of</u> | | <u>Range of Fixed Interest Rates (%)</u> | <u>Range of Interest Rate Margins Over One-Month LIBOR (%)</u> | <u>Range of Interest Rate Margins After Adjustment Date (%)</u> |
|----------------------------------|-----------------------------------------|---------------------------------------|-----------------|------------------------------------------------------|--------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| | | <u>3/31/04</u> | <u>12/31/03</u> | | | |
| | | | | | | |
| | | (as restated) | | | | |
| 1998 | \$ 583.0 | \$ | \$ | 6.65 - 7.25 | N/A | N/A |
| 2000 | 943.6 | | | N/A | 0.26 - 2.40 | 0.52 - 3.60 |
| 2001 | 1,500.9 | 366.7 | 444.9 | N/A | 0.28 - 2.30 | 0.56 - 3.45 |
| 2002 | 3,876.1 | 2,175.5 | 2,491.0 | 5.25 - 12.00 | 0.27 - 2.75 | 0.54 - 3.68 |
| 2003 | 5,966.1 | 5,294.4 | 5,583.5 | 4.34 - 12.75 | 0.27 - 3.00 | 0.54 - 4.50 |
| 2004 | 3,356.9 | 3,339.9 | | 3.579 | 0.25 - 1.85 | 0.50 - 2.78 |
| Sub-total CMOs | 16,226.6 | 11,176.5 | 8,519.4 | | | |
| Accrued interest | | 7.1 | 7.4 | | | |
| Capitalized securitization costs | | (44.5) | (36.9) | | | |
| Total CMOs | \$ 16,226.6 | \$ 11,139.1 | \$ 8,489.9 | | | |

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

Unless the context otherwise requires, the terms Company, we, us, and our refer to Impac Mortgage Holdings, Inc., or IMH, a Maryland corporation incorporated in August 1995, and our subsidiaries, IMH Assets Corp., or IMH Assets, Impac Warehouse Lending Group, Inc., or IWLG, Impac Multifamily Capital Corporation, or IMCC, and Impac Funding Corporation, or IFC, together with its wholly-owned subsidiary Novelle Financial Services, Inc., or NFS. References to IMH are made to differentiate IMH, the publicly traded company, as a separate entity from IMH Assets, IWLG, IMCC and IFC.

Forward-Looking Statements

This report on Form 10-Q/A contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements, some of which are based on various assumptions and events that are beyond our control may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as may, will, believe, expect, plan, anticipate, continue, or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a number of factors, including, but not limited to, failure to achieve projected earnings levels, the ability to generate sufficient liquidity, the ability to access the capital markets, the size, frequency and manner of our securitizations, the ability to generate taxable income and pay dividends, risks related to restatement of our financial statements, interest rate fluctuations, frauds committed upon us, unknown weaknesses in our internal controls, natural disaster, interruption in our management information systems, new regulatory laws, increase in prepayment rates on our mortgage assets, changes in assumptions regarding estimated loan losses or fair value amounts, changes in expectations of future interest rates, the availability of financing and, if available, the terms of any financing, changes in origination and resale pricing of mortgages, changes in markets which we serve and changes in general market and economic conditions. For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see Risk Factors and Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations in this report. We do not undertake, and specifically disclaim any obligation, to publicly release the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Restatement of Consolidated Financial Statements

The consolidated balance sheets as of March 31, 2004 and December 31, 2003, the consolidated statements of operations and comprehensive earnings for the three months ended March 31, 2004 and 2003 and the consolidated statements of cash flows for the three months ended March 31, 2004 and 2003 have been restated. The effect of this restatement on net earnings for the three months ended March 31, 2004 and 2003 was a decrease of \$36.7 million and \$0.7 million, respectively. For a further discussion of the corrections and restatements, see Explanatory Note at the beginning of this Form 10-Q/A and Note A.2. Restatement of Consolidated Financial Statements in the accompanying notes to consolidated financial statements. The effect of the restatement of the consolidated financial statements is reflected in Management's Discussion and Analysis of Financial Condition and Results of Operations below.

Consolidation of IFC

The results of operations for the three months ended March 31, 2004 reflect the consolidation of IFC on July 1, 2003. On July 1, 2003, IMH entered into a stock purchase agreement with Joseph R. Tomkinson, our Chairman, Chief Executive Officer and a director, William S. Ashmore, our Chief Operating Officer, President and a director, and the Johnson Revocable Living Trust, of which Richard J. Johnson, our Executive Vice President and Chief Financial Officer is trustee, whereby IMH purchased all of the outstanding shares of voting common stock of IFC for

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aggregate consideration of \$750,000. Each of Messrs. Tomkinson and Ashmore and the Johnson Revocable Living Trust owned one-third of the outstanding common stock of IFC. Mr. Tomkinson elected to receive \$125,000 worth of his consideration for the sale of his IFC shares of common stock in the form of 7,687 shares of IMH common stock. The fairness opinion related to the purchase price of IFC, as rendered by an independent financial advisor, and the subsequent transaction was approved by our board of directors. As a result of acquiring 100% of IFC's common stock on July 1, 2003, IMH owns all of the common stock and preferred stock of IFC and began to consolidate IFC as of that date. As such, the consolidated financial statements for the three months ended March 31, 2004, or consolidation period, reflect the results of operations of IFC on

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a consolidated basis. The consolidated financial statements for the three months ended March 31, 2003, or non-consolidation period, include the results of operations of IFC as equity in net earnings of IFC.

General and Business Operations

We are a mortgage real estate investment trust, or REIT, that is a nationwide acquirer, originator, seller and investor of primarily non-conforming Alt-A mortgages, or Alt-A mortgages, and to a lesser extent, small-balance, multi-family mortgages, or multi-family mortgages and sub-prime mortgages, or B/C mortgages. We also provide warehouse and repurchase financing to originators of mortgages.

We operate three core businesses:

long-term investment operations that is conducted by IMH, IMH Assets and IMCC;

warehouse lending operations that is conducted by IWLG; and

mortgage operations that is conducted by IFC and NFS.

The long-term investment operations primarily invest in adjustable rate and fixed rate Alt-A mortgages that are acquired and originated by our mortgage operations. Alt-A mortgages are primarily first lien mortgages made to borrowers whose credit is generally within typical Fannie Mae and Freddie Mac guidelines, but have loan characteristics that make them non-conforming under those guidelines. Some of the principal differences between mortgages purchased by Fannie Mae and Freddie Mac and Alt-A mortgages are as follows:

credit and income histories of the mortgagor; and

documentation required for approval of the mortgagor.

For instance, Alt-A mortgages may not have certain documentation or verifications that are required by Fannie Mae and Freddie Mac and, therefore, in making our credit decisions, we may be more reliant upon the borrower's credit score and the adequacy of the underlying collateral. We believe that Alt-A mortgages provide an attractive net earnings profile by producing higher yields without commensurately higher credit losses than other types of mortgages.

The long-term investment operations also originate and invest in multi-family mortgages with initial fixed interest rate periods of three, five and seven years that subsequently adjust to adjustable rate mortgages with loan balances that generally range from \$250,000 to \$3.0 million. Multi-family mortgages have interest rate floors, which is the initial start rate, and prepayment penalty periods of three, five and seven years. Multi-family mortgages provide greater asset diversification on our balance sheet as borrowers of multi-family mortgages typically have higher credit scores and longer lives than Alt-A mortgages.

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The long-term investment operations generate earnings primarily from net interest income earned on mortgages held for long-term investment, which consists of mortgages held as CMO collateral and mortgages held for investment on our balance sheet. Investment in Alt-A mortgages and multi-family mortgages are initially financed with short-term borrowings under reverse repurchase agreements which are subsequently converted to long-term financing in the form of collateralized mortgage obligations, or CMO, financing. Cash flow from the mortgage loan investment portfolio and proceeds from the sale of capital stock also finance new Alt-A and multi-family mortgage acquisitions and originations.

The warehouse lending operations provide short-term financing to mortgage loan originators, including the mortgage operations, by funding mortgages from their closing date until sale to pre-approved investors. This business earns net interest income from the difference between its cost of borrowings and the interest earned on warehouse advances as well as fees from warehouse transactions.

The mortgage operations acquire and originate primarily adjustable and fixed rate Alt-A mortgages and, to a lesser extent, B/C mortgages as follows:

correspondent acquisitions;

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bulk acquisitions;

wholesale and retail originations; and

B/C originations.

The mortgage operations generate income by securitizing and selling mortgages to permanent investors, including the long-term investment operations. This business also earns revenue from interest income on mortgages held-for-sale and fees associated with mortgage acquisitions and originations, mortgage servicing rights and master servicing agreements. The mortgage operations use warehouse facilities provided by the warehouse lending operations to finance the acquisition and origination of mortgages.

Our goal is to generate consistent reliable income for distribution to our stockholders primarily from earnings generated by our core operating businesses.

Critical Accounting Policies

We define critical accounting policies as those that are important to the portrayal of our financial condition and results of operations and require estimates and assumptions based on our judgment of changing market conditions and the performance of our assets and liabilities at any given time. In determining which accounting policies meet this definition, we considered our policies with respect to the valuation of our assets and liabilities and estimates and assumptions used in determining those valuations. We believe the most critical accounting issues that require the most complex and difficult judgments and that are particularly susceptible to significant change to our financial condition and results of operations include the following:

allowance for loan losses;

derivative financial instruments; and

securitization of financial assets as financing versus sale.

Allowance for loan losses. We provide an allowance for loan losses for mortgages held as CMO collateral, finance receivables and mortgages held-for-investment, or loans provided for. In evaluating the adequacy of the allowance for loan losses, management takes several items into consideration. For instance, a detailed analysis of historical loan performance data is accumulated and reviewed. This data is analyzed for loss performance and prepayment performance by product type, origination year and securitization issuance. The results of that analysis are then applied to the current mortgage portfolio and an estimate is created. We believe that pooling of mortgages with similar characteristics is an appropriate methodology in which to evaluate the allowance for loan losses. In addition, management provides an allowance for loan losses for Alt-A mortgages that are retained for long-term investment and which are not underwritten to our specific underwriting guidelines. These mortgages are acquired on a bulk basis by the mortgage operations from other mortgage originators that underwrite mortgages substantially similar, but not specific, to our mortgage underwriting guidelines, or non-Impac mortgages. Management also recognizes that there are qualitative factors that must be taken into consideration when evaluating and measuring inherent loss in our loan portfolios. These items include, but are not limited to, economic indicators that may affect the borrower's ability to pay, changes in value of collateral, political factors and industry statistics. Specific valuation allowances may be established for loans that are deemed impaired, if default by the borrower is deemed probable, and if the fair value of the loan or the collateral is estimated to be less than the gross carrying value of the loan. Actual losses on loans

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are recorded as a reduction to the allowance through charge-offs. Subsequent recoveries of amounts previously charged off are credited to the allowance. For additional information regarding allowance for loan losses refer to Results of Operations and Financial Condition.

Derivative financial instruments. The mortgage operations acquire derivatives to mitigate changes in the value of its mortgage pipeline. The mortgage pipeline consists of mortgages that have not yet been acquired, however, the mortgage operations has committed to acquire the mortgages in the future at pre-determined interest rates through rate-lock commitments. On March 9, 2004, the SEC issued Staff Accounting Bulletin 105, Application of Accounting Principles to Loan Commitments, or SAB 105, which clarifies the SEC's position on the accounting and valuation for commitments to originate mortgage loans held-for-sale. Consistent with SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, or SFAS 149, SAB 105 states that loan commitments are treated as derivatives. Prior to the issuance of SAB 105, the mortgage operations recorded the fair value of its mortgage pipeline, inclusive of

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changes in benchmark interest rates and acquisition premiums, as it qualifies as a derivative under the provisions of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS 133. Therefore, the mortgage pipeline and the fair value of derivatives were marked to market each reporting period. SAB 105 requires that in valuing these loan commitments entities not include cash flows associated with servicing as to do so would result in the recognition of servicing assets prior to the sale or securitization of funded loans. This valuation methodology limits a company's ability to record an asset for its mortgage pipeline as of the applicable reporting date. Subsequent to SAB 105, as of April 1, 2004 we record the fair value change of the mortgage pipeline based solely on interest rate fluctuations from the date of rate-lock to the applicable reporting date even when the total fair value may include servicing-related acquisition premium. Other derivatives, as accounted for under SFAS 133 and which principally reduce exposure to interest rate risk associated with specific liabilities, are also carried at fair value with changes in fair value reflected in earnings.

Securitization of financial assets as financing versus sale. The mortgage operations recognize gains or losses on the sale of mortgages when the sales transaction settles or upon the securitization of the mortgages when the risks of ownership have passed to the purchasing party. Gains and losses may be increased or decreased by the amount of any servicing related premiums received and costs associated with the acquisition or origination of mortgages. A transfer of financial assets in which control is surrendered is accounted for as a sale to the extent that consideration other than a beneficial interest in the transferred assets is received in the exchange. The long-term investment operations structure CMO securitizations as financing arrangements and recognize no gain or loss on the transfer of mortgage assets. The CMO securitization trusts do not meet criteria within SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140), to be qualifying special purpose entities, and further, are considered variable interest entities under FASB Interpretation No. 46R and, therefore, are consolidated by the long-term investment operations as the entities' primary beneficiary. The mortgage operations structure REMIC securitizations as sales, and gains and losses are recognized. Liabilities and derivatives incurred or obtained at the transfer of financial assets are required to be measured at fair value, if practicable. Also, servicing assets and other retained interests in the transferred assets must be measured by allocating the previous carrying value between the asset sold and the interest retained, if any, based on their relative fair values at the date of transfer. To determine the value of the securities and retained interest, management estimates future rates of prepayments, prepayment penalties to be received, delinquencies, defaults and default loss severity and their impact on estimated cash flows.

Financial Highlights for the First Quarter of 2004

Estimated taxable income per diluted share increased to \$0.75 compared to \$0.73 for the fourth quarter of 2003 and \$0.58 for the first quarter of 2003;

Cash dividends declared per share increased to \$0.65 compared to \$0.55 for the fourth quarter of 2003 and \$0.50 for the first quarter of 2003;

Total assets increased to \$12.9 billion as of March 31, 2004 from \$10.6 billion as of December 31, 2003 and \$7.4 billion as of March 31, 2003;

Book value per share increased to \$8.96 as of March 31, 2004 compared to \$8.39 as of December 31, 2003 and \$6.64 as of March 31, 2003;

Total market capitalization increased to \$1.7 billion as of March 31, 2004 compared to \$1.0 billion as of December 31, 2003 and \$639.1 million as of March 31, 2003;

Dividend yield as of March 31, 2004 was 9.56%, based on annualized first quarter cash dividend of \$0.65 per share and closing stock price of \$27.20 per share;

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The mortgage operations acquired and originated \$3.5 billion of primarily Alt-A mortgages compared to \$3.1 billion for the fourth quarter of 2003 and \$1.8 billion for the first quarter of 2003;

The long-term investment operations retained \$2.9 billion of primarily Alt-A mortgages compared to \$2.3 billion for the fourth quarter of 2003 and \$1.4 billion for the first quarter of 2003; and

IMCC originated \$94.5 million of multi-family mortgages compared to \$84.3 million for the fourth quarter of 2003 and \$42.1 million for the first quarter of 2003.

Table of Contents**Taxable Income**

After adjusting for our estimates of the differences between net earnings and taxable income, estimated taxable income was \$45.5 million, or \$0.75 per diluted share, for the first quarter of 2004 as compared to \$27.6 million, or \$0.58 per diluted share, for the first quarter of 2003. When we file our annual tax returns there are certain adjustments that we make to net earnings and taxable income due to differences in the nature and extent that revenues and expenses are recognized under the two methods. As an example, to calculate taxable income we deduct actual loan losses as compared to the determination of net earnings that require a deduction of loan loss provisions which are determined based on estimated losses inherent in our loan portfolios. To maintain our REIT status, we are required to distribute a minimum of 90% of our annual taxable income to our stockholders. Because we pay dividends based on taxable income, dividends may be more or less than net earnings. As such, we believe that the disclosure of estimated taxable income, which is a non-generally accepted accounting principle, or GAAP, financial measurement, is useful information for our investors. Of estimated taxable income of \$45.5 million, we declared total regular cash dividends of \$40.7 million or \$0.65 per outstanding share during the first quarter of 2004. Upon the filing of our 2002 tax return, we had federal and state net operating tax loss carry-forwards of \$18.7 million that may or may not be used to offset taxable income in subsequent years.

The following table presents a reconciliation of net earnings to estimated taxable income for the periods indicated (dollars in thousands, except per share amounts):

| | For the Three Months Ended March 31, | |
|----------------------------------------------------------------------------------|-------------------------------------------------|------------------|
| | 2004 | 2003 |
| | (as restated) | |
| Net earnings | \$ 9,372 | \$ 24,809 |
| Adjustments to GAAP earnings: | | |
| Loan loss provision | 9,725 | 6,484 |
| Dividend from IFC | 7,500 | 4,455 |
| Fair value of free-standing derivative ⁽¹⁾ | 26,647 | (3,525) |
| Tax deduction for actual loan losses | (2,022) | (3,325) |
| Anticipated partial worthlessness deduction on warehouse advances ⁽²⁾ | (6,000) | |
| Net earnings of IFC ⁽³⁾ | 323 | (1,293) |
| Estimated taxable income ⁽⁴⁾ | <u>\$ 45,545</u> | <u>\$ 27,605</u> |
| Estimated taxable income per diluted share | <u>\$ 0.75</u> | <u>\$ 0.58</u> |
| Estimated taxable income per outstanding share | <u>\$ 0.73</u> | <u>\$ 0.56</u> |
| Diluted weighted average shares outstanding | <u>60,812</u> | <u>47,896</u> |

⁽¹⁾ The mark-to-market change for the valuation of free-standing derivatives is income or expense for GAAP financial reporting but is not included as an addition or deduction for taxable income calculations.

⁽²⁾ Represents estimated partial impairment on specific warehouse advances that we anticipate will be non-collectible. For additional information, refer to Provision for Loan Losses and Allowance for Loan Losses below.

- (3) Represents GAAP net earnings or equity in net earnings of IFC, which may not necessarily equal taxable income. Therefore, dividend distributions from IFC to IMH may exceed IFC's GAAP net earnings.
- (4) Excludes the deduction for dividends paid and the availability of a deduction attributable to net operating loss carry-forwards.

Results of Operations and Financial Condition

Results of Operations-

For the Three Months Ended March 31, 2004 compared to the Three Months Ended March 31, 2003

Net earnings decreased 62% to \$9.4 million, or \$0.15 per diluted share, for the first quarter of 2004 compared to \$24.9 million, or \$0.52 per diluted share, for the first quarter of 2003. The quarter-over-quarter decrease in net earnings of \$15.5 million was primarily due to the following:

\$29.5 million increase in mark-to-market loss derivative instruments;

\$18.3 million increase in non-interest and income tax expense, and

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\$3.2 million increase in provision for loan losses, which was partially offset by;

\$36.4 million increase in net interest income.

These variances are discussed in further detail below.

Mark-to-Market Loss-Derivative Instruments

During the first quarter of 2004, mark-to-market loss on derivative instruments increased \$29.5 million to \$36.6 million as compared to \$7.1 million for the first quarter of 2003. The increase in mark-to-market loss on derivative instruments was the result of changes in future expectations of short term rates which affected the value of our derivatives. We enter into derivative contracts to manage the various risks associated with certain specific liabilities. On the date we enter into various derivative contracts, the derivatives were designated as an economic hedge of the variability in expected future cash flows associated with a financing obligation or future liability. In our consolidated financial statements, we now record a market valuation adjustment for economic hedges and any subsequent cash payments paid or received on these derivatives as a current period expense or revenue in mark-to-market loss derivative instruments on the consolidated financial statements. In addition, we account for certain forward purchase commitments on mortgage loans as free-standing derivatives, and record the change in fair value of such instruments and the related derivatives used to hedge the mortgage pipeline as a current period expense or revenue.

Non-Interest and Income Tax Expense

Non-interest and income tax expense increased to \$20.2 million for the first quarter of 2004 as compared to \$1.8 million for the first quarter of 2003. The quarter-over-quarter increase in non-interest expense of \$18.4 million was primarily due to a \$19.3 million increase in operating costs. The increase in operating costs was primarily due to the consolidation of the mortgage operations on July 1, 2003. Operating costs generated by the mortgage operations was reported on a consolidated basis for the consolidation period, however, for the non-consolidation period the financial results of IFC were reported as equity in net earnings of IFC on the consolidated financial statements. As such, operating costs increased to \$21.1 million for the first quarter of 2004 as compared to \$1.8 million for the first quarter of 2003. Operating costs include personnel expense, professional services, equipment expense, occupancy expense, data processing expense and general and administrative and other expense. Personnel expense, which primarily includes salary, wages and benefit costs, was \$13.7 million, or 72% of total operating costs, during the first quarter of 2004 as compared to \$686,000 during the first quarter of 2003. Personnel related costs are variable expenses and are primarily driven by mortgage acquisitions and originations.

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The following table summarizes the principal balance of mortgage acquisitions and originations by loan characteristic for the periods indicated (in thousands):

| | For the Three Months Ended March 31, | | | |
|----------------------------------------------------------|---------------------------------------------|------------|------------------------------|------------|
| | 2004 | | 2003 | |
| | Principal Balance | % | Principal Balance | % |
| By Loan Type: | | | | |
| Fixed rate first trust deed | \$ 654,398 | 19 | \$ 894,427 | 50 |
| Fixed rate second trust deed | 111,358 | 3 | 28,896 | 2 |
| Adjustable rate: | | | | |
| Primarily six-month LIBOR indexed ARMs ⁽¹⁾ | 669,444 | 19 | 500,067 | 28 |
| Primarily six-month LIBOR indexed hybrids ⁽²⁾ | 2,033,882 | 59 | 347,965 | 20 |
| Total adjustable rate | 2,703,326 | 78 | 848,032 | 48 |
| Total Mortgage Acquisitions and Originations | \$ 3,469,082 | 100 | \$ 1,771,355 | 100 |
| By Production Channel: | | | | |
| Correspondent acquisitions: | | | | |
| Flow | \$ 2,171,424 | 63 | \$ 1,042,306 | 59 |
| Bulk | 782,746 | 22 | 317,409 | 18 |
| Total correspondent acquisitions | 2,954,170 | 85 | 1,359,715 | 77 |
| Wholesale and retail originations | 371,578 | 11 | 305,090 | 17 |
| Novelle Financial Services, Inc. | 143,334 | 4 | 106,550 | 6 |
| Total Mortgage Acquisitions and Originations | \$ 3,469,082 | 100 | \$ 1,771,355 | 100 |
| By Credit Quality: | | | | |
| Alt-A | \$ 3,312,135 | 95 | \$ 1,656,908 | 94 |
| B/C ⁽³⁾ | 156,947 | 5 | 114,447 | 6 |
| Total Mortgage Acquisitions and Originations | \$ 3,469,082 | 100 | \$ 1,771,355 | 100 |
| By Purpose: | | | | |
| Purchase | \$ 2,055,085 | 59 | \$ 764,032 | 43 |
| Refinance | 1,413,997 | 41 | 1,007,323 | 57 |
| Total Mortgage Acquisitions and Originations | \$ 3,469,082 | 100 | \$ 1,771,355 | 100 |
| By Prepayment Penalty: | | | | |
| With prepayment penalty | \$ 2,435,576 | 70 | \$ 1,471,904 | 83 |
| Without prepayment penalty | 1,033,506 | 30 | 299,451 | 17 |
| Total Mortgage Acquisitions and Originations | \$ 3,469,082 | 100 | \$ 1,771,355 | 100 |

- (1) Also includes minimal principal balances of one-year LIBOR and constant maturity Treasury ARMs.
- (2) Mortgages are fixed rate for initial two to five year periods and subsequently adjust to the indicated index plus a margin.
- (3) The first quarter of 2004 and 2003 includes \$143.3 million and \$106.6 million, respectively, of B/C mortgages originated by NFS, a subsidiary of IFC, that are subsequently sold to third party investors for cash gains.

We believe that our efficient centralized operating structure and our web-based automated underwriting system, iDASLg2, allows us to maintain our position as a low cost nationwide acquirer and originator of Alt-A mortgages. In addition, a higher percentage of non-Impac mortgage acquisitions during the first quarter of 2004 contributed to lower per loan acquisition costs as compared to the first quarter of 2003 as non-Impac Alt-A mortgage acquisitions generally require less staffing and corresponding operating costs than Impac Alt-A mortgages, which are acquired on a flow, or loan-by-loan basis.

Provision for Loan Losses

Provision for loan losses increased \$3.2 million to \$9.7 million for the first quarter of 2004 compared to \$6.5 million for the first quarter of 2003. The quarter-over-quarter increase in provision for loan losses was primarily due to an increase in our mortgage loan portfolio as the long-term investment operations retained \$7.2 billion of primarily Alt-A mortgages from the mortgage operations and \$342.9 million of multi-family mortgages originated by IMCC since the end of the first quarter of 2003, which required a corresponding increase in allowance for loan losses.

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In addition, at the end of the first quarter of 2004, we discovered that one client of the warehouse lending operations and certain of its officers had perpetrated a fraud pursuant to which they defrauded the warehouse lending operations into making advances pursuant to a warehouse line of credit. As of the date the fraud was discovered, an aggregate of \$12.6 million of fraudulent loan advances were outstanding. We immediately terminated the warehouse line of credit and have been cooperating with federal investigators in their ongoing investigation of the defrauding parties. It appears that the defrauding parties had perpetrated a similar fraud on another warehouse lender. We retained an independent consultant to investigate the matter; the investigator reported that no principals of the warehouse lending operations had knowingly participated in the fraud and stated that it is not likely that any other client of the warehouse lending operations could duplicate the same fraud. With the aid of independent counsel, the audit committee of our board of directors reviewed the report and the scope of the investigation and concurs with the assessment set forth in the report. In response, we have taken steps to enhance procedures at our warehouse lending operations, including improvements of the application approval and funding processes of mortgage bankers and follow-up quality control checks. As a result of the fraud, during the first quarter of 2004 we established a specific allowance for loan losses in the amount of \$6.0 million to provide for anticipated losses on the fraudulent warehouse advances as we have deemed this amount to be non-collectible. Based on available information, we believe we will be able to recover the remaining \$6.6 million of related warehouse advances over time. To the extent that we believe that the actual losses will exceed the \$6.0 million allowance, we will make an additional allowance for loan losses when, or if, we determine it is appropriate to do so as events and circumstances dictate. However, we believe that this specific allowance is adequate to provide for anticipated loan losses based on currently available information.

Net Interest Income

We earn interest income primarily on mortgage assets which include CMO collateral, mortgages held-for-investment, mortgages held-for-sale, finance receivables and investment securities available-for-sale, or collectively, mortgage assets, and, to a lesser extent, interest income earned on cash and cash equivalents. Interest expense is primarily interest paid on borrowings on mortgage assets, which include CMO borrowings, reverse repurchase agreements and borrowings on investment securities available-for-sale.

Net interest income increased \$36.4 million to \$73.1 million for the first quarter of 2004 compared to \$36.7 million for the first quarter of 2003. The quarter-over-quarter increase in net interest income was primarily due to an increase in average mortgage assets, which increased to \$11.4 billion for the first quarter of 2004 compared to \$6.3 billion for the first quarter of 2003 as the long-term investment operations retained \$7.2 billion of primarily Alt-A mortgages from the mortgage operations and \$342.9 million of multi-family mortgages originated by IMCC since the end of the first quarter of 2003. We primarily retain Alt-A mortgages that are acquired and originated by the mortgage operations and multi-family mortgages originated by IMCC that fit within our investment criteria. Alt-A and multi-family mortgages are ARMs and FRMs with good credit profiles with mortgage insurance enhancements, when required, that generally have prepayment penalty features and are primarily purchase money transactions.

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The following table summarizes the principal balance of Alt-A mortgages acquired by the long-term investment operations from the mortgage operations and multi-family mortgages originated by IMCC by loan characteristic for the periods indicated (in thousands):

| | For the Three Months Ended March 31, | | | |
|-------------------------------------------------------------|--------------------------------------|------------|----------------------|------------|
| | 2004 | | 2003 | |
| | Principal Balance | % | Principal Balance | % |
| Volume by Type: | | | | |
| Adjustable rate | \$ 2,696,543 | 92 | \$ 866,253 | 60 |
| Fixed rate | 249,883 | 8 | 567,986 | 40 |
| Total Mortgage Acquisitions | \$ 2,946,426 | 100 | \$ 1,434,239 | 100 |
| Volume by Product: | | | | |
| Primarily six-month LIBOR indexed ARMs ⁽¹⁾ | \$ 676,743 | 23 | \$ 491,241 | 34 |
| Primarily six-month LIBOR indexed hybrids ⁽¹⁾⁽²⁾ | 2,019,800 | 69 | 375,011 | 26 |
| Fixed rate first trust deeds | 249,883 | 8 | 564,639 | 39 |
| Fixed rate second trust deeds | | 0 | 3,348 | 1 |
| Total Mortgage Acquisitions | \$ 2,946,426 | 100 | \$ 1,434,239 | 100 |
| Volume by Credit Quality: | | | | |
| Alt-A loans | \$ 2,934,124 | 100 | \$ 1,427,484 | 100 |
| B/C loans ⁽³⁾ | 12,302 | 0 | 6,755 | 0 |
| Total Mortgage Acquisitions | \$ 2,946,426 | 100 | \$ 1,434,239 | 100 |
| Volume by Purpose: | | | | |
| Purchase | \$ 1,839,942 | 62 | \$ 611,529 | 43 |
| Refinance | 1,106,484 | 38 | 822,710 | 57 |
| Total Mortgage Acquisitions | \$ 2,946,426 | 100 | \$ 1,434,239 | 100 |
| Volume by Prepayment Penalty: | | | | |
| With prepayment penalty | \$ 2,247,046 | 76 | \$ 1,163,745 | 81 |
| Without prepayment penalty | 699,380 | 24 | 270,494 | 19 |
| Total Mortgage Acquisitions | \$ 2,946,426 | 100 | \$ 1,434,239 | 100 |

⁽¹⁾ Also includes minimal principal balances of one-year LIBOR and constant maturity Treasury ARMs.

⁽²⁾ Mortgages are fixed rate for initial two to five year periods and subsequently adjust to the indicated index plus a margin.

⁽³⁾ B/C loans, as defined by us, which were acquired and originated through correspondent or wholesale channels.

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The increase in net interest income was also due to an increase in net interest margins on mortgage assets, which increased 21 basis points to 2.54% for the first quarter of 2004 as compared to 2.33% for the first quarter of 2003. The following table summarizes average balance, interest and weighted average yield on mortgage assets and borrowings on mortgage assets for the periods indicated (dollars in thousands):

| | For the Three Months Ended March 31, | | | | | |
|-------------------------------------------------------------------------------|--------------------------------------|-------------------|------------------------|---------------------|------------------|--------------|
| | 2004 | | | 2003 | | |
| | Average Balance | Interest | Yield (as restated) | Average Balance | Interest | Yield |
| MORTGAGE ASSETS | | | | | | |
| Investment securities available-for-sale | \$ 12,981 | \$ 907 | 27.95% | \$ 25,536 | \$ 630 | 9.87% |
| CMO collateral ⁽¹⁾ | 9,540,537 | 106,777 | 4.48 | 5,541,476 | 72,309 | 5.22% |
| Mortgages held-for-investment and mortgages held-for-sale ⁽²⁾ | 1,434,117 | 21,486 | 5.99 | 180,912 | 2,540 | 5.62 |
| Finance receivables ⁽³⁾ | 457,039 | 5,097 | 4.46 | 523,182 | 6,737 | 5.15 |
| Total mortgage assets | \$ 11,444,674 | \$ 134,267 | 4.69% | \$ 6,271,106 | \$ 82,216 | 5.24% |
| BORROWINGS | | | | | | |
| CMO borrowings | \$ 9,307,437 | \$ 51,994 | 2.23% | \$ 5,425,691 | \$ 38,294 | 2.82% |
| Reverse repurchase agreements | 1,742,935 | 9,554 | 2.19 | 1,129,251 | 6,790 | 2.41 |
| Borrowings secured by investment securities ⁽⁴⁾ | | | | 6,233 | 632 | 40.56 |
| Total borrowings on mortgage assets | \$ 11,050,372 | \$ 61,548 | 2.23% | \$ 6,561,175 | \$ 45,716 | 2.79% |
| Net Interest Spread ⁽⁵⁾ | | | 2.46% | | | 2.45% |
| Net Interest Margin ⁽⁶⁾ | | | 2.54% | | | 2.33% |
| Net Cash Payments on Derivatives ⁽⁷⁾ | | \$ 12,323 | | | \$ 10,642 | |
| Net Interest Margin including Net Cash Payments on Derivatives ⁽⁸⁾ | | | 2.11% | | | 1.65% |

(1) Interest includes \$17.2 million and \$8.9 million, respectively, of amortization of acquisition costs on mortgages acquired from the mortgage operations. Interest also includes \$8.2 million and \$4.3 million, respectively, of accretion of loan discounts, which represents the amount allocated to MSRs when they are sold to third parties and mortgages are transferred from the mortgage operations to the long-term investment operations and retained for long-term investment.

(2) Includes mortgages held-for-sale which were acquired via the consolidation of the mortgage operations on July 1, 2003.

(3) Total average borrowings on mortgage assets exceed total average mortgage assets during the three months ended March 31, 2003 as we eliminated warehouse borrowings between the warehouse lending operations and mortgage operations prior to July 1, 2003 as part of the accounting restatements.

(4) Payments and excess cash flows received from investment securities collateralizing these borrowings were used to pay down the outstanding borrowings. The payments were received from a collateral base that was in excess of the borrowings. Therefore, while the payment amounts remained relatively stable, the average balance of the borrowings continued to decline. These borrowings were repaid during the third quarter of 2003.

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- (5) Net interest spread is calculated by subtracting the weighted average yield on total borrowings on mortgage assets from the weighted average yield on total mortgage assets.
- (6) Net interest margin is calculated by subtracting interest expense on total borrowings on mortgage assets from interest income on total mortgage assets and then dividing by total average mortgage assets.
- (7) Represents net cash paid on derivatives, which is a component of mark-to-market loss on derivative instruments on the consolidated financial statements.
- (8) Net interest margin including net cash payments on derivatives is calculated by subtracting interest expense on total borrowings on mortgage assets and net cash payments on derivatives from interest income on total mortgage assets and then dividing by total average mortgage assets.

The increase in net interest margins was primarily due to the consolidation of the mortgage operations on July 1, 2003. Net interest income generated by the mortgage operations was reported on a consolidated basis for the consolidation period, however, for the non-consolidation period the financial results of IFC were reported as equity in net earnings of IFC on the consolidated financial statements. As such, the consolidation of the mortgage operations resulted in a 30 basis point increase in net interest margins on Mortgage Assets during the first quarter of 2004 as mortgages held-for-sale were consolidated with total average mortgage assets. During the first quarter of 2003, mortgages held-for-sale were not consolidated with total average mortgage assets as the mortgage operations was a non-consolidating entity prior to July 1, 2003.

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Net interest margins on mortgage assets are susceptible to changes in interest rates due to mismatched interest rate adjustments between mortgage assets and borrowings on mortgage assets as follows:

interest rate adjustment limitations on mortgages held for long-term investment due to periodic and lifetime interest rate cap features which are not limited on CMO and warehouse borrowings;

mismatched interest rate adjustment periods between mortgages held for long-term investment and CMO and warehouse borrowings; and

mismatched interest rate indexes on mortgages held for long-term investment and CMO and warehouse borrowings.

Some examples of mismatched interest rate adjustments on mortgage assets and borrowings on mortgage assets include the following:

at the time mortgages are retained for long-term investment, ARMs have initial coupons above the fully-indexed rate, which is the margin on the mortgage plus the index. Upon the mortgage interest rate reset date, interest rates on ARMs adjust downward to the fully-indexed rate. The reset to lower coupons on these mortgages during low interest rate environments is consistent with our strategy to mitigate the borrower's propensity to refinance their mortgage, which we believe will extend the duration of the mortgages;

hybrid ARMs acquired for long-term investment have initial fixed interest rate periods of two- to five years which subsequently convert to ARMs as compared to adjustable rate CMO and warehouse borrowings that are indexed to one-month LIBOR and are, therefore, not constrained by interest rate changes; and

the interest rate index used for ARMs, which is primarily six-month LIBOR, adjust unequally as compared to the interest rate index used for adjustable rate CMO and warehouse borrowings, which are primarily indexed to one-month LIBOR.

Therefore, our interest rate risk management policies are formulated with the intent to offset the potential adverse effects of changing interest rates on mortgage assets and borrowings on mortgage assets which may result in variability in net interest margins. For further information on our interest rate risk management policies refer to Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Results of Operations by Business Segment-

For the Three Months Ended March 31, 2004 compared to the Three Months Ended March 31, 2003

Long-Term Investment Operations

Net earnings from the long-term investment operations was \$6.3 million for the first quarter of 2004 as compared to \$18.2 million for the first quarter of 2003. The decrease in net earnings of \$11.9 million was primarily due to the following:

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\$31.9 million increase in mark-to-market loss derivative instruments, which was partially offset by:

\$20.1 million increase in net interest income.

Mark-to-market loss derivative instruments. Mark-to-market loss derivative instruments increased by \$31.9 million to a loss of \$39.0 million for the first quarter of 2004 as compared to a loss of \$7.1 million for the first quarter of 2003. Mark-to-market loss derivative instruments declined as future expectations of short-term rates positively affected the value of derivatives.

Net interest income. Net interest income rose by \$20.1 million to \$51.4 million for the first quarter of 2004 as compared to \$31.3 million for the first quarter of 2003 primarily due to an increase in total average mortgage assets. Mortgage assets increased as the long-term investment operations retained \$7.2 billion of primarily Alt-A mortgages from the mortgage operations and \$342.9 million of multi-family mortgages originated by IMCC since the end of the first quarter of 2003, which in turn led to an increase in average CMO collateral and mortgages held-for-investment as shown in the comparative yield table above. Refer to Note C. Segment Reporting in the notes to consolidated financial statements for additional detail.

Table of Contents*Mortgage Operations*

Net earnings from the mortgage operations include its results of operations for the consolidation period on a consolidated basis, see

Consolidation of IFC above. Prior to the consolidation of IFC, its results of operations were included in equity in net earnings of IFC on the consolidated financial statements. Equity in net earnings of IFC is reflected in the Inter-company segment for purposes of segment reporting as shown in Note C. Segment Reporting in the notes to consolidated financial statements. As such, net earnings from the mortgage operations was a loss of \$323,000 during the consolidation period while equity in net earnings of IFC during the non-consolidation period was \$1.3 million.

Warehouse Lending Operations

Net earnings from the warehouse lending operations was \$3.4 million for the first quarter of 2004 as compared to \$5.7 million for the first quarter of 2003. The decrease in net earnings of \$2.3 million was primarily due to a decrease in net interest income. Net interest income declined during the first quarter of 2004 as total average finance receivables declined to \$457.0 million as compared to \$523.2 million during the first quarter of 2003 as shown in the comparative yield table above. Refer to Note C. Segment Reporting in the notes to consolidated financial statements for additional detail.

Financial Condition-

Total assets grew 22% to \$12.9 billion as of March 31, 2004 as compared to \$10.6 billion as of December 31, 2003 as the long-term investment operations retained \$2.9 billion of primarily adjustable rate and fixed rate Alt-A mortgages and multi-family mortgages during the first quarter of 2004. The following table presents selected financial data as of the dates indicated (dollars in thousands, except per share data and master servicing portfolio):

| | As of and For the Quarter Ended, | | |
|-------------------------------------------------------------------------------------|-----------------------------------------|------------------------------|---------------------------|
| | March 31, 2004 | December 31, 2003 | March 31, 2003 |
| Book value per share | \$ 8.96 | \$ 8.39 | \$ 6.64 |
| Return on average assets | 0.32% | 1.95% | 1.44% |
| Return on average equity | 7.37% | 49.57% | 33.01% |
| Assets to equity ratio | 23.04:1 | 22.35:1 | 22.58:1 |
| Debt to equity ratio | 21.83:1 | 21.28:1 | 21.39:1 |
| Mortgages owned 60+ days delinquent | \$ 192,464 | \$ 175,313 | \$ 190,003 |
| 60+ day delinquency of mortgages owned | 1.62% | 1.79% | 3.17% |
| Mortgages owned 90+ days delinquent and other real estate owned | \$ 142,379 | \$ 140,369 | \$ 155,597 |
| 90+ days delinquency of mortgages owned and other real estate owned to total assets | 1.10% | 1.33% | 2.11% |
| Master servicing portfolio (in billions) | \$ 16,240 | \$ 13,920 | \$ 9,529 |

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The retention of mortgages during the first quarter of 2004 resulted in a 30% increase in mortgages held as CMO collateral to \$11.2 billion as of March 31, 2004 as compared to \$8.6 billion as of December 31, 2003. The following table presents selected information about mortgages held as CMO collateral as of the dates indicated:

| | As of | | |
|------------------------------------------------|-----------|--------------|-----------|
| | March 31, | December 31, | March 31, |
| | 2004 | 2003 | 2003 |
| Percent of Alt-A mortgages | 99 | 99 | 99 |
| Percent of ARMs | 88 | 86 | 79 |
| Percent of FRMs | 12 | 14 | 21 |
| Percent of hybrid ARMs | 55 | 48 | 31 |
| Weighted average coupon | 5.53 | 5.56 | 6.29 |
| Weighted average margin | 3.19 | 3.10 | 2.99 |
| Weighted average original LTV | 78 | 79 | 80 |
| Weighted average original credit score | 695 | 694 | 687 |
| Prior 3-month constant prepayment rate, or CPR | 25 | 31 | 24 |
| Prior 12-month CPR | 31 | 28 | 24 |
| Percent with active prepayment penalty | 80 | 81 | 78 |
| Percent of mortgages in California | 64 | 64 | 62 |
| Percent of purchase transactions | 59 | 57 | 57 |
| Percent of owner occupied | 86 | 87 | 91 |
| Percent of first lien | 99 | 99 | 99 |

We believe that in order for us to generate positive cash flows and earnings we must successfully manage the following primary operational and market risks:

credit risk;

prepayment risk;

liquidity risk; and

interest rate risk.

Credit Risk. We manage credit risk by retaining for long-term investment high credit quality Alt-A and multi-family mortgages, adequately providing for loan losses and actively managing delinquencies and defaults. Alt-A mortgages are primarily first lien mortgages made to borrowers whose credit is generally within typical Fannie Mae and Freddie Mac guidelines, but that have loan characteristics that make them non-conforming under those guidelines.

We believe that by improving the overall credit quality of our long-term mortgage portfolio we can consistently generate stable future cash flow and net earnings. As of March 31, 2004, the original weighted average credit score of mortgages held as CMO collateral was 695 and the original weighted average LTV ratio was 78%. During the first quarter of 2004, we retained \$2.9 billion of primarily adjustable and fixed rate

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Alt-A mortgages that were acquired or originated by the mortgage operations with an original weighted average credit score of 697 and an original weighted average LTV ratio of 78%. In addition, during the first quarter of 2004, we retained \$639.0 million of non-Impac mortgages that were acquired by the mortgage operations with an original weighted average credit score of 702 and an original weighted average LTV ratio of 78%. IMCC also originated \$94.5 million of multi-family mortgages with a weighted average credit score of 722 and an original weighted average LTV of 66%.

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We monitor our sub-servicers to make sure that they perform loss mitigation, foreclosure and collection functions according to our servicing guide. This includes an effective and aggressive collection effort in order to minimize mortgages from becoming seriously delinquent. However, when resolving delinquent mortgages, sub-servicers are required to take timely and aggressive action. The sub-servicer is required to determine payment collection under various circumstances, which will result in maximum financial benefit. This is accomplished by either working with the borrower to bring the mortgage current or by foreclosing and liquidating the property. We perform ongoing review of mortgages that display weaknesses and believe that we maintain adequate loss allowance on the mortgages. When a borrower fails to make required payments on a mortgage and does not cure the delinquency within 60 days, we generally record a notice of default and commence foreclosure proceedings. If the mortgage is not reinstated within the time permitted by law for reinstatement, the property may then be sold at a foreclosure sale. In foreclosure sales, we generally acquire title to the property. As of March 31, 2004, our long-term mortgage portfolio included 1.62% of mortgages that were 60 days or more delinquent compared to 1.79% as of December 31, 2003. The following table summarizes mortgages in our long-term mortgage portfolio that were 60 or more days delinquent for the periods indicated (in thousands):

| | At March 31, 2004 | At December 31, 2003 |
|-----------------------------------------|----------------------|-------------------------|
| 60-89 days delinquent | \$ 66,246 | \$ 51,173 |
| 90 or more days delinquent | 37,936 | 52,080 |
| Foreclosures | 78,521 | 66,767 |
| Delinquent bankruptcies | 9,761 | 5,293 |
| Total 60 or more days delinquent | \$ 192,464 | \$ 175,313 |

Seriously delinquent assets consist of mortgages that are 90 days or more delinquent, including loans in foreclosure and delinquent bankruptcies. When real estate is acquired in settlement of loans, or other real estate owned, the mortgage is written-down to a percentage of the property's appraised value or broker's price opinion. As of March 31, 2004, seriously delinquent assets and other real estate owned as a percentage of total assets was 1.10% as compared to 1.33% as of December 31, 2003. The following table summarizes mortgages in our long-term mortgage portfolio that were seriously delinquent and other real estate owned for the periods indicated (in thousands):

| | At March 31, 2004 | At December 31, 2003 |
|----------------------------|----------------------|-------------------------|
| 90 or more days delinquent | \$ 126,218 | \$ 124,140 |
| Other real estate owned | 16,161 | 16,229 |
| Total | \$ 142,379 | \$ 140,369 |

Additionally, an allowance is maintained for losses on mortgages held-for-investment, mortgages held as CMO collateral and finance receivables (loans provided for) at an amount that management believes provides for losses inherent in those loan portfolios. We have implemented a methodology designed to analyze the performance of various loan portfolios, based upon the relatively homogeneous nature within these loan portfolios. The allowance for losses is also analyzed using the following factors:

management's judgment of the net loss potential of mortgages in the long-term mortgage portfolio based on prior loan loss experience;

changes in the nature and volume of the long-term mortgage portfolio;

value of the collateral;

delinquency trends; and

current economic conditions that may affect the borrowers' ability to pay.

In evaluating the adequacy of the allowance for loan losses, a detailed analysis of historical loan performance data is accumulated and reviewed. This data is analyzed for loss performance and prepayment performance by product type, origination year and securitization issuance. The results of that analysis are then applied to the current mortgage portfolio and an estimate is created. We believe that pooling of mortgages with similar characteristics is an appropriate methodology in which to evaluate the allowance for loan losses. In addition, management provides an allowance for loan losses for Alt-A mortgages that are retained for long-term investment and which are not underwritten to our specific underwriting guidelines. These mortgages are acquired on a bulk basis by the mortgage operations from other mortgage originators that underwrite mortgages substantially similar, but not specific, to our mortgage underwriting guidelines, or non-Impac mortgages. Management also recognizes that there are qualitative factors that must be taken into consideration when evaluating and measuring inherent loss in our loan portfolios. These items include, but are not limited to, economic indicators that may affect the borrower's ability to pay, changes in value of collateral, political factors and industry statistics.

Additions to the allowance are provided through a charge to earnings. Specific valuation allowances may be established for loans that are deemed impaired, if default by the borrower is deemed probable, and if the fair value of the loan or the collateral is estimated to be less than the gross carrying value of the loan. Actual losses on loans are recorded as a reduction to the allowance through charge-offs. Subsequent recoveries of amounts previously charged off are credited to the allowance. For loans on non-accrual status, cash receipts are applied, and interest income is recognized, on a cash basis.

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For all other impaired loans, cash receipts are applied to principal and interest in accordance with the contractual terms of the loan and interest income is recognized on the accrual basis. Generally, a loan may be returned to accrual status when all delinquent principal and interest are brought current in accordance with the terms of the loan agreement.

As of March 31, 2004, allowance for loan losses increased to \$46.3 million as compared to \$38.6 million as of December 31, 2003 as we retained \$2.9 billion of mortgages year-to-date and increased allowance for loan losses accordingly. In addition, we established a specific allowance for loan losses in the amount of \$6.0 million to provide for anticipated losses on the fraudulent warehouse advances, as discussed above, as we have deemed this amount to be non-collectible. In our opinion and in accordance with our loan loss allowance methodology, we believe that the present allowance for loan losses is adequate to provide for losses inherent in our loan portfolios.

Prepayment Risk. As of March 31, 2004, 80% of mortgages held as CMO collateral had prepayment penalty features as compared to 81% as of December 31, 2003. 76% of Alt-A mortgages retained during the first quarter of 2004 had prepayment penalty features ranging from two to seven years as compared to 81% during the first quarter of 2003. Mortgages held as CMO collateral had a 25% CPR during the first quarter of 2004 as compared to 24% CPR during the first quarter of 2003.

Liquidity Risk. We employ a leveraging strategy to increase assets by financing our long-term mortgage portfolio primarily with CMO borrowings, reverse repurchase agreements and capital and then using cash proceeds to acquire additional mortgage assets. We retain ARMs and FRMs that are acquired and originated by the mortgage operations and finance the acquisition of those mortgages, during this accumulation period, with reverse repurchase agreements. After accumulating a pool of mortgages, generally between \$200 million and \$1.0 billion, we securitize the mortgages in the form of CMOs. Our strategy is to securitize our mortgages every 15 to 45 days in order to reduce the accumulation period that mortgages are outstanding on short-term warehouse or reverse repurchase facilities, which reduces our exposure to margin calls on these facilities. CMOs are classes of bonds that are sold to investors in mortgage-backed securities and as such are not subject to margin calls. In addition, CMOs generally require a smaller initial cash investment as a percentage of mortgages financed than does interim warehouse and reverse repurchase financing.

Because of the prepayment and loss rates of our Alt-A mortgages, we have received favorable credit ratings on our CMOs from credit rating agencies, which has reduced our required initial capital investment as a percentage of mortgages securing CMO financing. The ratio of total assets to total equity, or leverage ratio, was 23.04 to 1 as of March 31, 2004 compared to 22.35 to 1 as of December 31, 2003. We continually monitor our leverage ratio and liquidity levels to insure that we are adequately protected against adverse changes in market conditions. For additional information regarding liquidity refer to *Liquidity and Capital Resources* below.

Interest Rate Risk. Refer to Item 3. *Quantitative and Qualitative Disclosures About Market Risk.*

Liquidity and Capital Resources

We recognize the need to have funds available for our operating businesses and our customer's demands for obtaining short-term warehouse financing until the settlement or sale of mortgages with us or with other investors. It is our policy to have adequate liquidity at all times to cover normal cyclical swings in funding availability and mortgage demand and to allow us to meet abnormal and unexpected funding requirements. We plan to meet liquidity through normal operations with the goal of avoiding unplanned sales of assets or emergency borrowing of funds. Toward this goal, our asset/liability committee, or ALCO, is responsible for monitoring our liquidity position and funding needs. ALCO is comprised of senior executives of the mortgage operations and warehouse lending operations. ALCO meets on a weekly basis to review current and projected sources and uses of funds. ALCO monitors the composition of the balance sheet for changes in the liquidity of our assets. Our

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primary liquidity consists of cash and cash equivalents and maturing mortgages, or liquid assets. We believe that current cash balances, currently available financing facilities, capital raising capabilities and excess cash flows generated from our long-term mortgage portfolio will adequately provide for projected funding needs and asset growth. However, if we are unable to raise capital in the future, we may not be able to grow as planned. Refer to Risk Factors for additional information regarding risks that could adversely affect our liquidity.

Our operating businesses primarily use available funds as follows:

acquisition and origination of mortgages,

investment in mortgages;

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provide short-term warehouse advances to affiliates and non-affiliated clients; and

pay common stock dividends.

Acquisition and origination of mortgages. During the first quarter of 2004, the mortgage operations acquired \$3.5 billion of primarily Alt-A mortgages, of which \$2.9 billion was retained for long-term investment. Capital invested in mortgages is outstanding until we sell or securitize mortgages, which is one of the reasons we attempt to sell or securitize mortgages between 15 to 45 days of acquisition or origination. Initial capital invested in mortgages includes premiums paid when mortgages are acquired and originated and initial capital investment, or haircut, required upon financing, which is generally determined by the type of collateral provided. The mortgage operations paid weighted average premiums of 2.29% on the principal balance of mortgages acquired and originated during the first quarter of 2004, which were financed with warehouse borrowings at a haircut generally between 2% to 5% of the outstanding principal balance of the mortgages.

When we finance mortgages with long-term CMO borrowings, we repay short-term warehouse financing and recoup our 2% to 5% haircut. Then, depending on credit ratings from national credit rating agencies on our CMOs, we are generally required to provide an over-collateralization, or OC, of 0.50% to 1% of the principal balance of mortgages securing CMO financing as compared to a haircut of 2% to 5% of the principal balance of mortgages securing short-term warehouse financing. Our total capital investment in CMOs generally range from approximately 3% to 5% of the principal balance of mortgages securing CMO borrowings which includes premiums paid upon acquisition of mortgages, costs paid for completion of CMOs, costs to acquire derivatives and OC required to achieve desired credit ratings.

In addition, IMCC originated \$94.5 million of multi-family mortgages which were initially financed with short-term warehouse financing that generally require a 10% to 15% haircut. Multi-family mortgages are either sold as whole loan sales or are financed with CMO borrowings at lower OC requirements than haircut requirements for warehouse financing.

Provide short-term warehouse advances to affiliates and non-affiliates. We utilize committed and uncommitted warehouse facilities with various lenders to provide short-term warehouse financing to affiliates and non-affiliated clients of the warehouse lending operations.

The warehouse lending operations provides short-term financing to the mortgage operations and non-affiliated clients from the closing of mortgages to their sale or other settlement with investors. The warehouse lending operations generally finances between 95% and 98% of the fair market value of the principal balance of mortgages, which equates to a haircut requirement of between 2% and 5%, at prime rate plus a spread. The mortgage operations has uncommitted warehouse line agreements to obtain financing of up to \$800.0 million from the warehouse lending operations at prime minus 0.50% during the period that the mortgage operations accumulates mortgages until the mortgages are securitized or sold. In addition, as of March 31, 2004, the warehouse lending operations had \$917.0 million of approved warehouse lines available to non-affiliated clients, of which \$526.4 million was outstanding.

Our ability to meet liquidity requirements and the financing needs of our customers is subject to the renewal of our credit and repurchase facilities or obtaining other sources of financing, if required, including additional debt or equity from time to time. Any decision our lenders or investors make to provide available financing to us in the future will depend upon a number of factors, including:

our compliance with the terms of our existing credit arrangements;

our financial performance;

industry and market trends in our various businesses;

the general availability of and rates applicable to financing and investments;

our lenders or investors resources and policies concerning loans and investments; and

the relative attractiveness of alternative investment or lending opportunities.

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Pay common stock dividends. We did not pay common stock dividends that normally would have been paid during the first quarter of 2004 as the fourth quarter of 2003 dividend was paid in December 2003. We are required to distribute a minimum of 90% of our taxable income to our stockholders in order to maintain our REIT status, exclusive of the application of any tax loss carry forwards that may be used to offset current period taxable income. Because we pay dividends based on taxable income, dividends may be more or less than net earnings. We declared cash dividends of \$0.65 per outstanding share during the first quarter of 2004. A portion of dividends paid to IMH's stockholders come from dividend distributions from the mortgage operations to IMH. During the first quarter of 2004, the mortgage operations provided a dividend distribution of \$7.5 million to IMH. However, because the mortgage operations may seek to retain earnings to fund the acquisition and origination of mortgages or to expand the mortgage operations, the board of directors may decide that the mortgage operations should cease making dividend distributions in the future. This could reduce the amount of taxable income that would be distributed to IMH stockholders in the form of dividends.

Our operating businesses are primarily funded as follows:

CMO borrowings and reverse repurchase agreements;

excess cash flows from our long-term mortgage portfolio;

sale and securitization of mortgages; and

cash proceeds from the issuance of securities.

CMO borrowings and reverse repurchase agreements. We use CMO borrowings and reverse repurchase agreements to fund substantially all warehouse financing to affiliates and non-affiliated clients and the acquisition and origination of mortgages. As we accumulate mortgages, we finance the acquisition of mortgages primarily through borrowings on reverse repurchase agreements with third party lenders. We primarily use committed and uncommitted repurchase facilities with major investment banks to finance substantially all warehouse financing, as needed. During 2003, we added an additional \$750.0 million of new uncommitted warehouse facilities to finance asset growth. The new warehouse facilities provide us with a higher aggregate credit limit to fund the acquisition and origination of mortgages at terms comparable to those we have received in the past. These reverse repurchase agreements may have certain covenant tests which we continue to satisfy. As of March 31, 2004, the warehouse lending operations had \$1.95 billion of committed and uncommitted repurchase facilities with various lenders of which \$1.1 billion was outstanding. Of total repurchase facilities, one of our lenders provides financing up to \$125.0 million to finance the origination of multi-family mortgages.

From time to time, we may utilize term reverse repurchase financing provided to us by an underwriter who underwrites some of our securitizations. The term reverse repurchase financing funds mortgages that are specifically allocated to securitization transactions, which allows us to reduce overall borrowings outstanding on reverse repurchase agreements with other lenders during the period immediately prior to the settlement of the securitization. Terms and interest rates on the term reverse repurchase facilities are similar to other reverse repurchase agreements. Term reverse repurchase financing are generally repaid with 30 days from the date funds are advanced. During the first quarter of 2004, average balances outstanding on term reverse repurchases were \$258.9 million.

We expect to continue to use short-term warehouse facilities to fund the acquisition of mortgages. If we cannot renew or replace maturing borrowings, we may have to sell, on a whole loan basis, the mortgages securing these facilities, which, depending upon market conditions may result in substantial losses. Additionally, if for any reason the market value of our mortgages securing warehouse facilities decline, our lenders may require us to provide them with additional equity or collateral to secure our borrowings, which may require us to sell mortgages at substantial losses.

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In order to mitigate the liquidity risk associated with reverse repurchase agreements, we attempt to sell or securitize our mortgages between 15 to 45 days from acquisition or origination. Although securitizing mortgages more frequently adds operating and securitization costs, we believe the added cost is offset as liquidity is provided more frequently with less interest rate and price volatility, as the accumulation and holding period of mortgages is shortened. When we have accumulated a sufficient amount of mortgages, generally between \$200 million and \$1.0 billion, we seek to issue CMOs and convert short-term advances under reverse repurchase agreements to long-term CMO borrowings. The use of CMO borrowings provides the following benefits:

allows us to lock in our financing cost over the life of the mortgages securing the CMO borrowings;

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provides a perfect duration match between mortgages held as CMO collateral and CMO borrowings; and

eliminates margin calls on reverse repurchase borrowings that are converted to CMO financing as well as associated derivative instruments that hedge CMO financing.

During the first quarter of 2004, we completed \$3.4 billion of CMOs, of which \$3.1 billion were adjustable rate CMOs and \$253.5 million were fixed rate CMOs, to provide long-term financing for the retention of primarily Alt-A mortgages and the origination of multi-family mortgages. Because of the credit profile, historical loss performance and prepayment characteristics of our Alt-A mortgages, we have been able to borrow a higher percentage against the principal balance of mortgages held as CMO collateral, which means that we have to provide less initial capital upon completion of CMOs. Capital investment in the CMOs is established at the time CMOs are issued at levels sufficient to achieve desired credit ratings on the securities from credit rating agencies. As of March 31, 2004, total capital invested in mortgages held as CMO collateral was \$246.6 million, which includes capitalized premiums paid, capitalized costs incurred to complete CMO borrowings, fair value of derivative instruments and OC.

Excess cash flows from our long-term mortgage portfolio. During the first quarter of 2004, mortgages held as CMO collateral, which primarily comprises the long-term mortgage portfolio, generated excess cash flows of \$60.4 million as compared to \$34.2 million during the fourth quarter of 2003. We receive excess cash flows on mortgages held as CMO collateral after distributions are made to investors in CMOs to the extent cash or other collateral required to maintain desired credit ratings on the CMOs is fulfilled. Excess cash flows represent the difference between principal and interest payments on the mortgages less the following (in order of priority paid):

servicing fees paid to mortgage servicers and sub-servicers;

insurance premiums paid to mortgage insurers;

cash received or paid to counterparties on derivative instruments hedging CMO financing;

actual losses incurred upon disposition of real estate acquired in settlement of mortgages;

interest paid to bondholders; and

pro-rata early principal prepayments paid to bondholders.

Sale and securitization of mortgages. When the mortgage operations accumulates a sufficient amount of mortgages, generally between \$100 million and \$300 million, it sells mortgages to the long-term investment operations or to third party investors as whole loan sales or securitizes the mortgages as REMICs.

The mortgage operations sold \$2.9 billion of mortgages to the long-term investment operations during the first quarter of 2004 and sold \$632.2 million of mortgages as whole loan sales and REMICs. The mortgage operations sold mortgage servicing rights on substantially all mortgages sold during the first quarter of 2004. The sale of mortgage servicing rights generated substantially all cash, which was used to acquire and originate additional mortgage assets.

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In order to mitigate interest rate and market risk, the mortgage operations attempts to sell and securitize mortgages between 15 and 45 days from acquisition and origination. Since we rely significantly upon sales and securitizations to generate cash proceeds to repay borrowings and to create credit availability, any disruption in our ability to complete sales and securitizations may require us to utilize other sources of financing, which, if available at all, may be on unfavorable terms. In addition, delays in closing sales and securitizations of our mortgages increase our risk by exposing us to credit and interest rate risk for this extended period of time.

Cash proceeds from the issuance of securities. In December 2003, we filed with the SEC a shelf registration statement that allows us to sell up to \$500.0 million of securities, including common stock, preferred stock, debt securities and warrants. In February of 2004, we raised \$106.5 million in net proceeds from the issuance of 5,750,000 new shares of common stock. In addition, pursuant to an equity distribution agreement with UBS Securities, LLC, we sold 452,165 shares of common stock and received net proceeds of \$10.7 million during the first quarter of 2004. UBS Securities, LLC received a commission of 3% of the gross sales price per share of the shares of common stock sold pursuant to the equity distribution agreement, which amounted to an aggregate commission of \$332,000. With the sale of the 452,165 shares,

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there are no shares of common stock remaining to be sold pursuant to the equity distribution agreement. By issuing new shares periodically throughout the year, we believe that we were able to utilize new capital more efficiently and profitably.

Cash Flows

Operating Activities - Net cash used in operating activities was \$288.3 million for the first quarter of 2004 as compared to \$167.2 million for the first quarter of 2003. Net cash flows of \$211.0 million were used in operating activities to primarily acquire and originate mortgages, net of loan sales.

Investing Activities - Net cash used in investing activities was \$1.9 billion for the first quarter of 2004 as compared to \$1.0 billion for the first quarter of 2003. Net cash flows of \$2.5 billion were used in investing activities to primarily invest in mortgages, net of principal repayments.

Financing Activities - Net cash provided by financing activities was \$2.3 billion for the first quarter of 2004 as compared to \$795.1 million for the first quarter of 2003. Net cash flows of \$2.6 billion were provided by financing activities primarily from CMO financing, net of principal repayments.

Inflation

The consolidated financial statements and corresponding notes to the consolidated financial statements have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased costs of our operations. Unlike industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Inflation affects our operations primarily through its effect on interest rates, since interest rates normally increase during periods of high inflation and decrease during periods of low inflation. During periods of increasing interest rates, demand for mortgages and a borrower's ability to qualify for mortgage financing in a purchase transaction may be adversely affected. During periods of decreasing interest rates, borrowers may prepay their mortgages, which in turn may adversely affect our yield and subsequently the value of our portfolio of mortgage assets.

Risk Factors

Some of the following risk factors relate to a discussion of our assets. For additional information on our asset categories refer to Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations, Note D Mortgages Held-for-Sale, Note E CMO Collateral and Note G CMO Borrowings in the accompanying notes to the consolidated financial statements.

Risks Related To Our Businesses

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

The United States economy has undergone and may in the future, undergo, a period of slowdown, which some observers view as a recession. An economic downturn or a recession may have a significant adverse impact on our operations and our financial condition. For example, a reduction in new mortgages will adversely affect our ability to expand our long-term mortgage portfolio, our principal means of increasing our earnings. In addition, a decline in new mortgage activity will likely result in reduced activity for our warehouse lending operations and our long-term investment operations. In the case of our mortgage operations, a decline in mortgage activity may result in fewer loans that meet its criteria for purchase and securitization or sale, thus resulting in a reduction in interest income and fees and gain on sale of loans. We may also experience larger than previously reported losses on our long-term mortgage portfolio due to a higher level of defaults or foreclosures on our mortgages.

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

If we cannot generate sufficient liquidity, we will be unable to continue to grow our operations, grow our asset base, maintain our current interest rate risk management policies and pay dividends. We have traditionally derived our liquidity from the following primary sources:

financing facilities provided to us by others to acquire or originate mortgage assets;

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whole loan sales and securitizations of acquired or originated mortgages;

our issuance of equity and debt securities;

excess cash flow from our long-term mortgage portfolio; and

earnings from operations.

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

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

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

the lack of financing to acquire these securitization interests;

the widening of returns expected by institutional investors on securitization interests over the prevailing Treasury rate; and

market uncertainty.

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

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

We face risks related to our recent accounting restatements.

On July 22, 2004, we publicly announced that we had discovered accounting inaccuracies in previously reported financial statements. As a result, following consultation with our auditors, we decided to restate our financial statements for each of the years ended December 31, 2003, 2002 and 2001 and for the three months ended March 31, 2004 and 2003. The restatements relate to a correction to our revenue recognition policy with respect to the cash sales of mortgage servicing rights to unrelated third parties when the mortgage loans are retained, our accounting for derivatives and interest rate risk management activities, the accounting for loan purchase commitments as derivatives and selected elimination entries to

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consolidate IFC with that of IMH. The increase (decrease) in net earnings as a result of the net effect of the restatements for each of the years in the three-year period ended December 31, 2003 and for the three months ended March 31, 2004 and 2003 was \$21.7 million, \$(34.6) million, \$(35.4) million, \$(36.7) million and \$(0.7) million, respectively.

The restatement of these financial statements may lead to litigation claims and/or regulatory proceedings against us. The defense of any such claims or proceedings may cause the diversion of management's attention and resources, and we may be required to pay damages if any such claims or proceedings are not resolved in our favor. Any litigation or regulatory proceeding, even if resolved in our favor, could cause us to incur significant legal and other expenses. We also may have difficulty raising equity capital or obtaining other financing, such as lines of credit or otherwise. We may not be able to effectuate our current operating strategy, including the ability to originate, acquire or securitize mortgages loans for retention or sale at projected levels. We may be subject to resignation of our current external auditors which may, among other things, cause a delay in the preparation of our financial statements and increase expenditures related to the retention of new external auditors and the lead time required to become familiar with our operations. The process of retaining new external auditors may limit our access to the capital markets for an extended period of time. Moreover, we may be the subject of negative publicity focusing on the financial statement inaccuracies and resulting restatement and negative reactions from our stockholders, creditors or others with which we do business. The occurrence of any of the foregoing could harm our business and reputation and cause the price of our securities to decline and could result in a delisting of our securities from the New York Stock Exchange.

If we fail to maintain an effective system of internal and disclosure controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting which would harm our business and the trading price of our securities.

Effective internal and disclosure controls are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have in the past discovered, and may in the future discover, areas of our disclosure and internal controls that need improvement. As a result after a review of our June 30, 2004 operating results, we identified certain deficiencies in some of our disclosure controls and procedures which we believe require remediation.

Furthermore, in planning and performing its audit of our restated consolidated financial statements, our external auditors also noted in a letter to management and the audit committee dated August 16, 2004 certain matters involving internal controls and operations that they consider to be a material weakness, as defined by the Public Company Accounting Oversight Board (PCAOB). According to the letter, we need to improve the evaluation and documentation of accounting policies and procedures for complex transactions, such as transfers of financial assets, derivatives and hedge accounting and allowance for credit losses, and we currently do not have a sufficient amount or type of staff in the financial reporting and accounting departments, including the lack of a Controller. Furthermore, our auditors also noted significant deficiencies, as defined by the PCAOB, for our consideration stating that our internal audit function does not provide an adequate or effective monitoring of our controls and we need to evaluate whether we have appropriate internal resources to manage and monitor work performed by our outsourced tax compliance function. We are currently taking steps to address these conditions, but we may be hampered in this regard by our current staffing.

We cannot be certain that our efforts to improve our internal and disclosure controls will be successful or that we will be able to maintain adequate controls over our financial processes and reporting in the future. Any failure to develop or maintain effective controls or difficulties encountered in their implementation or other effective improvement of our internal and disclosure controls could harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to adequately establish or improve our internal controls over financial reporting, our external auditors will not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities and could result in regulatory proceedings against us by, among others, the SEC.

We incurred losses for fiscal years 1997, 1998, 2000 and 2001 and may incur losses in the future.

During the years ended December 31, 2001 and 2000, we experienced a net loss of \$2.2 million and \$54.5 million. The 2001 loss was related to the mark-to-market loss on derivatives and the 2000 loss was the result of write-downs of non-performing investment securities secured by mortgages and additional increases in the provision for loan losses to provide for the deterioration of the performance of collateral supporting specific investment securities for 2000. During the year ended December 31, 1998, we experienced a net loss of \$5.9 million primarily as the mortgage industry experienced

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substantial turmoil as a result of a lack of liquidity in the secondary markets, which caused us to sell mortgages at losses to meet margin calls on our financing facilities. During the year ended December 31, 1997, we experienced a net loss of \$16.0 million. The net loss incurred during 1997 included an accounting charge of \$44.4 million that was the result of expenses related to the termination and buyout of our management agreement with Imperial Credit Advisors, Inc. We cannot be certain that revenues will remain at current levels or improve or that we will be profitable or generate taxable income for distribution to our stockholders in the future, which could prevent us from effectuating our business strategy.

If we are unable to complete securitizations or if we experience delayed mortgage loan sales or securitization closings, we could face a liquidity shortage which would adversely affect our operating results.

We rely significantly upon securitizations to generate cash proceeds to repay borrowings and replenish our borrowing capacity. If there is a delay in a securitization closing or any reduction in our ability to complete securitizations we may be required to utilize other sources of financing, which, if available at all, may be on unfavorable terms. In addition, delays in closing mortgage sales or securitizations of our mortgages increase our risk by exposing us to credit and interest rate risks for this extended period of time. Furthermore, gains on sales from certain of our securitizations represent a significant portion of our taxable income. Several factors could affect our ability to complete securitizations of our mortgages, including:

conditions in the securities and secondary markets;

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

volume of our mortgage loan acquisitions and originations;

our ability to obtain credit enhancements; and

lack of investors purchasing higher risk components of the securities.

If we are unable to sell a sufficient number of mortgages at a premium or profitably securitize a significant number of our mortgages in a particular financial reporting period, then we could experience lower income or a loss for that period, which could have a material adverse affect on our operations. We cannot assure you that we will be able to continue to profitably securitize or sell our loans on a whole loan basis, or at all.

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

Our borrowings and use of substantial leverage may cause losses.

Our use of CMOs may expose our operations to credit losses.

To grow our long-term mortgage portfolio, we borrow a substantial portion of the market value of substantially all of our investments in mortgages in the form of CMOs. There are no limitations on the amount of CMO financing we may incur, other than the aggregate value of the underlying mortgages. We currently use CMOs as financing vehicles to increase our leverage, since mortgages held for CMO collateral are retained for investment rather than sold in a secondary market transaction.

Retaining mortgages as collateral for CMOs exposes our operations to greater credit losses than does the use of other securitization techniques that are treated as sales because as the equity holder in the security, we are allocated losses from the liquidation of defaulted loans first prior to any other security holder. Although our liability under a collateralized mortgage obligation is limited to the collateral used to create the collateralized mortgage obligation, we generally are required to make a cash equity investment to fund collateral in excess of the amount of the securities issued in order to obtain the appropriate credit ratings for the securities being sold, and therefore obtain the lowest interest rate available, on the CMOs. If we experience greater credit losses than expected on the pool of loans subject to the CMO, the value of our equity investment will decrease and we may have to increase the allowance for loan losses on our financial statements.

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If we default under our financing facilities, we may be forced to liquidate collateral.

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

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

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

Interest rate fluctuations may adversely affect our operating results.

Our operations, as a mortgage loan acquirer and originator or a warehouse lender, may be adversely affected by rising and falling interest rates. Interest rates have been low over the past few years; however any increase in interest rates may discourage potential borrowers from refinancing mortgages, borrowing to purchase homes or seeking second mortgages. This may decrease the amount of mortgages available to be acquired or originated by our mortgage operations and decrease the demand for warehouse financing provided by our warehouse lending operations, which could adversely affect our operating results. If short-term interest rates exceed long-term interest rates, there is a higher risk of increased loan prepayments, as borrowers may seek to refinance their fixed and adjustable rate mortgages at lower long-term fixed interest rates. Increased loan prepayments could lead to a reduction in the number of loans in our long-term mortgage portfolio and reduce our net interest income. Rising interest rates may also increase delinquencies, foreclosures and losses on our adjustable rate mortgages.

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

We may experience losses if our liabilities re-price at different rates than our assets.

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

earning on our assets and we will be exposed to a risk of loss.

Additionally, the rates paid on our borrowings and the rates received on our assets may be based upon different indices. If the index used to determine the rate on our borrowings, typically one-month LIBOR, increases faster than the indices used to determine the rates on our assets, such as six-month LIBOR or the prime rate, we will experience a declining net interest spread, which will have a negative effect on our profitability, and may result in losses.

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

Our long-term mortgage portfolio includes mortgages that are six-month LIBOR hybrid ARMs. These are mortgages with fixed interest rates for an initial period of time, after which they begin bearing interest based upon short-term interest

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rate indices and adjust periodically. We generally fund mortgages with adjustable interest rate borrowings having interest rates that are indexed to short-term interest rates and adjust periodically at various intervals. To the extent that there is an increase in the interest rate index used to determine our adjustable interest rate borrowings and that increase is not offset by a corresponding increase in the rates at which interest accrues on our assets or by various interest rate hedges that we have in place at any given time, our net interest margin will decrease or become negative. We may suffer a net interest loss on our ARMs that have interest rate caps if the interest rates on our related borrowings increase.

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

Increased levels of early prepayments of mortgages may accelerate our expenses and decrease our net income.

Mortgage prepayments generally increase on our ARMs when fixed mortgage interest rates fall below the then-current interest rates on outstanding ARMs. Prepayments on mortgages are also affected by the terms and credit grades of the mortgages, conditions in the housing and financial markets and general economic conditions. If we acquire mortgages at a premium and they are subsequently repaid, we must expense the unamortized premium at the time of the prepayment. We could possibly lose the opportunity to earn interest at a higher rate over the expected life of the mortgage. Also, if prepayments on mortgages increase when interest rates are declining, our net interest income may decrease if we cannot reinvest the prepayments in mortgage assets bearing comparable rates.

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

We may be subject to losses on mortgages for which we do not obtain credit enhancements.

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

Our mortgage products expose us to greater credit risks.

We are an acquirer and originator of Alt-A mortgages, and to a lesser extent, multi-family and B/C mortgages. These are mortgages that generally may not qualify for purchase by government-sponsored agencies such as Fannie Mae and Freddie Mac. Our operations may be

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negatively affected due to our investments in these mortgages. Credit risks associated with these mortgages may be greater than those associated with conforming mortgages. The interest rates we charge on these mortgages are often higher than those charged for conforming loans in order to compensate for the higher risk and lower liquidity. Lower levels of liquidity may cause us to hold loans or other mortgage-related assets supported by these loans that we otherwise would not hold. By doing this, we assume the potential risk of increased delinquency rates and/or credit losses as well as interest rate risk. Additionally, the combination of different underwriting criteria and higher rates of interest leads to greater risk, including higher prepayment rates and higher delinquency rates and/or credit losses.

Lending to our type of borrowers may expose us to a higher risk of delinquencies, foreclosures and losses.

Our market includes borrowers who may be unable to obtain mortgage financing from conventional mortgage sources. Mortgages made to such borrowers generally entail a higher risk of delinquency and higher losses than mortgages made to borrowers who utilize conventional mortgage sources. Delinquency, foreclosures and losses generally increase during

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economic slowdowns or recessions. The actual risk of delinquencies, foreclosures and losses on mortgages made to our borrowers could be higher under adverse economic conditions than those currently experienced in the mortgage lending industry in general.

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

Our multi-family mortgages expose us to increased lending risks.

Generally, we consider multi-family mortgages to involve a higher degree of risk compared to first mortgages on one- to four-family, owner occupied residential properties. These mortgages have higher risks than mortgages secured by residential real estate because repayment of the mortgages often depends on the successful operations and the income stream of the borrowers. Furthermore, multi-family mortgages typically involve larger mortgage balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgages.

Our use of second mortgages exposes us to greater credit risks.

Our security interest in the property securing second mortgages is subordinated to the interest of the first mortgage holder and the second mortgages have a higher combined LTV ratio than does the first mortgage. If the value of the property is equal to or less than the amount needed to repay the borrower's obligation to the first mortgage holder upon foreclosure, our second mortgage loan will not be repaid.

The geographic concentration of our mortgages increases our exposure to risks in those areas.

We do not set limitations on the percentage of our long-term mortgage portfolio composed of properties located in any one area (whether by state, zip code or other geographic measure). Concentration in any one area increases our exposure to the economic and natural hazard risks associated with that area. Historically, a majority of our mortgage acquisitions and originations, long-term mortgage portfolio and finance receivables were secured by properties in California and, to a lesser extent, Florida. For instance, certain parts of California have experienced an economic downturn in past years and California and Florida have suffered the effects of certain natural hazards. Declines in those residential real estate markets may reduce the values of the properties collateralizing the mortgages, increase foreclosures and losses and have material adverse effect on our results of operations or financial condition.

Furthermore, if borrowers are not insured for natural disasters, which are typically not covered by standard hazard insurance policies, then they may not be able to repair the property or may stop paying their mortgages if the property is damaged. This would cause increased foreclosures and decrease our ability to recover losses on properties affected by such disasters. This would have a material adverse effect on our results of operations or financial condition.

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

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

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In the ordinary course of our business, we are subject to claims made against us by borrowers and trustees in our securitizations arising from, among other things, losses that are claimed to have been incurred as a result of alleged breaches of fiduciary obligations, misrepresentations, errors and omissions of our employees, officers and agents (including our appraisers), incomplete documentation and our failure to comply with various laws and regulations applicable to our business. Any claims asserted against us may result in legal expenses or liabilities that could have a material adverse effect on our results of operations or financial condition.

A substantial interruption in our use of iDASLg2 may adversely affect our level of mortgage acquisitions and originations.

We utilize the Internet in our business principally for the implementation of our automated mortgage origination program, iDASLg2. iDASLg2 allows our customers to pre-qualify borrowers for various mortgage programs based on criteria requested from the borrower and renders an automated underwriting decision by issuing an approval of the mortgage loan or a referral for further review or additional information. Substantially, all of our correspondents submit mortgages through iDASLg2 and all wholesale mortgages delivered by mortgage bankers and brokers are directly underwritten through the use of iDASLg2. iDASLg2 may be interrupted if the Internet experiences periods of poor performance, if our computer systems or the systems of our third-party service providers contain defects, or if customers are reluctant to use or have inadequate connectivity to the Internet. Increased government regulation of the Internet could also adversely affect our use of the Internet in unanticipated ways and discourage our customers from using our services. If our ability to use the Internet in providing our services is impaired, our ability to originate or acquire mortgages on an automated basis could be delayed or reduced. Furthermore, we rely on a third party hosting company in connection with the use of iDASLg2. If the third party hosting company fails for any reason, and adequate back-up is not implemented in a timely manner, it may delay and reduce those mortgage acquisitions and originations done through iDASLg2. Any substantial delay and reduction in our mortgage acquisitions and originations will reduce our taxable income for the applicable period.

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

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

Competition for mortgages is intense and may adversely affect our operations.

We compete in acquiring and originating Alt-A, B/C and multi-family mortgages and issuing mortgage-backed securities with other mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift and loan associations, finance companies, mortgage bankers and brokers, insurance companies, other lenders, and other entities purchasing mortgage assets.

We also face intense competition from Internet-based lending companies where entry barriers are relatively low. Some of our competitors are much larger than we are, have better name recognition than we do, and have far greater financial and other resources. Government-sponsored entities, in particular Fannie Mae and Freddie Mac, are also expanding their participation in the Alt-A mortgage industry. These government-sponsored entities have a size and cost-of-funds advantage over us that allows them to price mortgages at lower rates than we are able to offer. This phenomenon may seriously destabilize the Alt-A mortgage industry. In addition, if as a result of what may be less-conservative, risk-adjusted pricing, these government-sponsored entities experience significantly higher-than-expected losses, it would

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likely adversely affect overall investor perception of the Alt-A and B/C mortgage industry because the losses would be made public due to the reporting obligations of these entities.

The intense competition in the Alt-A, B/C and multi-family mortgage industry has also led to rapid technological developments, evolving industry standards and frequent releases of new products and enhancements. As mortgage products are offered more widely through alternative distribution channels, such as the Internet, we may be required to make significant changes to our current retail and wholesale structure and information systems to compete effectively. Our

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inability to continue enhancing our current Internet capabilities, or to adapt to other technological changes in the industry, could have a material adverse effect on our business, financial condition, liquidity and results of operations.

The need to maintain mortgage loan volume in this competitive environment creates a risk of price competition in the Alt-A, B/C and multi-family mortgage industry. Competition in the industry can take many forms, including interest rates and costs of a loan, less stringent underwriting standards, convenience in obtaining a loan, customer service, amount and term of a loan and marketing and distribution channels. Price competition would lower the interest rates that we are able to charge borrowers, which would lower our interest income. Price-cutting or discounting reduces profits and will depress earnings if sustained for any length of time. If our competition uses less stringent underwriting standards we will be pressured to do so as well, resulting in greater loan risk without being able to price for that greater risk. Our competitors may lower their underwriting standards to increase their market share. If we do not relax underwriting standards in the face of competition, we may lose market share. Increased competition may also reduce the volume of our loan originations and acquisitions. Any increase in these pricing and credit pressures could have a material adverse effect on our business, financial condition, liquidity and results of operations.

We are exposed to potential credit losses in providing warehouse financing.

As a warehouse lender, we lend money to mortgage bankers on a secured basis and we are subject to the risks associated with lending to mortgage bankers, including the risks of fraud, borrower default and bankruptcy, any of which could result in credit losses for us. Fraud risk may include the financing of nonexistent loans or fictitious mortgage loan transactions that could result in the loss of all sums we have advanced to the borrower. Also, our claims as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay.

Our operating results will be affected by the results of our interest rate risk management activities.

To offset the risks associated with our mortgage operations, we enter into transactions designed to limit our exposure to interest rate risks. To offset the risks associated with adjustable rate borrowings, we attempt to match the interest rate sensitivities of our ARMs with the associated financing liabilities. Management determines the nature and quantity of derivative transactions based on various factors, including market conditions and the expected volume of mortgage acquisitions. While we believe that we properly manage our interest rate risk on an economic and tax basis, we are not able to apply hedge accounting, as established by the Financial Accounting Standards Board, or FASB, under the provisions of Statement of Financial Accounting Standards No. 133, or SFAS 133, for our interest rate risk management activities in our financial statements. The effect of not applying hedge accounting means that our interest rate risk management activities may result in significant volatility in our quarterly earnings as interest rates go up or down. It is possible that there will be periods during which we will incur losses on derivative transactions that may result in net losses, as was the case in 2001 after the restatement of our consolidated financial statements. In addition, if the counter parties to our derivative transactions are unable to perform according to the terms of the contracts, we may incur losses. While we believe we prudently manage interest rate risk, our derivative transactions may not offset the risk of adverse changes in net interest margins.

A reduction in the demand for our loan products may adversely affect our operations.

The availability of sufficient mortgages meeting our criteria is dependent in part upon the size and level of activity in the residential real estate lending market and, in particular, the demand for residential mortgages, which is affected by:

interest rates;

national economic conditions;

residential property values; and

regulatory and tax developments.

If our mortgage acquisitions and originations decline, we may have:

decreased economies of scale;

higher origination costs per loan;

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reduced fee income;

smaller gains on the sale of mortgages; and

an insufficient volume of mortgages to generate securitizations which thereby causes us to accumulate mortgages over a longer period.

Our delinquency ratios and our performance may be adversely affected by the performance of parties who service or sub-service our mortgages.

We sell or contract with third-parties for the servicing of all mortgages, including those in our securitizations. Our operations are subject to risks associated with inadequate or untimely servicing. Poor performance by a servicer may result in greater than expected delinquencies and losses on our mortgages. A substantial increase in our delinquency or foreclosure rate could adversely affect our ability to access the capital and secondary markets for our financing needs. Also, with respect to mortgages subject to a securitization, greater delinquencies would adversely impact the value of our equity interest, if any, we hold in connection with that securitization.

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

We are a defendant in purported class actions and may not prevail in these matters.

Class action lawsuits and regulatory actions alleging improper marketing practices, abusive loan terms and fees, disclosure violations, improper yield spread premiums and other matters are risks faced by all mortgage originators, particularly those in the Alt-A and B/C market. We are a defendant in purported class actions pending in different states. The class actions allege generally that the loan originator improperly charged fees in violation of various state lending or consumer protection laws in connection with mortgages that we acquired. Although the suits are not identical, they generally seek unspecified compensatory damages, punitive damages, pre- and post-judgment interest, costs and expenses and rescission of the mortgages, as well as a return of any improperly collected fees. The other purported class action claims damages for sending out unsolicited faxes and seeks statutory and treble damages. These actions are in the early stages of litigation and, accordingly, it is difficult to predict the outcome of these matters. We believe we have meritorious defenses to the actions and intend to defend against them vigorously; however, an adverse judgment in any of these matters could have a material adverse effect on us.

Regulatory Risks

We may be subject to fines or other penalties based upon the conduct of our independent brokers or correspondents.

The mortgage brokers and correspondents from which we obtain mortgages have parallel and separate legal obligations to which they are subject. While these laws may not explicitly hold the originating lenders responsible for the legal violations of mortgage bankers and brokers, increasingly federal and state agencies have sought to impose such liability. Previously, for example, the United States Federal Trade Commission, or "FTC," entered into a settlement agreement with a mortgage lender where the FTC characterized a broker that had placed all of its

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loan production with a single lender as the agent of the lender; the FTC imposed a fine on the lender in part because, as principal, the lender was legally responsible for the mortgage broker's unfair and deceptive acts and practices. The United States Justice Department in the past has sought to hold a sub-prime mortgage lender responsible for the pricing practices of its mortgage bankers and brokers, alleging that the mortgage lender was directly responsible for the total fees and charges paid by the borrower under the Fair Housing Act even if the lender neither dictated what the mortgage banker could charge nor kept the money for its own account. Accordingly, we may be subject to fines or other penalties based upon the conduct of our independent mortgage bankers and brokers or correspondents.

Violation of various federal, state and local laws may result in losses on our loans.

Applicable state and local laws generally regulate interest rates and other charges, require certain disclosure, and require licensing of the lender. In addition, other state and local laws, public policy and general principles of equity relating

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to the protection of consumers, unfair and deceptive practices and debt collection practices may apply to the origination, servicing and collection of our loans. Mortgage loans are also subject to federal laws, including:

the Federal Truth-in-Lending Act and Regulation Z promulgated thereunder, which require certain disclosures to the borrowers regarding the terms of the loans;

the Equal Credit Opportunity Act and Regulation B promulgated thereunder, which prohibit discrimination on the basis of age, race, color, sex, religion, marital status, national origin, receipt of public assistance or the exercise of any right under the Consumer Credit Protection Act, in the extension of credit;

the Fair Credit Reporting Act, which regulates the use and reporting of information related to the borrower's credit experience;

the Depository Institutions Deregulation and Monetary Control Act of 1980, which preempts certain state usury laws; and

the Alternative Mortgage Transaction Parity Act of 1982, which preempts certain state lending laws which regulate alternative mortgage transactions.

Violations of certain provisions of these federal and state laws may limit our ability to collect all or part of the principal of or interest on the loans and in addition could subject us to damages and administrative enforcement and could result in the mortgagors rescinding the loans whether held by us or subsequent holders of the loans.

Our operations may be adversely affected if we are subject to the Investment Company Act.

We intend to conduct our business at all times so as not to become regulated as an investment company under the Investment Company Act. The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

In order to qualify for this exemption we must maintain at least 55% of our assets directly in mortgages, qualifying pass-through certificates and certain other qualifying interests in real estate. Our ownership of certain mortgage assets may be limited by the provisions of the Investment Company Act. If the SEC adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exception, we could be required to restructure our activities or sell certain of our assets. To insure that we continue to qualify for the exemption we may be required at times to adopt less efficient methods of financing certain of our mortgage assets and we may be precluded from acquiring certain types of higher-yielding mortgage assets. The net effect of these factors will be to lower our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption.

New regulatory laws affecting the mortgage industry may increase our costs and decrease our mortgage origination and acquisition.

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The regulatory environments in which we operate have an impact on the activities in which we may engage, how the activities may be carried out, and the profitability of those activities. Therefore, changes to laws, regulations or regulatory policies can affect whether and to what extent we are able to operate profitably. For example, recently enacted and proposed local, state and federal legislation targeted at predatory lending could have the unintended consequence of raising the cost or otherwise reducing the availability of mortgage credit for those potential borrowers with less than prime-quality credit histories, thereby resulting in a reduction of otherwise legitimate Alt-A or B/C lending opportunities. Similarly, recently enacted and proposed local, state and federal privacy laws and laws prohibiting or limiting marketing by telephone, facsimile, email and the Internet may limit our ability to market and our ability to access potential loan applicants. For example, the recently enacted Can Spam Act of 2003 establishes the first national standards for the sending of commercial email allowing, among other things, unsolicited commercial email provided it contains certain information and an opt-out mechanism. We cannot provide any assurance that the proposed laws, rules and regulations, or other similar laws, rules or regulations, will not be adopted in the future. Adoption of these laws and regulations could have a material adverse impact on our business by substantially increasing the costs of compliance with a variety of inconsistent federal, state and local rules, or by restricting our ability to charge rates and fees adequate to compensate us for the risk associated with certain loans.

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Some states and local governments have enacted, or may enact, laws or regulations that prohibit inclusion of some provisions in mortgage loans that have mortgage rates or origination costs in excess of prescribed levels, and require that borrowers be given certain disclosures prior to the consummation of such mortgage loans. Our failure to comply with these laws could subject us to monetary penalties and could result in the borrowers rescinding the mortgage loans, whether held by us or subsequent holders. Lawsuits have been brought in various states making claims against assignees of these loans for violations of state law.

Risks Related To Our Status As A REIT

We may not pay dividends to stockholders.

REIT provisions of the Internal Revenue Code generally require that we annually distribute to our stockholders at least 90% of all of our taxable income, exclusive of the application of any tax loss carry forwards that may be used to offset current period taxable income. These provisions restrict our ability to retain earnings and thereby generate capital from our operating activities. We may decide at a future date to terminate our REIT status, which would cause us to be taxed at the corporate levels and cease paying regular dividends. In addition, for any year that we do not generate taxable income, we are not required to declare and pay dividends to maintain our REIT status. For instance, due to losses incurred in 2000, we did not declare any dividends from September 2000 until September 2001.

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

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

We believe that we have operated and intend to continue to operate in a manner that enables us to meet the requirements for qualification as a REIT for federal income tax purposes. We have not requested, and do not plan to request, a ruling from the Internal Revenue Service that we qualify as a REIT.

Moreover, no assurance can be given that legislation, new regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a REIT or the federal income tax consequences of such qualification. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational and stockholder ownership requirements on a continuing basis.

If we fail to qualify as a REIT, we would not be allowed a deduction for distributions to stockholders in computing our taxable income and would be subject to federal income tax at regular corporate rates. We also may be subject to the federal alternative minimum tax. Unless we are entitled to relief under specific statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year during which we were disqualified. Therefore, if we lose our REIT status, the funds available for distribution to stockholders would be reduced substantially for each of the years involved. Failure to qualify as a REIT could adversely affect the value of our securities.

Potential characterization of distributions or gain on sale as unrelated business taxable income to tax-exempt investors.

If (1) all or a portion of our assets are subject to the rules relating to taxable mortgage pools, (2) we are a pension-held REIT, (3) a tax-exempt stockholder has incurred debt to purchase or hold our common stock, or (4) the residual REMIC interests we buy generate excess inclusion income, then a portion of the distributions to and, in the case of a stockholder described in (3), gains realized on the sale of common stock by such tax-exempt stockholder may be subject to Federal income tax as unrelated business taxable income under the Internal Revenue Code.

Classification as a taxable mortgage pool could subject us or certain of our stockholders to increased taxation.

If we have borrowings with two or more maturities and, (1) those borrowings are secured by mortgages or mortgage-backed securities and, (2) the payments made on the borrowings are related to the payments received on the underlying assets, then the borrowings and the pool of mortgages or mortgage-backed securities to which such borrowings relate may

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be classified as a taxable mortgage pool under the Internal Revenue Code. If any part of our Company were to be treated as a taxable mortgage pool, then our REIT status would not be impaired, but a portion of the taxable income we recognize may, under regulations to be issued by the Treasury Department, be characterized as excess inclusion income and allocated among our stockholders to the extent of and generally in proportion to the distributions we make to each stockholder. Any excess inclusion income would:

not be allowed to be offset by a stockholder's net operating losses;

be subject to a tax as unrelated business income if a stockholder were a tax-exempt stockholder;

be subject to the application of federal income tax withholding at the maximum rate (without reduction for any otherwise applicable income tax treaty) with respect to amounts allocable to foreign stockholders; and

be taxable (at the highest corporate tax rate) to us, rather than to our stockholders, to the extent the excess inclusion income relates to stock held by disqualified organizations (generally, tax-exempt companies not subject to tax on unrelated business income, including governmental organizations).

Based on advice of our tax counsel, we take the position that our existing financing arrangements do not create a taxable mortgage pool.

We may be subject to possible adverse consequences as a result of limits on ownership of our shares.

Our charter limits ownership of our capital stock by any single stockholder to 9.5% of our outstanding shares unless waived by the board of directors. Our board of directors may increase the 9.5% ownership limit. In addition, to the extent consistent with the REIT provisions of the Internal Revenue Code, our board of directors may, pursuant to our articles of incorporation, waive the 9.5% ownership limit for a stockholder or purchaser of our stock. In order to waive the 9.5% ownership limit our board of directors must require the stockholder requesting the waiver to provide certain representations to the Company to ensure compliance with the REIT provisions of the Internal Revenue Code. Our charter also prohibits anyone from buying shares if the purchase would result in us losing our REIT status. This could happen if a share transaction results in fewer than 100 persons owning all of our shares or in five or fewer persons, applying certain broad attribution rules of the Internal Revenue Code, owning more than 50% (by value) of our shares. If you or anyone else acquires shares in excess of the ownership limit or in violation of the ownership requirements of the Internal Revenue Code for REITs, we:

will consider the transfer to be null and void;

will not reflect the transaction on our books;

may institute legal action to enjoin the transaction;

will not pay dividends or other distributions with respect to those shares;

will not recognize any voting rights for those shares;

may redeem the shares; and

will consider the shares held in trust for the benefit of a charitable beneficiary as designated by us.

Notwithstanding the above, we recently amended our charter so that nothing in the charter will preclude the settlement of transactions entered into through the facilities of the New York Stock Exchange (NYSE).

The trustee shall sell the shares held in trust and the owner of the excess shares will be entitled to the lesser of:

- (a) the price paid by the owner;
- (b) if the owner did not purchase the excess shares, the closing price for the shares on the national securities exchange on which IMH is listed on the day of the event causing the shares to be held in trust; or
- (c) the price received by the trustee from the sale of the shares.

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Limitations on acquisition and change in control ownership limit.

The 9.5% ownership limit discussed above may have the effect of precluding acquisition of control of our Company by a third party without consent of our board of directors.

Risks Related To Ownership of Our Securities

Our share prices have been and may continue to be volatile.

Historically, the market price of our securities has been volatile. The market price of our securities is likely to continue to be highly volatile and could be significantly affected by factors including:

the amount of dividends paid;

availability of liquidity in the securitization market;

loan sale pricing;

termination of financing agreements;

margin calls by warehouse lenders or changes in warehouse lending rates;

unanticipated fluctuations in our operating results;

prepayments on mortgages;

valuations of securitization related assets;

the effect of the restatement of our financial condition and results of operations;

mark to market adjustments related to the fair value of derivatives;

cost of funds; and

general market conditions.

In addition, significant price and volume fluctuations in the stock market have particularly affected the market prices for the securities of mortgage REIT companies such as ours. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. If our results of operations fail to meet the expectations of securities analysts or investors in a future quarter, the market price of our securities could also be materially adversely affected and we may experience difficulty in raising capital.

Sales of additional common stock may adversely affect its market price.

To sustain our growth strategy we intend to raise capital through the sale of equity. The sale or the proposed sale of substantial amounts of our common stock in the public market could materially adversely affect the market price of our common stock or other outstanding securities. We do not know the actual or perceived effect of these offerings, the timing of these offerings, the potential dilution of the book value or earnings per share of our securities then outstanding; and the effect on the market price of our securities then outstanding. In December 2003, we filed a shelf registration statement for a total of \$500.0 million, which may be used in connection with offerings of debt securities, common stock, preferred stock, warrants, and/or units for general corporate purposes. In May and June 2004, we issued 1,725,000 shares of common stock and 2,000,000 shares of Series B Preferred Stock from this shelf. We may currently sell additional securities worth approximately \$177.1 million (gross proceeds) from this shelf registration statement in the future. We also have shares reserved for future issuance under our stock plans. The sale of a large amount of shares or the perception that such sales may occur, could adversely affect the market price for our common stock or other outstanding securities.

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ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General Overview

Although we manage credit, prepayment and liquidity risk in the normal course of business, we consider interest rate risk to be a significant market risk, which could potentially have the largest material impact on our financial condition and results of operations. Since a significant portion of our revenues and earnings are derived from net interest income, we strive to manage our interest-earning assets and interest-bearing liabilities to generate what we believe to be an appropriate contribution from net interest income. When interest rates fluctuate, profitability can be adversely affected by changes in the fair market value of our assets and liabilities and by the interest spread earned on interest-earning assets and interest paid on interest-bearing liabilities. We derive income from the differential spread between interest earned on interest-earning assets and interest paid on interest-bearing liabilities. Any change in interest rates affects income received and income paid from assets and liabilities in varying and typically in unequal amounts. Changing interest rates may compress our interest rate margins and adversely affect overall earnings.

Interest rate risk management is the responsibility of ALCO, which reports results of interest rate risk analysis to the board of directors on at least a quarterly basis. ALCO establishes policies that monitor and coordinate sources, uses and pricing of funds. ALCO also attempts to reduce the volatility in net interest income by managing the relationship of interest rate sensitive assets to interest rate sensitive liabilities. In addition, various modeling techniques are used to value interest sensitive mortgage-backed securities, including interest-only securities. The value of investment securities available-for-sale is determined using a discounted cash flow model using prepayment rate, discount rate and credit loss assumptions. Our investment securities portfolio is available-for-sale, which requires us to perform market valuations of the securities in order to properly record the portfolio. We continually monitor interest rates of our investment securities portfolio as compared to prevalent interest rates in the market. We do not currently maintain a securities trading portfolio and are not exposed to market risk as it relates to trading activities.

Changes in Interest Rates

ALCO follows an interest rate risk management policy intended to limit our exposure to changes in interest rates primarily associated with cash flows on our adjustable rate CMO borrowings. Our primary objective is to limit our exposure to the variability in future cash flows attributable to the variability of one-month LIBOR, which is the underlying index of our adjustable rate CMO borrowings. We also monitor on an ongoing basis the prepayment risks that arise in fluctuating interest rate environments. Our interest rate risk management policy is formulated with the intent to offset the potential adverse effects of changing interest rates on CMO borrowings.

We primarily acquire for long-term investment ARMs and hybrid ARMs and, to a lesser extent, FRMs. ARMs are generally subject to periodic and lifetime interest rate caps. This means that the interest rate of each ARM is limited to upwards or downwards movements on its periodic interest rate adjustment date, generally six months, or over the life of the mortgage. Periodic caps limit the maximum interest rate change, which can occur on any interest rate change date to generally a maximum of 1% per semiannual adjustment. Also, each ARM has a maximum lifetime interest rate cap. Generally, borrowings are not subject to the same periodic or lifetime interest rate limitations. During a period of rapidly increasing or decreasing interest rates, financing costs could increase or decrease at a faster rate than the periodic interest rate adjustments on mortgages would allow, which could affect net interest income. In addition, if market rates were to exceed the maximum interest rates of our ARMs, borrowing costs could increase while interest rates on ARMs would remain constant.

We also acquire hybrid ARMs that have initial fixed interest rate periods generally ranging from two to seven years which subsequently convert to ARMs. During a rapidly increasing or decreasing interest rate environment financing costs would increase or decrease more rapidly than would interest rates on mortgages, which would remain fixed until their next interest rate adjustment date. In order to provide some protection against any resulting basis risk shortfall on the related liabilities, we purchase derivatives. Derivatives are based upon the principal balance that

would result under assumed prepayment speeds.

We measure the sensitivity of our net interest income to changes in interest rates affecting interest sensitive assets and liabilities using various simulations. These simulations take into consideration changes that may occur in investment and financing strategies, changes in the forward yield curve, changes in interest rate risk management strategy, changes in mortgage prepayment speeds and changes in the volume of mortgage acquisitions and originations.

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As part of various interest rate simulations, we calculate the effect of potential changes in interest rates on our interest-earning assets and interest-bearing liabilities and their affect on overall earnings. The simulations assume instantaneous and parallel shifts in interest rates and to what degree those shifts affect net interest income. First, we estimate net interest income along with net cash flows on derivatives for the next twelve months using balance sheet data and the notional amount of derivatives as of the applicable date with 12-month projections of the following:

future interest rates using forward yield curves, which are market consensus estimates of future interest rates;

mortgage acquisition and originations;

mortgage prepayment rate assumptions; and

forward swap rates.

We refer to the 12-month projection of net interest income along with the 12-month projection of net cash flows on derivatives as the base case. For financial reporting purposes, net cash flows on derivative instruments are included in mark-to-market loss derivative instruments on the consolidated financial statements. However, for purposes of interest rate risk analysis we include net cash flows on derivatives in our base case simulations as we acquire derivatives to offset the effect that changes in interest rates have on variable borrowing costs, such as CMO and warehouse borrowings. We believe that including net cash flows on derivatives in our interest rate risk analysis presents a more useful simulation of the effect of changing interest rates on net cash flows generated by our long-term mortgage portfolio. Once the base case has been established, we shock the base case with instantaneous and parallel shifts in interest rates in 100 basis point increments upward and downward. Calculations are made for each of the defined instantaneous and parallel shifts in interest rates over or under the forward yield curve used to determine the base case and including any associated changes in projected mortgage prepayment rates caused by changes in interest rates. The results of each 100 basis point change in interest rates are then compared against the base case to determine the estimated dollar and percentage change to base case. The simulations consider the affect of interest rate changes on interest sensitive assets and liabilities as well as derivatives. The simulations also consider the impact that instantaneous and parallel shift in interest rates have on prepayment rates and the resulting affect of accelerating or decelerating amortization rates of premium and securitization costs.

The following table estimates the financial impact to base case, including net cash flows from derivatives, from various instantaneous and parallel shifts in interest rates based on both our on- and off-balance sheet structure as of the period indicated:

| | Changes in base case as of March 31, 2004 ⁽¹⁾ | | | | |
|--------------------------------------------------------------------------|----------------------------------------------------------|------|------------------------------|---------------------------------------------------|-----|
| | Base case, excluding net cashflow on derivatives | | Net Cash flow on derivatives | Base case, including net cash flow on derivatives | |
| | (\$) | (%) | (\$) | (\$) | (%) |
| Instantaneous and Parallel Change in Interest Rates⁽²⁾ | | | | | |
| Up 300 basis points, or 3% | (182.3) | (59) | 128.3 | 12.8 | 5 |
| Up 200 basis points, or 2% | (112.3) | (37) | 63.3 | 17.8 | 7 |
| Up 100 basis points, or 1% | (51.2) | (17) | (1.7) | 13.9 | 6 |
| Down 100 basis points, or 1% | 62.8 | 20 | (65.0) | (2.2) | (1) |
| Down 200 basis points, or 2% ⁽³⁾ | n/a | n/a | n/a | n/a | n/a |

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- (1) The dollar and percentage changes represent base case for the next twelve months versus the change in base case in the various instantaneous and parallel interest rate change simulations, excluding the effect of amortization of loan discounts to base case.
- (2) Instantaneous and parallel interest rate changes over and under the projected forward yield curve.
- (3) The interest rate environment as of March 31, 2004 makes this simulation irrelevant as a 200 basis point downward shock to short-term interest rates would result in negative interest rates.

The use of derivatives to manage risk associated with changes in interest rates is an integral part of our strategy to limit interest rate risk. The amount of cash payments or cash receipts on derivatives is determined by (1) the notional amount of the derivative and (2) current interest rate levels in relation to the various strike prices of derivatives during a particular time period. By using derivatives, we attempt to minimize the effect of both upward and downward interest rate changes on our long-term mortgage portfolio. Our goal is to minimize significant changes to base case net interest income, including net cash flows from derivatives, as interest rates change.

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ITEM 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 (the Exchange Act) is properly recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include processes to accumulate and communicate relevant information to management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow for timely decisions regarding required disclosures.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) or 15(d)-15(e) promulgated under the Exchange Act, as of March 31, 2004. Based on their evaluation, our management concluded at the time of our original Form 10-Q filing that our disclosure controls and procedures were effective.

Subsequent to filing our original annual report on Form 10-K and in connection with the preparation and review of our financial statements for the quarter ended June 30, 2004, management identified errors that led to a decision to restate our financial statements for the quarters ended March 31, 2004 and 2003 and for the years ended December 31, 2003, 2002 and 2001. The restatements for the quarters ended March 31, 2004 and 2003 are further discussed in Note A.2. Restatement of Consolidated Financial Statements in our Notes to Consolidated Financial Statements.

Subsequent to management's identification of the errors in our financial statements and after reporting the error to our independent registered public accounting firm, KPMG LLP (KPMG), we noted certain matters regarding financial reporting and the interpretation of financial accounting standards in accordance with generally acceptable accounting principles to be a material weakness in internal controls as defined under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Inadequate controls and procedures in the accounting and financial reporting departments for appropriately interpreting and applying accounting principles along with the production and review of financial statements in order to prevent or detect misstatements of accounting information was a material weakness that was identified.

Furthermore, in planning and performing its audit of our restated consolidated financial statements, our external auditors also noted in a letter to management and the audit committee dated August 16, 2004 certain matters involving internal controls and operations that they consider to be a material weakness, as defined by the PCAOB. According to the letter, we need to improve the evaluation and documentation of accounting policies and procedures for complex transactions, such as transfers of financial assets, derivatives and hedge accounting and allowance for credit losses, and we currently do not have a sufficient amount or type of staff in the financial reporting and accounting departments, including the lack of a Controller. Furthermore, our auditors also noted significant deficiencies, as defined by the PCAOB, for our consideration stating that our internal audit function does not provide an adequate or effective monitoring of our controls and we need to evaluate whether we have appropriate internal resources to manage and monitor work performed by our outsourced tax compliance function.

In connection with restating our financial statements as provided in this report, our CEO and CFO, with the participation of other management, re-evaluated the effectiveness of our disclosure controls and procedures for the quarter ended March 31, 2004 and based on the re-evaluation by our CEO and CFO, they concluded that, as of March 31, 2004, there were certain deficiencies in some of our disclosure controls and procedures,

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which has resulted in a conclusion that such disclosure controls were ineffective.

As a result of the findings described above and in addition to our obligations under Section 404 of the Sarbanes-Oxley Act of 2002, we began implementing the following actions:

we sought to thoroughly understand the nature of the issues through discussions with KPMG and our Audit Committee;

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as part of our new internal control procedures, we are enhancing our documentation of critical accounting policies;

we hired outside consultants to assist our internal audit group in documenting our accounting and business processes and identifying areas that require control or process improvement;

we have begun establishing and continue to establish new internal control processes based on discussions with our consultants that we have engaged to help us in this regard and our own management team seeking to remedy any problems identified;

in June 2004, we hired a Director of Internal Audit whose primary responsibilities are to oversee the establishment of formalized policies and procedures throughout our organization and to document and assess our system of internal controls;

we began instituting, and continue to institute, new procedures around our quarterly reporting processes whereby significant accounting issues are discussed and documented, reviewed with our external auditors and our Audit Committee, formally approved by our management, and given timely effect in our books and records;

in October 2004, we hired a Controller; and

we have embarked on the hiring of additional resources in the accounting and finance areas with expertise in technical accounting and SEC reporting.

We anticipate expenditures of approximately \$1.0 million to \$1.5 million to implement these actions along with other items related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

We believe that our disclosure controls and procedures, including our internal control over financial reporting, have improved due to the scrutiny of such matters by our management and Audit Committee, and other consultants we have engaged to assist us in assessing and improving our controls and procedures. Since the initial identification of the issues resulting from the restatements, we believe our controls and procedures will continue to improve as we complete the implementation of the actions described above. We note, however, that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our control systems as we develop them may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Based in part upon these changes, our CEO and CFO believe that as of the filing date of this report on Form 10-Q/A, our disclosure controls and procedures are effective and designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. The Company has not yet evaluated or tested the operating effectiveness of the matters listed above that have been and are being implemented to correct the referenced material weakness and significant deficiencies.

Changes in Internal Controls

During the first quarter of 2004, there were no changes in our internal controls over financial reporting that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting (as defined in Rule 13a-15(f) promulgated under the Exchange Act). Subsequent to the first quarter of 2004, specifically in August 2004, we began implementation of the changes discussed above which actions have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. When fully implemented, we will test the operating effectiveness of such controls, as performed, in the normal course of business.

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PART II. OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS

Please refer to IMH's report on Form 10-K/A for the year ended December 31, 2003 regarding litigation and claims.

ITEM 2: CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

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 AND REPORTS ON FORM 8-K

(a) Exhibits:

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

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

(b) Reports on Form 8-K

Current Report on Form 8-K, dated January 30, 2004, furnished to the SEC reporting Items 5, 9 and 12, relating to a press release issued by the Company on January 29, 2004 reporting financial results for the quarter and fiscal year ended December 31, 2003.

Current Report on Form 8-K, dated February 6, 2004, furnished to the SEC reporting Items 5 and 7, relating to the execution of an underwriting agreement with UBS Securities LLC, Friedman, Billings, Ramsey & Co., Inc., Sandler O'Neill & Partners, L.P. and JMP Securities LLC.

Current Report on Form 8-K, dated February 26, 2004, furnished to the SEC reporting Item 9, relating to the posting of the Company's unaudited monthly fact sheet.

Current Report on Form 8-K, dated March 31, 2004, furnished to the SEC reporting Item 9, relating to the posting of the Company's unaudited monthly fact sheet.

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SIGNATURES

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

IMPAC MORTGAGE HOLDINGS, INC.

/s/ Richard J. Johnson
by: Richard J. Johnson
Executive Vice President
and Chief Financial Officer
(authorized officer of registrant and principal financial officer)

Date: October 20, 2004