

IMPAC MORTGAGE HOLDINGS INC

Form 10-Q

November 08, 2005

[Table of Contents](#)

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended September 30, 2005

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 ☒ No ☐

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

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

There were 76,058,363 shares of common stock outstanding as of November 4, 2005.

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**Table of Contents**

**IMPAC MORTGAGE HOLDINGS, INC.**

**FORM 10-Q QUARTERLY REPORT**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
ITEM 1. <b><u>CONSOLIDATED FINANCIAL STATEMENTS</u></b>	
Consolidated Balance Sheets as of September 30, 2005 and December 31, 2004	1
Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2005 and 2004	2
Consolidated Statements of Comprehensive Earnings for the Three and Nine Months Ended September 30, 2005 and 2004	3
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2005 and 2004	4
Notes to Consolidated Financial Statements	6
ITEM 2. <b><u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	14
General Overview	14
Critical Accounting Policies	15
Financial Highlights for the Third Quarter of 2005	15
Financial Highlights for the First Nine Months of 2005	16
Third Quarter and Year-to-Date 2005 Taxable Income	16
Financial Condition and Results of Operations	17
Liquidity and Capital Resources	32
Forward-Looking Statements and Risk Factors Related to Our Business Arising in the Quarterly Period Ended September 30, 2005	37
ITEM 3. <b><u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	38
ITEM 4. <b><u>CONTROLS AND PROCEDURES</u></b>	41
<b>PART II. OTHER INFORMATION</b>	
ITEM 1. <b><u>LEGAL PROCEEDINGS</u></b>	44
ITEM 2. <b><u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u></b>	44
ITEM 3. <b><u>DEFAULTS UPON SENIOR SECURITIES</u></b>	44
ITEM 4. <b><u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u></b>	44
ITEM 5. <b><u>OTHER INFORMATION</u></b>	44
ITEM 6. <b><u>EXHIBITS</u></b>	44
<b><u>SIGNATURES</u></b>	44

**CERTIFICATIONS**

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(dollar amounts in thousands, except share data)**

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
	<b>(unaudited)</b>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 129,904	\$ 324,351
Restricted cash	396	253,360
CMO collateral	24,537,379	21,308,906
Finance receivables	305,143	471,820
Mortgages held-for-investment	192,310	586,686
Allowance for loan losses	(78,570)	(63,955)
Mortgages held-for-sale	2,214,215	587,745
Accrued interest receivable	116,329	97,617
Other assets	471,843	249,237
<b>Total assets</b>	<b>\$ 27,888,949</b>	<b>\$ 23,815,767</b>
<b>LIABILITIES</b>		
CMO borrowings	\$ 24,055,473	\$ 21,206,373
Reverse repurchase agreements	2,553,886	1,527,558
Trust preferred securities	76,318	
Accrued dividends payable	34,194	
Other liabilities	32,374	37,761
<b>Total liabilities</b>	<b>26,752,245</b>	<b>22,771,692</b>
<b>Commitments and contingencies</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Series A junior participating preferred stock, \$0.01 par value; 2,500,000 shares authorized; none issued and outstanding as of September 30, 2005 and December 31, 2004		
Series B 9.375% cumulative redeemable preferred stock, \$0.01 par value; liquidation value \$50,000; 2,000,000 shares authorized, issued and outstanding as of September 30, 2005 and December 31, 2004	20	20
Series C 9.125% cumulative redeemable preferred stock, \$0.01 par value; liquidation value \$107,500; 5,500,000 shares authorized; 4,300,000 shares issued and outstanding as of September 30, 2005 and December 31, 2004	43	43
Common stock, \$0.01 par value; 200,000,000 shares authorized; 75,744,263 and 75,153,926 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively	757	752
Additional paid-in capital	1,159,142	1,152,861
Accumulated other comprehensive income	616	979
Net accumulated surplus (deficit):		

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Cumulative dividends declared	(671,714)	(513,453)
Retained earnings	647,840	402,873
	<hr/>	<hr/>
Net accumulated (deficit)	(23,874)	(110,580)
	<hr/>	<hr/>
Total stockholders' equity	1,136,704	1,044,075
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 27,888,949	\$ 23,815,767
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See accompanying notes to consolidated financial statements.

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

(in thousands, except per share data)

(unaudited)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>INTEREST INCOME:</b>				
Mortgage assets	\$ 322,705	\$ 209,766	\$ 907,065	\$ 503,954
Other interest income	1,345	622	4,149	1,290
<b>Total interest income</b>	<b>324,050</b>	<b>210,388</b>	<b>911,214</b>	<b>505,244</b>
<b>INTEREST EXPENSE:</b>				
CMO borrowings	243,945	97,965	639,667	215,146
Reverse repurchase agreements	35,448	16,978	78,192	36,594
Other borrowings	1,761	24	3,200	110
<b>Total interest expense</b>	<b>281,154</b>	<b>114,967</b>	<b>721,059</b>	<b>251,850</b>
<b>Net interest income</b>	<b>42,896</b>	<b>95,421</b>	<b>190,155</b>	<b>253,394</b>
Provision for loan losses	13,434	(229)	25,219	24,778
<b>Net interest income after provision for loan losses</b>	<b>29,462</b>	<b>95,650</b>	<b>164,936</b>	<b>228,616</b>
<b>NON-INTEREST INCOME:</b>				
Realized gain (loss) from derivative instruments	10,975	(31,466)	(4,209)	(67,211)
Change in fair value of derivative instruments	107,881	(52,961)	141,521	24,035
Gain (loss) on sale of loans	12,118	(5,923)	44,063	8,552
Gain on sale of investment securities				5,474
Other income	1,280	742	8,664	3,892
<b>Total non-interest income</b>	<b>132,254</b>	<b>(89,608)</b>	<b>190,039</b>	<b>(25,258)</b>
<b>NON-INTEREST EXPENSE:</b>				
Personnel expense	19,592	13,733	59,282	43,747
Amortization of deferred charge	6,908	6,182	19,503	14,866
General and administrative and other expense	7,111	3,794	18,584	11,278
Provision for repurchases	3,242	(828)	8,606	(372)
Amortization and impairment of mortgage servicing rights	551	527	1,577	1,502
Data processing expense	1,296	798	3,075	2,576
Occupancy expense	1,284	890	3,599	2,588
Equipment expense	1,414	1,011	3,797	2,625
Professional services	1,730	(493)	7,170	1,669

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Gain on sale of other real estate owned	(432)	(819)	(1,261)	(3,569)
Total non-interest expense	42,696	24,795	123,932	76,910
Net earnings (loss) before income tax benefit	119,020	(18,753)	231,043	126,448
Income tax benefit	(7,337)	(9,436)	(13,924)	(16,821)
Net earnings (loss)	126,357	(9,317)	244,967	143,269
Cash dividends on cumulative redeemable preferred stock	(3,624)	(1,172)	(10,872)	(1,615)
Net earnings (loss) available to common stockholders	\$ 122,733	\$ (10,489)	\$ 234,095	\$ 141,654
NET EARNINGS (LOSS) PER SHARE:				
Basic	\$ 1.62	\$ (0.15)	\$ 3.10	\$ 2.18
Diluted	\$ 1.61	\$ (0.15)	\$ 3.07	\$ 2.14
DIVIDENDS DECLARED PER COMMON SHARE				
	\$ 0.45	\$ 0.75	\$ 1.95	\$ 2.15

See accompanying notes to consolidated financial statements.



**Table of Contents**

**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS**

(in thousands)

(unaudited)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net earnings (loss)	\$ 126,357	\$ (9,317)	\$ 244,967	\$ 143,269
Net unrealized gains (losses) arising during period:				
Unrealized holding losses on securities	(803)	(439)	(363)	(470)
Reclassification of losses included in net earnings				(3,447)
Net unrealized gains (losses)	(803)	(439)	(363)	(3,917)
Comprehensive earnings (loss)	\$ 125,554	\$ (9,756)	\$ 244,604	\$ 139,352

See accompanying notes to consolidated financial statements.

**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net earnings	\$ 244,967	\$ 143,269
Adjustments to reconcile net earnings to net cash used in operating activities:		
Provision for loan losses	25,219	24,778
Amortization of premiums, deferred securitization costs and trust preferred securities	216,284	106,592
Gain on sale of other real estate owned	(1,261)	(3,569)
Gain on sale of loans	(44,063)	(8,552)
Change in fair value of derivative instruments	(141,521)	(24,035)
Purchase of mortgages held-for-sale	(16,284,234)	(15,851,639)
Sale and principal reductions on mortgages held-for-sale	14,693,022	15,512,193
Net change in deferred taxes	(2,077)	2,054
Gain on sale of investment securities available-for-sale		(5,474)
Amortization of deferred charge	19,503	14,866
Depreciation and amortization	3,427	1,861
Amortization and impairment of mortgage servicing rights	1,577	1,502
Net change in mortgage servicing rights	(736)	430
Net change in accrued interest receivable	(18,712)	(39,045)
Net change in restricted cash	252,964	(655)
Net change in other assets and liabilities	(35,365)	(78,364)
Net cash used in operating activities	(1,071,006)	(203,788)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Net change in CMO collateral	(3,456,974)	(8,964,269)
Net change in finance receivables	166,677	42,934
Purchase of premises and equipment	(5,880)	(5,412)
Net change in mortgages held-for-investment	377,501	(289,020)
Sale of investment securities available-for-sale		4,510
Purchase of investment securities available-for-sale	(36,413)	(3,920)
Purchase of deferred investments	(3,201)	(1,660)
Net principal reductions on investment securities available-for-sale	1,501	6,215
Proceeds from the sale of other real estate owned, net	38,960	30,384
Net cash used in investing activities	(2,917,829)	(9,180,238)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net change in reverse repurchase agreements	1,026,328	552,027
Proceeds from CMO borrowings	10,564,127	11,979,684
Repayment of CMO borrowings	(7,754,514)	(3,296,796)
Issuance of trust preferred securities	76,202	

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Dividends paid common	(113,194)	(93,365)
Dividends paid preferred	(10,872)	(1,615)
Proceeds from sale of common stock		138,553
Proceeds from sale of common stock via equity distribution agreement		133,671
Proceeds from sale of cumulative redeemable preferred stock		48,285
Proceeds from exercise of stock options	6,311	925
	<hr/>	<hr/>
Net cash provided by financing activities	3,794,388	9,461,369
	<hr/>	<hr/>
Net change in cash and cash equivalents	(194,447)	77,343
Cash and cash equivalents at beginning of period	324,351	125,153
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 129,904	\$ 202,496
	<hr/>	<hr/>

**Table of Contents**

**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS**

**(in thousands)**

**(unaudited)**

	<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>SUPPLEMENTARY INFORMATION:</b>		
Interest paid	\$ 656,422	\$ 226,207
Taxes paid	17,821	26,614
<b>NON-CASH TRANSACTIONS:</b>		
Transfer of mortgages to other real estate owned	\$ 58,169	\$ 27,181
Dividends declared and unpaid	34,194	52,954
Net change in other comprehensive earnings	(363)	(3,917)

See accompanying notes to consolidated financial statements.

**Table of Contents**

**IMPAC MORTGAGE HOLDINGS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**(unaudited)**

**Note A Summary of Business and Significant Accounting Policies**

**1. Business Summary and Financial Statement Presentation**

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).

We are a mortgage real estate investment trust, or REIT, that is a nationwide acquirer, originator, seller and investor of 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 or B/C mortgages. We also provide warehouse financing to originators of mortgages.

We operate three core businesses:

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

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

the warehouse lending operations that is conducted by IWLG.

The long-term investment operations primarily invest in adjustable rate and, to a lesser extent, fixed rate Alt-A mortgages that are acquired and originated by our mortgage operations and small-balance multi-family 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. This business earns net interest income and prepayment penalty income on collateralized mortgage obligations (CMOs) and loans held for investment.

The mortgage operations acquire, originate, sell and securitize primarily adjustable rate and fixed rate Alt-A mortgages and, to a lesser extent, B/C mortgages. 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 fees associated with 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

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acquisition and origination of mortgages.

The warehouse lending operations provide short-term financing to mortgage loan originators, including our mortgage operations, by funding mortgages from their closing or acquisition 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 warehouse transactions fees.

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 nine-month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

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

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these financial statements in conformity with GAAP. Management's estimates and assumptions include allowance for loan losses, valuation of derivative financial instruments, repurchase liabilities related to sold loans and the amortization of various loan premiums and discounts due to prepayment estimates. Actual results could differ from those estimates.

**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data or as otherwise indicated)****(unaudited)**

Premiums, discounts and securitization costs associated with the CMO collateral and CMO financing are amortized or accreted into interest income/interest expense over the projected lives of the CMO collateral and CMO financings using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, market prepayment speeds, and current conditions. If our estimate of prepayments is incorrect, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

**2. Stock Options**

No compensation cost has been recognized for stock-based awards to employees as the stock option exercise price is equal to the fair market value of the underlying common stock as of the stock option grant date. Summarized below are the pro forma effects on net earnings and net earnings per share as if the Company had elected to use the fair value approach to account for its employee stock-based compensation plans:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net earnings (loss) available to common stockholders	\$ 122,733	\$ (10,489)	\$ 234,095	\$ 141,654
Less: Total stock-based employee compensation expense using the fair value method	(686)	(537)	(1,764)	(1,120)
Pro forma net earnings	\$ 122,047	\$ (11,026)	\$ 232,331	\$ 140,534
Net earnings (loss) per share as reported:				
Basic	\$ 1.62	\$ (0.15)	\$ 3.10	\$ 2.18
Diluted	\$ 1.61	\$ (0.15)	\$ 3.07	\$ 2.14
Pro forma net earnings (loss):				
Basic	\$ 1.61	\$ (0.16)	\$ 3.08	\$ 2.16
Diluted	\$ 1.59	\$ (0.16)	\$ 3.01	\$ 2.11

**3. Recent Accounting Pronouncements**

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In December 2004, the FASB issued Statement No. 123(R), *Share-Based Payment* (SFAS 123R). It requires all public companies to report share-based compensation expense at fair value at the grant date of the related share-based awards. The Company is required to adopt the provisions of the SFAS 123R effective for annual periods beginning after June 15, 2005. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS 123R in prior periods, the impact of SFAS 123R would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net earnings per share in Note A.2. Stock Options. As a result of this change, the Company is required to adopt SFAS 123R effective January 1, 2006. Management has not yet determined the effect of implementation of SFAS 123R or whether the Statement will be implemented prospectively or retrospectively.

### **4. Legal Proceedings**

The Company is party to litigation and claims which are normal in the course of our operations. While the results of such litigation and claims can not be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on our financial condition or results of operations.



**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data or as otherwise indicated)****(unaudited)****Note B Reconciliation of Earnings Per Share**

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

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Numerator for earnings per share:</b>				
Net earnings (loss)	\$ 126,357	\$ (9,317)	\$ 244,967	\$ 143,269
Less: Cash dividends on cumulative redeemable preferred stock	(3,624)	(1,172)	(10,872)	(1,615)
Net earnings (loss) available to common stockholders	<u>\$ 122,733</u>	<u>\$ (10,489)</u>	<u>\$ 234,095</u>	<u>\$ 141,654</u>
<b>Denominator for basic net earnings per share:</b>				
Basic weighted average number of common shares outstanding	<u>75,720</u>	<u>70,573</u>	<u>75,440</u>	<u>65,106</u>
<b>Denominator for earnings per share:</b>				
Basic weighted average number of common shares outstanding	75,720	70,573	75,440	65,106
Net effect of dilutive stock options	598		871	1,149
Diluted weighted average common and common equivalent shares	<u>76,318</u>	<u>70,573</u>	<u>76,311</u>	<u>66,255</u>
<b>Net earnings (loss) per share:</b>				
Basic	<u>\$ 1.62</u>	<u>\$ (0.15)</u>	<u>\$ 3.10</u>	<u>\$ 2.18</u>
Diluted	<u>\$ 1.61</u>	<u>\$ (0.15)</u>	<u>\$ 3.07</u>	<u>\$ 2.14</u>

For the three and nine month periods ended September 30, 2005, 1.4 million stock options were outstanding. For the three and nine month periods ended September 30, 2004, stock options in the amount of 1.3 million and 341,000, respectively, were outstanding, that were not included in the above weighted average calculations because they were anti-dilutive.

**Note C Segment Reporting**

The following tables present reporting segments as of and for the nine and three month periods ended September 30, 2005 and 2004:

**Reporting Segments as of and for the Nine Months**

	<b>Ended September 30, 2005</b>				
	<b>Long-Term Investment Operations</b>	<b>Warehouse Lending Operations</b>	<b>Mortgage Operations</b>	<b>Inter- Company(1)</b>	<b>Consolidated</b>
<b>Balance Sheet Items:</b>					
CMO collateral and mortgages held-for-investment	\$ 24,859,044	\$	\$	\$ (129,355)	\$ 24,729,689
Mortgages held-for-sale			2,214,215		2,214,215
Finance receivables		2,619,075		(2,313,932)	305,143
Total assets	25,109,976	2,757,884	2,267,415	(2,246,326)	27,888,949
Total stockholders' equity	981,721	203,324	19,469	(67,810)	1,136,704
<b>Income Statement Items:</b>					
Net interest income	\$ 89,967	\$ 40,455	\$ 6,559	\$ 53,174	\$ 190,155
Provision for loan losses	25,219				25,219
Non-interest income	143,155	6,268	109,173	(68,557)	190,039
Non-interest expense and income taxes	10,256	5,833	99,478	(5,559)	110,008
Net earnings (loss)	\$ 197,647	\$ 40,890	\$ 16,254	\$ (9,824)	\$ 244,967

Table of Contents

## IMPAC MORTGAGE HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(unaudited)

## Reporting Segments for the Three Months

Ended September 30, 2005

	Long-Term Investment Operations	Warehouse Lending Operations	Mortgage Operations	Inter- Company(1)	Consolidated
<b>Income Statement Items:</b>					
Net interest income (loss)	\$ 8,941	\$ 15,475	\$ (101)	\$ 18,581	\$ 42,896
Provision for loan losses	13,434				13,434
Non-interest income	119,350	2,011	33,777	(22,884)	132,254
Non-interest expense and income taxes	3,257	1,978	32,846	(2,722)	35,359
Net earnings (loss)	\$ 111,600	\$ 15,508	\$ 830	\$ (1,581)	\$ 126,357

- (1) Income statement items include inter-company loan sale transactions and the elimination of related gains. Corporate overhead expenses are allocated to the segments based on actual time devoted to the segment.

## Reporting Segments as of and for the Nine Months

Ended September 30, 2004

	Long-Term Investment Operations	Warehouse Lending Operations	Mortgage Operations	Inter- Company(1)	Consolidated
<b>Balance Sheet Items:</b>					
CMO collateral and mortgages held-for-investment	\$ 18,551,116	\$	\$	\$ (113,629)	\$ 18,437,487
Mortgages held-for-sale			742,684		742,684
Finance receivables		2,250,459		(1,663,363)	587,096
Total assets	18,872,737	2,229,002	827,243	(1,684,567)	20,244,415
Total stockholders' equity	650,869	149,245	30,998	(44,944)	786,168
<b>Income Statement Items:</b>					
Net interest income	\$ 174,680	\$ 33,608	\$ 12,881	\$ 32,225	\$ 253,394
Provision for loan losses	19,050	5,728			24,778
Non-interest income	(35,646)	7,505	89,497	(86,614)	(25,258)
Non-interest expense and income taxes	3,628	4,870	76,196	(24,605)	60,089
Net earnings (loss)	\$ 116,356	\$ 30,515	\$ 26,182	\$ (29,784)	\$ 143,269

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Reporting Segments for the Three Months

Ended September 30, 2004

	Long-Term Investment Operations	Warehouse Lending Operations	Mortgage Operations	Inter- Company(1)	Consolidated
<b>Income Statement Items:</b>					
Net interest income	\$ 61,644	\$ 15,642	\$ 4,835	\$ 13,300	\$ 95,421
Provision for loan losses	918	(1,147)			(229)
Non-interest income	(80,106)	2,740	12,324	(24,566)	(89,608)
Non-interest expense and income taxes	1,918	1,667	17,306	(5,532)	15,359
Net earnings (loss)	\$ (21,298)	\$ 17,862	\$ (147)	\$ (5,734)	\$ (9,317)

- (1) Income statement items include inter-company loan sale transactions and the elimination of related gains. Corporate overhead expenses are allocated to the segments based on actual time devoted to the segment.

**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data or as otherwise indicated)****(unaudited)****Note D Mortgages Held-for-Sale**

Mortgages held-for-sale for the periods indicated consisted of the following:

	At September 30, 2005	At December 31, 2004
Mortgages held-for-sale	\$ 2,174,394	\$ 576,777
Net premiums on mortgages held-for-sale	39,821	10,968
Total mortgages held-for-sale	\$ 2,214,215	\$ 587,745

The allowance for mortgage repurchases of \$10.8 million and \$2.2 million, was included in other liabilities as of September 30, 2005 and December 31, 2004, respectively. The allowance for mortgage repurchases is maintained for the purpose of repurchasing 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 determining the adequacy of the liability for mortgage repurchases, management considers such factors as amount of loan sales, specific requests for repurchase, historical experience, known problem loans, underlying collateral values, recent sales activity of similar loans and other appropriate information. In the first two quarters of 2004 gains (losses) from the sale of repurchased loans were recorded as a charge-off to the allowance for repurchases. Subsequent to June 30, 2004, gains (losses) from the sale of repurchased loans have been recorded as a gain (loss) on the sale of loans. In 2004, the losses from the sale of repurchased loans were none and \$(273,000), respectively, for the three and nine months ended September 30, 2004. In 2005, the losses from sales of repurchased loans were \$(170,000) and \$(852,000), respectively, for the three and nine months ended September 30, 2005. Activity for the allowance for repurchases for the periods indicated was as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2004	2005	2004
Beginning balance	\$ 7,547	\$ 2,511	\$ 2,183	\$ 2,327
Provision for loan repurchases (1)	3,242	(828)	8,606	(644)
Total provision for repurchases	\$ 10,789	\$ 1,683	\$ 10,789	\$ 1,683

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(1) The negative provision for the three and nine months ended September 30, 2004 represents the reversal of a provision no longer needed.

## Note E CMO Collateral

CMO collateral for the periods indicated consisted of the following:

	At September 30, 2005	At December 31, 2004
Mortgages secured by single-family residential real estate	\$ 23,205,266	\$ 20,428,144
Mortgages secured by multi-family residential real estate	1,005,985	604,934
Net premiums on mortgages	326,128	275,828
Total CMO collateral	\$ 24,537,379	\$ 21,308,906

## Note F Allowance for Loan Losses

The allowance for loan loss for the periods indicated is comprised of the following:

	At September 30, 2005	At December 31, 2004
CMO collateral and loans held for investment	\$ 61,502	\$ 53,272
Specific reserve for finance receivables	10,683	10,683
Specific reserve for estimated hurricane Katrina losses	6,385	
Total allowance for loan losses	\$ 78,570	\$ 63,955

**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data or as otherwise indicated)****(unaudited)**

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

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Beginning balance	\$ 69,826	\$ 60,249	\$ 63,955	\$ 38,596
Provision for loan losses (1)	13,434	(229)	25,219	24,778
Charge-offs, net of recoveries	(4,690)	(762)	(10,604)	(4,116)
Total allowance for loan losses	\$ 78,570	\$ 59,258	\$ 78,570	\$ 59,258

(1) The negative provision for the three months ended September 30, 2004 represents the reversal of a provision no longer needed.

The provision for loan losses for the three and nine month periods ended September 30, 2004 include specific impairments on finance receivables of \$2.3 million and \$10.3 million, respectively, that we have estimated to be non-collectible. No similar provision was recorded in 2005.

The Company reviewed the properties in areas affected by hurricanes Katrina and Rita. Based on information available at the time of filing this report, and included in the allowance for loan loss for CMO collateral and loans held for investment, the Company provided a specific reserve of \$6.4 million to record an estimated loss exposure attributable to Katrina for 219 properties securing a total unpaid principal balance of \$26 million in the affected areas. Although there may be anticipated losses, no specific reserve has been established for losses related to hurricane Rita. The Company is still evaluating the affect of the hurricanes and the amount of the provision may be adjusted as more information becomes available.

**Note G Other Assets**

Other assets for the periods indicated consisted of the following:

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	At September 30, 2005	At December 31, 2004
Derivative assets	\$ 244,927	\$ 95,390
Investment securities available-for-sale	60,008	25,427
Deferred charge	49,005	48,211
Real estate owned	38,747	18,277
Prepaid and other assets	50,514	43,323
Premises and equipment	11,513	9,092
Deferred income taxes	7,405	5,328
Investment in Impac Capital Trusts	2,334	
Restricted investments	7,390	4,189
Total other assets	\$ 471,843	\$ 249,237

**Note H CMO Borrowings**

Selected information on CMO borrowings for the periods indicated consisted of the following (dollars in millions):

Year of Issuance	Original Issuance	CMOs Outstanding as of		Range of Fixed Interest	Range of Interest Rate Margins Over One-Month	Range of Interest Rate Margins After Adjustment
	Amount	9/30/05	12/31/04	Rates (%)	LIBOR (%)	Date (%) (1)(2)
2002	\$ 3,876.1	\$ 258.8	\$ 1,237.3	5.25 - 12.00	0.27 - 2.75	0.54 - 3.68
2003	5,966.1	2,195.6	3,615.8	4.34 - 12.75	0.27 - 3.00	0.54 - 4.50
2004	17,710.7	11,799.7	16,407.5	3.58 - 5.56	0.25 - 2.50	0.50 - 3.75
2005	10,605.7	9,854.2		N/A	0.24 - 2.90	0.48 - 4.35
Sub-total CMO borrowings		24,108.3	21,260.6			
Accrued interest expense		16.5	12.9			
Unamortized securitization costs		(69.3)	(67.1)			
Total CMO borrowings		\$ 24,055.5	\$ 21,206.4			

(1) One-month LIBOR was 3.83% as of the last reset date on CMO borrowings prior to September 30, 2005.



**Table of Contents**

**IMPAC MORTGAGE HOLDINGS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**(unaudited)**

- (2) Interest rate margins over one-month LIBOR are generally increased when the unpaid principal balance is 20%-25% of the original issuance amount.

**Note I Reverse Repurchase Agreements**

Reverse repurchase agreements are entered into to finance our warehouse lending operations and to fund and purchase mortgages by the mortgage operations. These facilities consist of uncommitted lines, which may be withdrawn at any time by the lender, and committed lines. At September 30, 2005, the Company was in compliance with the financial covenants associated with the reverse repurchase agreements. During the third quarter of 2005, the total warehouse facilities amounted to \$4.3 billion, of which \$2.6 billion was outstanding at September 30, 2005.

**Note J Junior Subordinated Debt and Trust Preferred Securities**

During the nine months ended September 30, 2005, the Company formed three wholly-owned trust subsidiaries (Trusts) for the purpose of issuing an aggregate of \$76.3 million of trust preferred securities (the Trust Preferred Securities). The proceeds from the sale thereof were invested in junior subordinated debt issued by the Company. All proceeds from the sale of the Trust Preferred Securities and the common securities issued by the Trusts are invested in junior subordinated notes (Notes), which are the sole assets of the Trusts. The Trusts pay dividends on the Trust Preferred Securities at the same rate as paid by the Company on the Notes held by the Trusts.

On September 16, 2005, the Company entered into a Second Amended and Restated Trust Agreement with JPMorgan Bank, N.A., as Property Trustee, Chase Bank USA, N.A., as Delaware Trustee and the administrative trustees of the Impac Capital Trust #1 and an Amended and Restated Junior Subordinated Indenture with JPMorgan Chase Bank, N.A., as trustee, amending the agreements originally entered into on April 1, 2005. The amended agreements (i) change the date on which the variable interest rate will begin from the date after March 30, 2010 to the date after April 30, 2010, (ii) change the dividend payment dates from March 30, June 30, September 30 and December 30 to January 30, April 30, July 30 and October 30 of each year, (iii) change the date after which interest may be deferred from March 30, 2006 to April 30, 2006, (iv) change the optional redemption date from March 30, 2010 to April 30, 2010 and (v) change the maturity date from March 30, 2035 to April 30, 2035.

The following table shows the Trust Preferred Securities issued during the nine months ended September 30, 2005:

Trust Preferred Securities	Common Securities	Junior Subordinated Debt	Stated Maturity Date	Optional Redemption Date
	<hr/>			

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Impac Capital Trust #1 (1)	\$ 25,000	\$ 780	\$ 25,780	4/30/2035	4/30/2010(4)
Impac Capital Trust #2 (2)	25,000	774	25,774	4/30/2035	4/30/2010(5)
Impac Capital Trust #3 (3)	26,250	820	27,070	6/30/2035	6/30/2010(4)
Sub-total	\$ 76,250	\$ 2,374	\$ 78,624		
Unamortized Debt Issuance Costs			(2,306)		
Total			\$ 76,318		

- (1) Requires quarterly distributions initially at a fixed rate of 8.01% per annum through April 30, 2010 and thereafter at a variable rate of three-month LIBOR plus 3.75% per annum. Distributions are cumulative but after April 2006 may be deferred for a period of up to four consecutive quarterly interest payment periods if the Company exercises its right to defer the payment of interest on the Notes (Extension Period).
- (2) Requires quarterly distributions initially at a fixed rate of 8.065% per annum through April 30, 2010 and thereafter at a variable rate of three-month LIBOR plus 3.75% per annum. Distributions are cumulative but after April 2006 may be deferred for a period of up to four consecutive quarterly interest payment periods if the Company exercises its right to defer the payment of interest on the Notes (Extension Period).
- (3) Requires quarterly distributions initially at a fixed rate of 8.01% per annum through June 30, 2010 and thereafter at a variable rate of three-month LIBOR plus 3.75% per annum. Distributions are cumulative but after May 2006 may be deferred for a period of up to four consecutive quarterly interest payment periods if the Company exercises its right to defer the payment of interest on the Notes (Extension Period).
- (4) Redeemable at par at any time after the date indicated.
- (5) Redeemable at par at any time after the date indicated and before that date, under certain events, at a premium of 7.5% of the outstanding amount.

During any Extension Period, the Company may not declare or pay dividends on its capital stock. If an event of default occurs (such as a payment default that is outstanding for 30 days, a default in performance, a breach of any covenant or

**Table of Contents****IMPAC MORTGAGE HOLDINGS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data or as otherwise indicated)****(unaudited)**

representation, bankruptcy or insolvency of the Company or liquidation or dissolution of the Trust) either the trustee of the Notes or the holders of at least 25% of the aggregate principal amount of the outstanding Notes may declare the principal amount of, and all accrued interest on, all the Notes to be due and payable immediately, or if the holders of the Notes fail to make such declaration, the holders of at least 25% in aggregate liquidation amount of the Preferred Securities outstanding shall have a right to make such declaration.

In December 2003, the FASB modified and reissued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46R). FIN 46R requires the deconsolidation of trust preferred entities since the Company does not have a significant variable interest in the trust. Therefore, the Company records its investment in the trust preferred entities in other assets and accounts for such under the equity method of accounting and reflects a liability for the issuance of the junior subordinated notes to the trust preferred entities. The interest expense on such notes is recorded in Interest Expense other borrowings in the statement of operations.

**Note K Subsequent Events***Junior Subordinated Debt and Trust Preferred Securities*

During October 2005, the Company formed another wholly-owned trust subsidiary, Impac Capital Trust #4 (Trust), for the purpose of issuing an aggregate of \$20.0 million of trust preferred securities (the Trust Preferred Securities). The proceeds from the sale thereof were invested in junior subordinated debt issued by the Company. All proceeds from the sale of the Trust Preferred Securities and the common securities issued by the Trust are invested in junior subordinated notes, which are the sole assets of the Trust. The Trust pays dividends on the Trust Preferred Securities at the same rate as the distributions paid by the Company on the junior subordinated notes held by the Trust.

The following table shows the Trust Preferred Securities issued during October 2005:

	<b>Trust Preferred Securities</b>	<b>Common Securities</b>	<b>Junior Subordinated Debt</b>	<b>Stated Maturity Date</b>	<b>Optional Redemption Date</b>
Impac Capital Trust #4 (1)	\$ 20,000	\$ 620	\$ 20,620	7/30/2035	7/30/2010(2)

- (1) Requires quarterly distributions initially at a fixed rate of 8.55% per annum through July 30, 2010 and thereafter at a variable rate of three-month LIBOR plus 3.75% per annum. Distributions are cumulative but may be deferred for a period of up to twenty consecutive quarterly interest payment periods if the Company exercises its right to defer the payment of interest on the Notes (Extension Period).

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- (2) Redeemable at par at any time after the date indicated and before that date, under certain events, at a premium of 7.5% of the outstanding amount.

During any Extension Period, the Company may not declare or pay dividends on its capital stock. If an event of default occurs (such as a payment default that is outstanding for 30 days, a default in performance, a breach of any covenant or representation, bankruptcy or insolvency of the Company or liquidation or dissolution of the Trust) either the trustee of the Notes or the holders of at least 25% of the aggregate principal amount of the outstanding Notes may declare the principal amount of, and all accrued interest on, all the Notes to be due and payable immediately, or if the holders of the Notes fail to make such declaration, the holders of at least a majority in aggregate liquidation amount of the Preferred Securities outstanding shall have a right to make such declaration.

### *Authorization of a Common Stock Repurchase Plan*

On October 13, 2005, the Board of Directors approved and authorized the repurchase of up to 5.0 million shares of common stock. The Company has not repurchased any shares of common stock as of the filing date of this report.

## **Table of Contents**

### **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. ("IMH"), a Maryland corporation incorporated in August 1995, and its wholly-owned 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 subsidiaries Impac Secured Assets Corp., or "ISAC," and Novelle Financial Services, Inc., or "Novelle."

#### **The Mortgage Banking Industry and Discussion of Relevant Fiscal Periods**

The mortgage banking industry is continually subject to current events that occur in the financial services industry. Such events include changes in economic indicators, interest rates, price competition, geographic shifts, disposable income, market anticipation, customer perception as well as others. The factors that effect the industry change rapidly.

In this environment, mortgage banking companies generally anticipate the future marketplace, engage in hedging activities and continuously reassess business plans and strategies to effectively position themselves in the marketplace.

As a result, current events can diminish the relevance of "quarter over quarter" and "year-to-date over year-to-date" comparisons of financial information. In such instances, the Company presents financial information in its Management Discussion and Analysis that is the most relevant to its financial information.

#### **General Overview**

We are a mortgage real estate investment trust, or "REIT," that is a nationwide acquirer, originator, seller and investor of 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, or "B/C mortgages." We also provide warehouse financing to originators of mortgages.

We operate three core businesses:

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

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

the warehouse lending operations that is conducted by IWLG.

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The long-term investment operations primarily invest in adjustable rate and, to a lesser extent, 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;

documentation required for approval of the mortgagor; and

loan balances in excess of maximum Fannie Mae and Freddie Mac lending limits.

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 are 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 that are primarily adjustable rate mortgages with initial fixed interest rate periods of two-, three-, five-, seven- and ten-years that subsequently convert to adjustable rate mortgages, or hybrid ARMs, with balances that generally range from \$500,000 to \$5.0 million. Multi-family mortgages have interest rate floors, which are the initial start rate, and prepayment penalty periods of three-, five-,

## **Table of Contents**

seven- and ten-years. Multi-family mortgages provide greater asset diversification on our balance sheet as borrowers of multi-family mortgages typically have higher credit scores and multi-family mortgages typically have lower loan-to-value ratios, or LTV ratios, and longer average life to payoff than Alt-A mortgages.

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

The mortgage operations acquire, originate, sell and securitize primarily adjustable rate and fixed rate Alt-A mortgages and, to a lesser extent, B/C mortgages. 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 fees associated with mortgage servicing rights, 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 our mortgage operations, by funding mortgages from their closing date until sale 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.

## **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 may 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 allowance for loan losses, derivative financial instruments and securitization of financial assets as financing versus sale.

## **Financial Highlights for the Third Quarter of 2005**

Estimated taxable income per diluted share decreased to \$0.40 compared to \$0.54 for the second quarter of 2005 and \$0.69 for the third quarter of 2004;

Cash dividends declared per common share decreased to \$0.45 for the third quarter of 2005 compared to \$0.75 for the second quarter of 2005 and \$0.75 for the third quarter of 2004;

Total assets increased to \$27.9 billion as of September 30, 2005 from \$23.8 billion as of December 31, 2004 and \$20.2 billion as of September 30, 2004;

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Book value per common share increased to \$12.93 as of September 30, 2005 compared to \$11.80 as of December 31, 2004 and \$10.43 as of September 30, 2004;

The mortgage operations acquired and originated \$6.2 billion of primarily Alt-A mortgages compared to \$5.5 billion for the second quarter of 2005 and \$6.9 billion for the third quarter of 2004;

The long-term investment operations, excluding IMCC originations, retained for investment \$3.3 billion of primarily Alt-A mortgages compared to \$3.1 billion for the second quarter of 2005 and \$4.0 billion for the third quarter of 2004; and

IMCC originated \$211.9 million of multi-family mortgages compared to \$214.6 million for the second quarter of 2005 and \$124.1 million for the third quarter of 2004.



**Table of Contents****Financial Highlights for the First Nine Months of 2005**

Estimated taxable income per diluted share decreased to \$1.68 compared to \$2.31 for the first nine months of 2004;

Cash dividends declared per share decreased to \$1.95 for the 2005 nine month period compared to \$2.15 for the first nine months of 2004;

The mortgage operations acquired and originated \$16.3 billion of primarily Alt-A mortgages compared to \$15.9 billion for the first nine months of 2004;

The long-term investment operations, excluding IMCC originations, retained for investment \$9.7 billion of primarily Alt-A mortgages compared to \$12.1 billion for the first nine months of 2004; and

IMCC originated \$591.8 million of multi-family mortgages compared to \$335.1 million for the first nine months of 2004.

**Third Quarter and Year-to-Date 2005 Taxable Income**

Because dividend payments are based on estimated taxable income, dividends may be more or less than net earnings. As such, we believe that the disclosure of estimated taxable income available to common stockholders, which is a non-generally accepted accounting principle, or GAAP, financial measurement, is useful information for our investors.

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

	<b>For the Three Months</b>		<b>For the Nine Months</b>	
	<b>Ended September 30,</b>		<b>Ended September 30,</b>	
	<b>2005 (1)</b>	<b>2004 (1)</b>	<b>2005 (1)</b>	<b>2004 (1)</b>
Net earnings (loss)	\$ 126,357	\$ (9,317)	\$ 244,967	\$ 143,269
Adjustments to GAAP earnings (2):				
Loan loss provision	13,434	(229)	25,219	24,778
Tax deduction for actual loan losses	(4,690)	(762)	(10,604)	(4,116)
Anticipated partial worthlessness deduction on warehouse advances		(2,336)		(10,336)
Change in fair value of derivative instruments (3)	(108,905)	48,535	(146,913)	(26,843)
Dividends on preferred stock	(3,624)	(1,172)	(10,872)	(1,615)
Net (earnings) loss of IFC (4)	(830)	147	(16,254)	(26,182)
Dividend from IFC (5)	7,000	9,000	32,850	24,000
Elimination of inter-company loan sales transactions (6)	1,581	5,734	9,824	29,784
Estimated taxable income available to common stockholders (7)	\$ 30,323	\$ 49,600	\$ 128,217	\$ 152,739

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Estimated taxable income per diluted share (7)	\$ 0.40	\$ 0.69	\$ 1.68	\$ 2.31
Diluted weighted average shares outstanding	76,318	70,573	76,311	66,255

- (1) Estimated taxable income includes estimates of book to tax adjustments and can differ from actual taxable income as calculated when we file our annual corporate tax return. Since estimated taxable income is a non-GAAP financial measurement, the reconciliation of estimated taxable income available to common stockholders to net earnings meets the requirement of Regulation G as promulgated by the SEC for the presentation of non-GAAP financial measurements.
- (2) Certain adjustments are made to net earnings in order to calculate taxable income due to differences in the way revenues and expenses are recognized under the two methods. As an example, to calculate estimated taxable income, actual loan losses are deducted; however, the calculation of net earnings using GAAP requires a deduction for estimated losses inherent in our mortgage portfolios in the form of a provision for loan losses. To maintain our REIT status, we are required to distribute a minimum of 90% of our annual taxable income to our stockholders.
- (3) The mark-to-market change for the valuation of derivatives at IMH is income or expense for GAAP financial reporting but is not included as an addition or deduction for taxable income calculations.
- (4) Represents net earnings of IFC, a taxable REIT subsidiary, which may not necessarily equal taxable income.

**Table of Contents**

- (5) For the three and nine months ended September 30, 2005, approximately \$2.6 million and \$12.2 million, respectively, were from IFC's prior period undistributed taxable income, thus, the Company believes that none of these distributions were return of capital. However, the final determination will not be made until after IFC files its 2005 tax returns. Any dividends paid to IMH by IFC in excess of IFC's cumulative undistributed taxable income would be recognized as return of capital by IMH to the extent of IMH's capital investment in IFC. Distributions from IFC to IMH may not equal IFC's net earnings, however, IMH can only recognize dividend distributions received from IFC as taxable income to the extent that IFC's distributions are from current or prior period undistributed taxable income. Any distributions by IFC in excess of IMH's capital investment in IFC would be taxed as capital gains.
- (6) Includes the effects to taxable income associated with the elimination of gains from inter-company loan sales between IFC and IMH, net of tax and the related amortization of the deferred charge.
- (7) Excludes the deduction for dividends paid and the availability of a deduction attributable to net operating loss carry-forwards. During the third quarter, the Company filed its 2004 tax return. As of December 31, 2004, the company has Federal net operating loss carry-forwards of \$14.5 million that are expected to be utilized prior to its expiration in the year 2020.

**Third Quarter 2005 vs. Second Quarter 2005**

Estimated taxable income decreased \$0.14 to \$0.40 per diluted common share for the third quarter 2005 compared to \$0.54 per diluted common share for the second quarter 2005. The decline in estimated taxable income of \$10.8 million during the third quarter 2005 as compared to the second quarter 2005 was mainly attributable to a decline of \$5.4 million in adjusted net interest margin at IMH, which includes the realized gain (loss) from derivative instruments and, to a lesser extent, an increase in loan losses of \$2.0 million and a decrease in the dividend from IFC of \$2.0 million. The \$5.4 million decline in adjusted net interest margin at IMH was the result of a \$37.3 million increase in borrowing costs, offset by an increase in interest income of \$19.4 million and an increase in the realized gain (loss) from derivative instruments of \$12.5 million.

**Financial Condition and Results of Operations***Financial Condition***Condensed Balance Sheet Data**

(dollars in thousands)

	<b>September 30, 2005</b>	<b>December 31, 2004</b>	<b>Increase (Decrease)</b>	<b>% Change</b>
CMO collateral	\$ 24,537,379	\$ 21,308,906	\$ 3,228,473	15 %
Mortgages held-for-investment	192,310	586,686	(394,376)	(67)
Finance receivables	305,143	471,820	(166,677)	(35)
Allowance for loan losses	(78,570)	(63,955)	14,615	23
Mortgages held-for-sale	2,214,215	587,745	1,626,470	277
Other assets	718,472	924,565	(206,093)	(22)

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Total assets	\$ 27,888,949	\$ 23,815,767	\$ 4,073,182	17 %
CMO borrowings	\$ 24,055,473	\$ 21,206,373	\$ 2,849,100	13 %
Reverse repurchase agreements	2,553,886	1,527,558	1,026,328	67
Other liabilities	142,886	37,761	105,125	278
Total liabilities	26,752,245	22,771,692	3,980,553	17
Total stockholder's equity	1,136,704	1,044,075	92,629	9
Total liabilities and stockholder's equity	\$ 27,888,949	\$ 23,815,767	\$ 4,073,182	17 %

Total assets increased 17% to \$27.9 billion as of September 30, 2005 as compared to \$23.8 billion as of December 31, 2004 as the long-term investment operations retained \$9.7 billion of primarily Alt-A mortgages and originated \$591.8 million of multi-family mortgages during the first nine months of 2005. The retention of mortgages (less mortgage prepayments) during the third quarter of 2005 resulted in a 15% increase in mortgages held as CMO collateral to \$24.5 billion as of September 30, 2005 as compared to \$21.3 billion as of December 31, 2004.

## Table of Contents

The following table presents selected information about mortgages held as CMO collateral as of the dates indicated:

	As of		
	September 30,	December 31,	September 30,
	2005	2004	2004
Percent of Alt-A mortgages	99	99	99
Percent of ARMs	91	90	90
Percent of FRMs	9	10	10
Percent of hybrid ARMs	76	70	67
Percent of interest-only	65	63	56
Weighted average coupon	5.89	5.62	5.48
Weighted average margin	3.68	3.61	3.45
Weighted average original LTV	75	76	77
Weighted average original credit score	697	696	699
Percent with active prepayment penalty	77	76	76
Prior 3-month CPR	40	29	29
Prior 12-month CPR	36	29	29
Lifetime prepayment rate	24	21	21
Percent of mortgages in California	58	62	63
Percent of purchase transactions	59	60	59
Percent of owner occupied	78	81	84
Percent of first lien	99	99	99

The following table presents selected financial data as of the dates indicated (dollars in thousands, except per share data):

	As of and Year-to-Date Ended,		
	September 30,	December 31,	September 30,
	2005	2004	2004
Book value per share	\$ 12.93	\$ 11.80	\$ 10.43
Return on average assets	1.25%	1.51%	1.26%
Return on average equity	29.74%	35.62%	28.97%
Assets to equity ratio	24.53:1	22.81:1	25.75:1
Debt to equity ratio	23.39:1	21.77:1	24.57:1
Mortgages owned 60+ days delinquent	\$ 512,382	\$ 381,290	\$ 304,350
60+ day delinquency of mortgages owned	2.18%	1.74%	1.56%

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 acquiring for long-term investment high credit quality Alt-A and multi-family mortgages from our customers, 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.

As of September 30, 2005, the original weighted average credit score of mortgages held as CMO collateral was 697 and the original weighted average LTV ratio was 75%. During the third quarter of 2005, the long-term investment operations retained \$3.3 billion of primarily adjustable and fixed rate Alt-A mortgages that were acquired or originated by the mortgage operations with an original weighted average credit score of 688 and an original weighted average LTV ratio of 78%. In addition, during the third quarter of 2005, the long-term investment operations retained \$2.2 billion of mortgages that were acquired on a bulk basis by the mortgage operations with an original weighted average credit score of 682 and an original

## Table of Contents

weighted average LTV ratio of 80%. IMCC also originated \$211.9 million of multi-family mortgages with a weighted average credit score of 722, an average debt service cover ratio of 1.30 and an original weighted average LTV of 67%.

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 the number of mortgages becoming seriously delinquent. 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 an 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 period permitted by law for reinstatement, the property may then be sold at a foreclosure sale. At foreclosure sales, we generally acquire title to the property. As of September 30, 2005, our long-term mortgage portfolio included 2.18% of mortgages that were 60 days or more delinquent compared to 1.74% as of December 31, 2004.

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 September 30, 2005	At December 31, 2004
60-89 days delinquent	\$ 204,346	\$ 139,872
90 or more days delinquent	127,705	68,877
Foreclosures	135,143	157,867
Delinquent bankruptcies	45,188	14,674
Total 60 or more days delinquent	\$ 512,382	\$ 381,290

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 September 30, 2005, seriously delinquent assets and other real estate owned as a percentage of total assets was 1.24% as compared to 1.09% as of December 31, 2004. 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 September 30, 2005	At December 31, 2004
90 or more days delinquent	\$ 308,036	\$ 241,418
Other real estate owned	38,747	18,277
Total	\$ 346,783	\$ 259,695

For the year ended December 31, 2004, the Company's loan portfolio increased 147% to \$21.3 billion. For the nine months ended September 30, 2005, the Company's loan portfolio increased 15% to \$24.5 billion. During 2005, the Company increased the amount of sales to third party

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investors and retained less new loan production than in the past which results in a larger proportion of the mortgage portfolio as seasoned loans and a smaller proportion of newly originated loans that are current. The seasoned loans with higher expected delinquency rates are not being offset by as much newly originated current production.

*Prepayment Risk.* Mortgage industry evidence suggests that the increase in home appreciation rates and lower payment option mortgage products over the last three years was a significant factor affecting Alt-A borrowers refinancing decisions during 2004 and 2005. Mortgage prepayment rates accelerated during the latter part of 2004 and continued through the third quarter of 2005. It appears that borrowers are more willing to pay the penalties in order to cash out or obtain lower monthly payments by refinancing into other mortgage products. The Company uses prepayment penalties as a method of reducing prepayment risk.

As of September 30, 2005, 77% of mortgages held as CMO collateral had prepayment penalty features as compared to 76% as of December 31, 2004. Also, 72% of Alt-A mortgages retained by the long-term investment operations during the first nine months of 2005 had prepayment penalty features ranging from two to seven years as compared to 73% during the first nine months of 2004. Additionally, 100% of Multi-family mortgages originated have prepayment penalty features



**Table of Contents**

ranging from three to ten years. However, despite the prepayment penalties on our loans, mortgages held as CMO collateral had a 40% 3-month CPR as of September 30, 2005 as compared to 29% 3-month CPR as of September 30, 2004.

*Liquidity Risk.* We employ a leverage strategy to increase assets by financing our long-term mortgage portfolio primarily with CMO borrowings, reverse repurchase agreements and capital to acquire mortgage assets. The long-term investment operations acquires ARMs and FRMs that are acquired and originated by the mortgage operations and finances the acquisition of those mortgages, during this accumulation period, with reverse repurchase agreements. After accumulating a pool of mortgages, generally between \$200 million and \$2.0 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. We continually monitor our leverage ratios 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.

*Results of Operations*

*For the Three Months Ended September 30, 2005 compared to the Three Months Ended September 30, 2004*

## Condensed Statements of Operations Data

(dollars in thousands, except share data)

	2005	2004	Increase (Decrease)	% Change
Interest income	\$ 324,050	\$ 210,388	\$ 113,662	54 %
Interest expense	281,154	114,967	166,187	145
Net interest income	42,896	95,421	(52,525)	(55)
Provision for loan losses (1)	13,434	(229)	13,663	5,966
Net interest income after provision for loan losses	29,462	95,650	(66,188)	(69)
Total non-interest income	132,254	(89,608)	221,862	248
Total non-interest expense	42,696	24,795	17,901	72
Income tax benefit	(7,337)	(9,436)	2,099	22
Net earnings (loss)	\$ 126,357	\$ (9,317)	\$ 135,674	1,456 %
Net earnings (loss) per share diluted	\$ 1.61	\$ (0.15)	\$ 1.76	1,173 %

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Dividends declared per common share	\$	0.45	\$	0.75	\$	(0.30)	(40) %
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(1) The negative provision for the three months ended September 30, 2004 represents the reversal of a provision no longer needed.

**Table of Contents**

For the Nine Months Ended September 30, 2005 compared to the Nine Months Ended September 30, 2004

## Condensed Statements of Operations Data

(dollars in thousands, except share data)

	2005	2004	Increase (Decrease)	% Change
Interest income	\$ 911,214	\$ 505,244	\$ 405,970	80%
Interest expense	721,059	251,850	469,209	186
Net interest income	190,155	253,394	(63,239)	(25)
Provision for loan losses	25,219	24,778	441	2
Net interest income after provision for loan losses	164,936	228,616	(63,680)	(28)
Total non-interest income	190,039	(25,258)	215,297	852
Total non-interest expense	123,932	76,910	47,022	61
Income tax benefit	(13,924)	(16,821)	2,897	17
Net earnings	\$ 244,967	\$ 143,269	\$ 101,698	71%
Net earnings per share diluted	\$ 3.07	\$ 2.14	\$ 0.93	43%
Dividends declared per common share	\$ 1.95	\$ 2.15	\$ (0.20)	(9)%

*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 and reverse repurchase agreements. 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 September 30,						
	2005			2004		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield
<b>MORTGAGE ASSETS</b>						
CMO collateral (1)	\$ 23,294,226	\$ 271,661	4.66%	\$ 16,009,339	\$ 171,177	4.28%
Mortgages held-for-investment and mortgages held-for-sale	2,956,712	45,768	6.19	2,146,851	31,052	5.79

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Finance receivables	304,593	4,834	6.35	578,188	7,063	4.89
Investment securities available-for-sale	58,227	442	3.04	26,786	474	7.08
Total mortgage assets	\$ 26,613,758	\$ 322,705	4.85%	\$ 18,761,164	\$ 209,766	4.47%
<b>BORROWINGS</b>						
CMO borrowings	\$ 22,849,177	\$ 243,945	4.27%	\$ 15,839,884	\$ 97,965	2.47%
Reverse repurchase agreements	3,070,767	35,448	4.62	2,547,014	16,978	2.67
Total borrowings on mortgage assets	\$ 25,919,944	\$ 279,393	4.31%	\$ 18,386,898	\$ 114,943	2.50%
Net interest spread (2)			0.54%			1.97%
Net interest margin (3)						