MUNICIPAL MORTGAGE & EQUITY LLC
Form 10-Q
May 06, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2004

Commission File Number: 001-11981

MUNICIPAL MORTGAGE & EQUITY, LLC
(Exact name of registrant as specified in its charter)

Delaware	**52-1449733**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
621 E. Pratt Street, Suite 300 Baltimore, Maryland	**21202-3140**
(Address of principal executive offices)	(Zip Code)

(443) 263-2900
(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. **[x]** Yes [ ]_No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). **[x]** Yes [ ]_No

The Registrant had 34,784,093 common shares outstanding as of April 30, 2004.

MUNICIPAL MORTGAGE & EQUITY, LLC
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Forward-Looking Information

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve certain risks and uncertainties. Assumptions contained in various portions of this Quarterly Report on Form 10-Q involve judgments with respect to, among other things, future economic market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of Municipal Mortgage & Equity, LLC (MuniMae and together with its subsidiaries, the Company). Although the Company believes that the assumptions underlying the forward-looking information included herein are reasonable, any of the assumptions could be inaccurate. Therefore, there can be no assurance that such forward-looking information will prove to be accurate. In light of the significant uncertainties inherent in forward-looking information, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved.

PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements.

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(unaudited)

	March 31, 2004	December 31, 2003
ASSETS		
Investment in tax-exempt bonds, net (Note 2)	$1,097,764	$ 1,043,973
Loans receivable, net (Note 3)	541,516	497,884
Loans receivable held for sale (Note 3)	22,933	54,492
Investment in partnerships (Note 4)	1,624,073	282,492
Investments in derivative financial instruments (Note 5)	2,630	2,563
Cash and cash equivalents	40,527	50,826
Interest receivable	17,790	16,843
Restricted assets (Note 6)	195,016	75,525
Other assets	69,610	79,390
Mortgage servicing rights, net	10,631	10,967
Goodwill	107,505	107,505
Other intangibles	25,980	27,159
Total assets	$3,755,975	$ 2,249,619
LIABILITIES AND SHAREHOLDERS EQUITY		
Notes payable (Note 7)	$ 867,478	$ 646,096
Short-term debt (Note 7)	374,376	371,881
Long-term debt (Note 7)	186,792	190,090
Preferred shares subject to mandatory redemption (Note 8)	168,000	168,000
Tax credit equity guarantee liability (Note 9)	136,322	151,326
Investments in derivative financial instruments (Note 5)	17,709	15,287
Accounts payable and accrued expenses	8,116	17,506
Interest payable	10,610	9,581
Unearned revenue and other liabilities	34,139	37,986
Total liabilities	1,803,542	1,607,753

Commitments and contingencies (Note 10)		
Minority interest in subsidiary companies (Note 1)	1,274,458	31
Shareholders equity:		
Common shares, par value $0 (38,071,099 shares authorized, including 34,854,393 shares issued and outstanding, and 41,651 deferred shares at March 31, 2004 and 35,926,099 shares authorized, including 32,592,093 shares issued and outstanding, and 39,701 deferred shares at December 31, 2003)	695,311	654,700
Less common shares held in treasury at cost (124,715 at March 31, 2004 and December 31, 2003)	(2,615)	(2,615)
Less unearned compensation (deferred shares) (Note 12)	(4,067)	(3,992)
Accumulated other comprehensive loss	(10,654)	(6,258)
Total shareholders equity	677,975	641,835
Total liabilities and shareholders equity	$3,755,975	$ 2,249,619

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

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share data)
(unaudited)

	For the three months ended March 31,	
	2004	**2003**
INCOME:		
Interest income		
Interest on bonds and residual interests in bond securitizations	$ 19,178	$ 15,985
Interest on loans	10,283	9,503
Interest on short-term investments	223	192
Total interest income	29,684	25,680
Fee income		
Syndication fees	3,751	1,411
Origination fees	917	698
Loan servicing fees	1,881	1,909
Asset management and advisory fees	6,166	1,076
Guarantee fees	1,853	111
Other income	1,837	2,086
Total fee income	16,405	7,291
Net gain on sales	3,307	1,278
Total income	49,396	34,249
EXPENSES:		
Interest expense	14,880	10,368
Interest expense on preferred shares (Note 8)	3,046	
Salaries and benefits	13,059	5,966
General and administrative	3,920	1,656
Professional fees	1,494	989
Amortization of intangibles	1,612	389

Total expenses	38,011	19,368
Net holding gains (losses) on derivatives	(2,355)	2,873
Impairments and valuation allowances related to investments	(300)	
Net losses from equity investments in partnerships	(10,511)	(747)
Net income before income taxes, income allocated to preferred shareholders in a subsidiary company and cumulative effect of a change in accounting principle	(1,781)	17,007
Income tax benefit (expense)	2,510	(68)
Net income before income allocated to preferred shareholders in a subsidiary company and cumulative effect of a change in accounting principle	729	16,939
Income allocable to preferred shareholders in a subsidiary company		(2,994)
Net income before cumulative effect of a change in accounting principle	729	13,945
Cumulative effect of a change in accounting principle	520	
Net Income	$ 1,249	$ 13,945
Basic earnings per common share:		
Earnings before cumulative effect of accounting change	$ 0.02	$ 0.51
Cumulative effect of a change in accounting principle	0.02	
Basic earnings per common share	$ 0.04	$ 0.51
Weighted average common shares outstanding	33,301,337	27,342,870
Diluted earnings per common share:		
Earnings before cumulative effect of accounting change	$ 0.02	$ 0.50
Cumulative effect of a change in accounting principle	0.02	
Diluted earnings per common share	$ 0.04	$ 0.50
Weighted average common shares outstanding	33,679,188	27,681,511

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

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MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(unaudited)

	For the three months ended March 31,	
	2004	**2003**
Net income	$ 1,249	$13,945
Other comprehensive income (loss):		
Unrealized gains (losses) on investments:		
Unrealized holding gains (losses) arising during the period	(4,204)	4,576
Reclassification adjustment for gains included in net income	(192)	
Other comprehensive income (loss)	(4,396)	4,576
Comprehensive income (loss)	$(3,147)	$18,521

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

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(In thousands, except share data)
(unaudited)

	Common Shares	Treasury Shares	Unearned Compensation	Accumulated Other Comprehensive Loss	Total
Balance, January 1, 2004	$654,700	$(2,615)	$(3,992)	$ (6,258)	$641,835
Net income	1,249				1,249
Unrealized gains on investments, net of reclassifications				(4,396)	(4,396)
Distributions	(14,770)				(14,770)
Purchase of treasury shares					
Options exercised	758				758
Issuance of common shares	52,475				52,475
Deferred shares issued under the Non-Employee Directors Share Plans	47				47
Deferred share grants			(638)		(638)
Forfeiture of deferred shares					
Amortization of deferred compensation	852		563		1,415
Tax benefit from exercise of options and vesting of deferred shares					
Balance, March 31, 2004	$695,311	$(2,615)	$(4,067)	$(10,654)	$677,975

SHARE ACTIVITY:	Common Shares	Treasury Shares
Balance, January 1, 2004	32,507,079	124,715
Options exercised	41,000	
Purchase of treasury shares		
Issuance of common shares	2,145,351	
Issuance of common shares under employee share incentive plans	75,949	
Deferred shares issued under the Non-Employee Directors Share Plans	1,950	

Balance, March 31, 2004	34,771,329	124,715

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

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	For the three months ended March 31,	
	2004	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,249	$ 13,945
Adjustments to reconcile net income to net cash provided by operating activities:		
Income allocated to preferred shareholders		2,994
Cumulative effect of a change in accounting principle	(520)	
Net holding (gains) losses on trading securities	2,355	(2,873)
Impairments and valuation allowances related to investments	300	
Amortization of guarantee liability	(1,075)	
Net gain on sales	(3,307)	(1,278)
Loss from investments in partnerships	10,511	747
Distributions received from investments in partnerships	1,887	1,714
Net amortization of premiums, discounts and fees on investments	(106)	(116)
Depreciation and amortization	2,936	531
Tax benefit from deferred share compensation		313
Deferred share compensation expense	777	444
Common and deferred shares issued under the Non-Employee Directors Share Plans	56	67
Net change in assets and liabilities:		
(Increase) in interest receivable	(947)	(2,555)
(Increase) decrease in other assets and goodwill	(22,434)	16,275
Decrease in accounts payable, accrued expenses and other liabilities	(10,727)	(5,305)
Decrease in loans receivable held for sale	32,168	38,816
Net cash provided by operating activities	13,123	63,719
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of tax-exempt bonds and residual interests in bond securitizations	(67,000)	(27,345)
Loan originations	(90,504)	(76,248)
Purchases of property and equipment	(419)	(78)
Net (investment) in restricted assets	9,190	(3,264)
Principal payments received	47,465	60,671
Proceeds from the sale of investments	8,168	
Investments in partnerships	(43,433)	(19,770)
Return of capital invested in partnerships	60,369	18,617

Net cash used in investing activities	(76,164)	(47,417)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings from credit facilities	280,438	167,522
Repayment of credit facilities	(267,711)	(237,373)
Proceeds from tax credit syndication investors	2,364	
Proceeds from short-term debt	2,495	
Repayment of short-term debt		(355)
Proceeds from long-term debt	1,140	
Repayment of long-term debt	(4,438)	(370)
Issuance of common shares	52,466	71,944
Proceeds from stock options exercised	758	188
Distributions on common shares	(14,770)	(11,335)
Distributions to preferred shareholders in a subsidiary company		(2,994)
Net cash provided by (used in) financing activities	52,742	(12,773)
Net increase (decrease) in cash and cash equivalents	(10,299)	3,529
Cash and cash equivalents at beginning of period	50,826	43,745
Cash and cash equivalents at end of period	$ 40,527	$ 47,274
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	$ 24,492	$ 10,238
Income taxes paid	$ 1,146	$ 64
Non-cash activity resulting from consolidation of VIEs under FIN 46 (Note 1):		
Investment in partnership	1,382,800	
Restricted assets	133,107	
Other assets	(27,398)	
Notes payable	208,655	
Accounts payable, accrued expenses and other liabilities	4,740	
Minority interest in subsidiary companies	1,274,533	
Accumulated other comprehensive income	61	

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

MUNICIPAL MORTGAGE & EQUITY, LLC
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 BASIS OF PRESENTATION

Municipal Mortgage & Equity, LLC (**MuniMae** and, together with its subsidiaries, the **Company**) provides debt and equity financing to developers of multifamily housing and other real estate investments. The Company invests in tax-exempt bonds, or interests in bonds, issued by state and local governments or their agencies or authorities to finance multifamily housing developments. These tax-exempt bonds are not general obligations of state and local governments, or the agencies or authorities that issue the bonds. The multifamily housing developments, as well as the rents paid by the tenants, typically secure these investments. The Company also invests in other housing-related debt and equity investments, including equity investments in real estate operating partnerships; tax-exempt bonds, or interests in bonds, secured by student housing or assisted living developments; and tax-exempt bonds issued by community development districts to finance the development of community infrastructure supporting single-family housing or commercial developments and secured by specific payments or assessments pledged by the local improvement district that issues the bonds (**CDD bonds**). Interest income derived from the majority of the Company s bond investments is exempt income for Federal income tax purposes.

The Company is also a tax credit syndicator and a mortgage banker. As a syndicator, the Company acquires and sells to investors interests in partnerships that receive and distribute to investors low-income housing tax credits. The Company earns syndication fees on the placement of these interests with investors. The Company also earns fees for providing guarantees on certain tax credit funds and for managing the low-income housing tax credit funds it has syndicated. Mortgage banking activities include the origination of, investment in and servicing of investments in multifamily housing, both for its own account and on behalf of third parties. These investments generate taxable income.

MuniMae was organized in 1996 as a Delaware limited liability company. As a limited liability company, the Company combines many of the limited liability, governance and management characteristics of a corporation with the pass-through income features of a partnership. Since MuniMae is classified as a partnership for Federal income tax purposes, MuniMae is not itself subject to Federal and, in most cases, state and local income taxes. Instead, each shareholder must include his or her distributive share of MuniMae s income, deductions and credits on the shareholder s income tax return. Most of the Company s mortgage banking and tax credit syndication activities are conducted through subsidiaries classified as corporations for Federal income tax purposes, which do not have the pass-through income features of a partnership.

On July 1, 2003, the Company acquired the Housing and Community Investing (**HCI**) business of Lend Lease Corporation Limited for $102.0 million in cash. HCI is a syndicator of low income housing tax credit equity investments. The acquisition of this affordable housing tax credit syndication operation has enhanced the Company s competitive position, and as a result the Company is one of the nation s leaders in the affordable housing industry. The HCI business is owned by MMA Financial TC Corp. (**TC Corp**), a wholly owned subsidiary of the Company, and the Company s results for the first quarter of 2004 reflect a full quarter of activity from TC Corp.

In 1999, the Company placed a substantial portion of its tax-exempt bonds and residual interests in bond securitizations in an indirect subsidiary of the Company, MuniMae TE Bond Subsidiary, LLC (**TE Bond Sub**). TE Bond Sub sold Series A, Series B and Series A-1 and Series B-1 Cumulative Preferred Shares (collectively, the **TE Bond Sub Preferred Shares**) to institutional investors in May 1999, June 2000 and October 2001, respectively. The TE Bond Sub Preferred Shares have a senior claim to the income derived from the investments owned by TE Bond Sub. Any income from TE Bond Sub available after payment of the cumulative distributions of the TE Bond Sub Preferred Shares is allocated to the Company, which holds all of the common equity interests. **As a result, the assets of TE Bond Sub and its subsidiaries, while indirectly controlled by MuniMae and thus included in the consolidated financial statements of the Company, are legally owned by TE Bond Sub and are not available to the creditors of the Company.** The Company s common equity interest in TE Bond Sub was $268.8 million and $267.0 million at March 31, 2004 and December 31, 2003, respectively. The common equity interest in TE Bond Sub held by MuniMae is subject to the claims of the creditors of MuniMae and in certain circumstances could be foreclosed.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and in the opinion of management contain all adjustments (consisting of only normal recurring accruals) necessary to present a fair statement of the results for the periods presented. These results have been determined on the basis of accounting principles and policies discussed in Note 1 to the Company s Annual Report on Form 10-K for the year ended December 31, 2003 (the **Company s 2003 Form 10-K**). Certain information and footnote disclosures normally included in financial statements presented in accordance with generally accepted accounting principles (**GAAP**) have been condensed or omitted. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s 2003 Form 10-K. Certain 2003 amounts have been reclassified to conform to the 2004 presentation.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (**FASB**) approved Financial Interpretation No. 46, Consolidation of Variable Interest Entities (**FIN 46**). FIN 46 requires the consolidation of a company s equity investment in a variable interest entity (**VIE**) if the company is the primary beneficiary of the VIE and if risks are not effectively dispersed among the owners of the VIE. The company is considered to be the primary beneficiary of the VIE if the company absorbs the majority of the losses of the VIE. FIN 46 is effective for VIEs created after January 31, 2003. For any VIE in which the Company held an interest that it acquired before February 1, 2003, FIN 46 was effective for the first interim reporting period beginning after June 15, 2003. In December 2003, FASB approved various amendments to FIN 46 and released a revised version of FIN 46 (**FIN 46-R**). In addition, FASB extended the effective date of FIN 46 until the first reporting period ending after March 15, 2004 for VIEs which are not special purpose entities, and the Company elected to defer adoption of that portion of FIN 46 until that time.

The Company s residual interests in bond securitizations represent equity interests in VIEs, and the Company is the primary beneficiary of those VIEs. The Company determined that its residual interests in bonds were special purpose entities and did not qualify for the deferral. Therefore, these securitization trusts were consolidated at December 31, 2003.

The Company has general partner interests in low-income housing tax credit equity funds where the respective funds have one or more limited partners. The determination of whether the Company is the primary beneficiary of (and must consequently consolidate) a given tax credit equity fund depends on a number of factors, including the number of limited partners and the rights and obligations of the general and limited partners in that fund. Upon adoption of FIN 46 in March 2004, the Company determined that it is the primary beneficiary in certain of the funds it originates where there are multiple limited partners. As a result, the Company consolidated these equity investments at March 31, 2004. The Company s general partner interests typically represent a one percent or less interest in each fund. For those funds which it consolidates, the Company reports the net assets of the funds, consisting primarily of restricted cash, investments in partnerships and notes payable, in the Company s consolidated balance sheet. In addition, the limited partnership interests in the funds, owned by third party investors, are reported as a minority interest. The net income (loss) from these tax credit equity funds is reported in the appropriate line items of the Company s consolidated statement of income. An adjustment for the income (loss) allocable to the limited partners (investors) in the funds is recorded through minority interest expense (income) in the Company s consolidated statements of income. At March 31, 2004, the Company recorded net assets of these tax credit equity funds of $1.3 billion, consisting primarily of $1.4 billion in investment in partnerships, $133.1 million in restricted assets and $208.7 million in notes payable, which are non-recourse to the Company. The Company recorded $1.3 billion in minority interest in subsidiary companies. As of March 31, 2004, the Company also recorded a $0.5 million cumulative effect of a change in accounting principle as a result of recording the net equity allocable to the Company s general partner interest in the funds. The Company also has a general partner interest in certain other low-income housing tax credit equity funds where it has concluded that it is not the primary beneficiary. Accordingly, funds with assets of $970.3 million and liabilities of $90.8 million at March 31, 2004 have not been consolidated and continue to be accounted for using the equity method of accounting.

NOTE 2 INVESTMENT IN TAX-EXEMPT BONDS

The Company originates investments in tax-exempt bonds and taxable loans primarily to the affordable multifamily housing industry. Tax-exempt bonds are issued by state and local government authorities to finance multifamily housing developments or other real estate financings. The bonds are typically secured by nonrecourse mortgage loans on the underlying properties.

The Company invests in other housing-related securities, including tax-exempt bonds issued by community development districts, to finance the development of infrastructure supporting single-family housing or commercial developments and secured by specific payments or assessments pledged by the local improvement district that issues the bonds. The Company also invests in tax-exempt bonds, or interests in bonds, secured by student housing or assisted living developments.

The Company s sources of capital to fund these lending activities include proceeds from equity and debt offerings, securitizations, notes and warehousing facilities with various pension funds and commercial banks, and draws on lines of credit. The Company earns interest income from its investment in tax-exempt bonds and taxable loans. The Company also earns origination and construction administration fees, through subsidiaries classified as corporations for Federal income tax purposes, for originating and servicing the bonds during the construction period.

For a further discussion of the general terms of tax-exempt bonds see Note 1 to the Company s 2003 Form 10-K.

As of March 31, 2004 and December 31, 2003, the Company held $1,097.8 million and $1,044.0 million of tax-exempt bonds, respectively. The following tables summarize the tax-exempt bonds by type.

(in thousands)	March 31, 2004 Face Amount	March 31, 2004 Amortized Cost	March 31, 2004 Unrealized Gain (Loss)	March 31, 2004 Fair Value
Non-participating bonds	$ 976,257	$ 955,818	$(26,712)	$ 929,106
Participating bonds	101,503	100,606	878	101,484
Subordinate non-participating bonds	18,778	16,255	(77)	16,178
Subordinate participating bonds	58,890	35,800	15,196	50,996
Total	$1,155,428	$1,108,479	$(10,715)	$1,097,764

(in thousands)	December 31, 2003 Face Amount	December 31, 2003 Amortized Cost	December 31, 2003 Unrealized Gain (Loss)	December 31, 2003 Fair Value
Non-participating bonds	$ 922,544	$ 897,322	$(22,719)	$ 874,603
Participating bonds	101,589	100,693	1,666	102,359
Subordinate non-participating bonds	17,642	16,417	58	16,475
Subordinate participating bonds	58,890	35,799	14,737	50,536
Total	$1,100,665	$1,050,231	$ (6,258)	$1,043,973

Note:

TE Bond Sub owns $833.4 million and $840.1 million of tax exempt bonds as of March 31, 2004 and December 31, 2003, respectively.

During the three months ended March 31, 2004, the Company invested in tax-exempt bonds with a face amount of $67.7 million for $67.0 million. Of the total face amount of $67.7 million, $46.8 million represents the Company s new primary investments (bonds which the Company originated), $2.5 million reflects new secondary market investments (previously issued bonds purchased from third parties) and $7.3 million reflects the refunding of a non-performing bond that the Company had purchased in 2003.

The Company structures tax-exempt bonds that allow the borrower to make draws on the bonds throughout the construction period (**draw down bonds**). In the year these bonds are originated, the total draws for the year are reported as new primary investments. The Company did not originate any new draw down bonds in the first quarter of 2004. However, the Company funded an additional $11.1 million of existing tax-exempt draw down bonds with a face amount of $11.1 million.

Two tax-exempt bonds with an amortized cost of $8.2 million were paid off in the first quarter. One of the bonds was repaid as a result of a refunding of the bond. The Company continues to hold the refunded bond. The Company recognized a gain of $0.2 million on the pay off of the second bond.

NOTE 3 LOANS RECEIVABLE

The Company s loans receivable consist primarily of construction loans, permanent loans, supplemental loans and other taxable loans. For a further discussion of the general terms of loans held by the Company and the allowance for loan losses, see the description of mortgage banking activities in Note 1 to the Company s 2003 Form 10-K. The following table summarizes loans receivable by loan type at March 31, 2004 and December 31, 2003.

(in thousands)	**March 31, 2004**	**December 31, 2003**
Loan Type:		
Construction loans	$432,809	$396,817
Taxable permanent loans	22,933	54,492
Supplemental loans	76,102	72,966
Other taxable loans	34,284	29,780
	566,128	554,055
Allowance for loan losses	(1,679)	(1,679)
Total	$564,449	$552,376

The Company had loans receivable held for sale of $22.9 million and $54.5 million at March 31, 2004 and December 31, 2003, respectively. These loans committed for sale sold to Federal National Mortgage Association (**Fannie Mae**) and third party conduit lenders. Due to the short time the Company holds these loans, carrying value approximates fair value.

The Company pledges loans as collateral for the Company s notes payable, warehouse lending arrangements and line of credit borrowings. In addition, in order to facilitate the securitization of certain assets at higher leverage ratios than otherwise available to the Company without the posting of additional collateral, the Company has pledged additional taxable loans to a pool that acts as collateral for senior interests in certain securitization trusts and credit enhancement facilities. At March 31, 2004 and December 31, 2003, the total carrying amount of the loans receivable pledged as collateral was $521.9 million and $480.1 million, respectively.

NOTE 4 INVESTMENT IN PARTNERSHIPS

The Company s investments in partnerships consist of equity interests in real estate operating partnerships. The Company s investments in partnerships are accounted for using the equity method.

For partnerships in which the Company is a limited partner, the Company ceases recording losses on an investment in partnership when the cumulative losses and distributions from the partnership exceed the Company s original investment and, after the Company s investment in such partnership reaches $0, cash distributions received from these investments are recorded as income. For partnerships in which the Company is a general partner (for example, the Company s interests in the tax credit equity syndication funds which it originates and the Company s Joint Ventures with CAPREIT, Inc. and its affiliates (**CAPREIT**)), the Company recognizes losses to the extent of its partnership liability, regardless of the Company s basis in its partnership interest. The following table summarizes investment in partnerships by major category at March 31, 2004 and December 31, 2003:

(in thousands)	**March 31, 2004**	**December 31, 2003**
Non-guaranteed tax credit equity funds:		
Investment in real estate operating partnerships (1)	$1,382,799	$
Guaranteed tax credit equity funds:		
Investment in real estate operating partnerships (2)	95,913	110,593
Investment in real estate operating partnerships warehousing (3)	84,387	108,677
Investment in CAPREIT (4)	60,313	62,561
Other investments in partnerships	661	661
	$1,624,073	$ 282,492

(1) As a result of FIN 46, the Company must include on its balance sheet investments by certain non-guaranteed tax credit equity funds. These investments are real estate operating partnerships owned by tax credit funds, which have been consolidated as of March 31, 2004. See Note 1 for further discussion.

(2) These investments are real estate operating partnerships owned by tax credit funds where the Company provides a guarantee or otherwise has continuing involvement in the underlying assets of the fund. As a result of the guarantee, the Company includes the assets of the funds in its consolidated balance sheets until such time as the Company s guarantee expires.

(3) The Company acquires, through limited partnership interests, equity interests that typically represent a 99% interest in properties expected to earn tax credits. When the Company has a sufficient number of such limited partnership interests and has identified tax credit investors, it transfers those interests to a syndicated fund for the investors benefit. The Company typically owns these partnership interests for three to nine months before they are transferred to a fund.

(4) The Company makes equity investments in income-producing real estate partnerships in joint ventures with CAPREIT. In one such venture, the Company owns a 35% general partnership interest in 12 property partnerships (the **CAPREIT Tera** investment) and in a second such venture the Company owns a 30% general partnership interest in 20 property partnerships and four related swap partnerships (the **CAPREIT 3M** investment).

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NOTE 5 INVESTMENT IN DERIVATIVE FINANCIAL INSTRUMENTS

At March 31, 2004 and December 31, 2003, the Company s investments in derivative financial instruments consisted of interest rate swaps, put option contracts and total return swaps. For a further discussion of the Company s investment in derivative financial instruments, see Note 7 to the Company s 2003 Form 10-K. The following table provides certain information with respect to the derivative financial instruments held by the Company at March 31, 2004 and December 31, 2003:

Investment in derivative financial instruments:

	March 31, 2004			December 31, 2003		
	Notional	Fair Value (4)		Notional	Fair Value (4)	
(in thousands)	Amount	Assets	Liabilities (5)	Amount	Assets	Liabilities (5)
Interest rate swap agreements (1)	$310,975	$2,564	$(17,656)	$310,975	$2,559	$(15,244)
Total return swaps (2)	33,000	66		38,000		
Put option agreements (3)	122,524		(53)	122,524	4	(43)
Total investment in derivative financial instruments		$2,630	$(17,709)		$2,563	$(15,287)

(1) For the interest rate swap agreements, notional amount represents the total amount of the Company s interest rate swap contracts ($345,935 as of March 31, 2004 and December 31, 2003) less the total amount of the Company s reverse interest rate swap contracts ($34,960 as of March 31, 2004 and December 31, 2003).

(2) For the total return swaps, the notional amount represents the total amount of the Company s total return swap contracts.

(3) For put option agreements, the notional amount represents the Company s aggregate obligation under the put option agreements.

(4) The amounts disclosed represent the net fair values of all the Company s derivatives at the reporting date.

(5) The aggregate negative fair value of the investments is included in liabilities for financial reporting purposes. The negative fair value of these investments is considered temporary and is not indicative of the future earnings on these investments.

NOTE 6 RESTRICTED ASSETS

The table below summarizes restricted assets by major category at March 31, 2004 and December 31, 2003:

(in thousands)	March 31, 2004	December 31, 2003
Tax credit equity fund cash (1)	$169,648	$ 44,192
Margin call deposits (2)	10,934	9,122
Cash deposit for guarantee on sale of certain taxable loans (3)	1,278	1,278
CAPREIT total return swaps collateral (4)	4,895	19,670
Other cash collateral (5)	8,261	1,263
	$195,016	$ 75,525

(1) Under the financing method of accounting for guaranteed tax credit funds and due to the consolidation of certain other funds in accordance with FIN 46, the Company reports the restricted cash of the funds in the Company s consolidated balance sheet. The cash is to be used primarily for investments in partnerships and other approved uses as set out in the funds partnership agreements.

(2) Under the terms of the Company s interest rate swap agreements with counterparties, the Company is required to maintain cash deposits (**margin call deposits**). The margin call deposit requirements are specific to each counterparty. The Company must make margin call deposits when the total fair value of the Company s outstanding swap obligations to any one counterparty is, in most cases, greater than $1.0 million. In certain cases, the Company is also required to post up-front collateral on the swap contracts.

(3) In conjunction with a guarantee provided by the Company related to the sale of certain taxable notes, the Company deposited $1.3 million in cash in an account with a counterparty. This money serves as collateral for the Company s obligation under the guarantee; however, the Company s obligation under the guarantee is not limited to this deposit. In the event that any of the properties cannot fund their payments on the loan, the money in this account can be used to fund any shortfalls. The Company does not believe that any loss is likely. These funds will not be released to the Company until the interest and principal obligations on all the loans are fulfilled. The Company does not believe it will have to perform under the guarantee.

(4) Under the terms of the Company s investment with CAPREIT, the Company is required to post either bond or cash collateral for the CAPREIT total return swaps. From time to time the Company may elect to post short-term floating-rate marketable securities, in lieu of cash.

(5) From time to time, the Company may elect to pledge cash collateral for the Company s account or on behalf of its customers in order to facilitate letters of credit, secured lines of credit and other collateral requirements. These transactions are considered temporary and the Company expects to be fully reimbursed.

NOTE 7 NOTES PAYABLE AND DEBT

The Company s notes payable consist primarily of notes payable and advances under line of credit arrangements that are used to (1) finance construction lending needs; (2) finance working capital needs; (3) warehouse real estate operating partnerships before they are placed into tax credit equity funds; and (4) warehouse permanent loans before they are purchased by third parties. At March 31, 2004, notes payable also includes factored notes payable reflected on the Company s balance sheet as a result of consolidating certain tax credit equity funds upon adoption of FIN 46 (discussed in Note 1). These factored notes payable are obligations of the limited partners (investors) of the tax-credit funds and collateralized by the investors subscription receivables. The factored notes payable are non-recourse and not guaranteed by the Company. The Company s short- and long-term debt relates to securitization transactions and other financing transactions that the

Company has recorded as borrowings. The following table summarizes notes payable and debt at March 31, 2004 and December 31, 2003:

(in thousands)	Total of Facilities	March 31, 2004	December 31, 2003
Short-term notes payable	N/A	$ 210,862	$ 198,342
Lines of credit unaffiliated entities	$ 555,000	347,125	304,153
Lines of credit affiliated entities	$ 195,000		20,662
Short-term debt	N/A	374,376	371,881
Total short-term notes payable and debt		932,363	895,038
Long-term notes payable	N/A	100,836	122,939
Long-term debt	N/A	186,792	190,090
Total long-term notes payable and debt		287,628	313,029
Factored notes payable		208,655	
Total notes payable and debt		$1,428,646	$1,208,067

Covenant Compliance

As a result of the consolidation of certain assets and liabilities relating to the Company s tax credit equity syndication business pursuant to FIN 46 as of March 31, 2004, and the reclassification, pursuant to Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (**FAS 150**) as of September 30, 2003, as liabilities of the Company s outstanding preferred shares in a subsidiary company, the Company would, in the absence of a waiver or amendment, be in default of a financial covenant in a $200 million short-term line of credit by May 28, 2004. Consequently, the Company and the lender have executed a waiver of this default through June 30, 2004. The parties are also negotiating an amendment to the line of credit to address this issue. As of April 30, 2004, $168 million of debt was outstanding under this line of credit. In the event the Company is unsuccessful in negotiating an amendment prior to the expiration of the waiver, and a default ensues and the lender accelerates this line of credit, the Company will have to secure alternative short-term credit arrangements in order to meet its production targets and other business objectives for 2004. The Company was in compliance with all other covenants with respect to its credit facilities at March 31, 2004.

NOTE 8 PREFERRED SHARES SUBJECT TO MANDATORY REDEMPTION

In accordance with FAS 150, the Company classifies the liquidation preference value of its preferred shareholders equity of $168.0 million in a separate line in the liability section of the consolidated balance sheets. In addition, offering costs of $7.5 million related to these preferred shares are classified in other assets. Commencing on July 1, 2003, the offering costs are amortized through the mandatory redemption dates of the preferred shares and amounts previously classified as income allocable to preferred shareholders are now recorded as interest expense.

At March 31, 2004 and December 31, 2003, the Company had four classes of preferred shares outstanding, including Series A Cumulative Preferred Shares (**Series A Preferred Shares**), Series B Cumulative Preferred Shares (**Series B Preferred Shares**), Series A-1 Cumulative Preferred Shares (**Series A-1 Preferred Shares**) and Series B-1 Subordinate Cumulative Preferred Shares (**Series B-1 Preferred Shares**)(collectively, the **TE Bond Sub Preferred Shares**). The following discussion summarizes the significant terms of the TE Bond Sub Preferred Shares.

The Series A and A-1 Preferred Shares bear interest at 6.875% and 6.30% per annum, respectively, or, if lower, the aggregate net income of TE Bond Sub. The Series A and A-1 Preferred Shares have a senior claim to the income derived from the investments owned by TE Bond Sub. The Series A-1 Preferred Shares are equal in priority of payment to the Series A Preferred Shares. The Series B and B-1 Preferred Shares bear interest at 7.75% and 6.80% per annum, respectively, or, if lower, the aggregate net income of TE Bond Sub, after interest payments to the Series A and Series A-1 Preferred Shares. The Series B-1 Preferred Shares are equal in priority of payment to the Series B Preferred Shares. Any income from TE Bond Sub available after payment of the cumulative distributions of the TE Bond Sub Preferred Shares is allocated to the Common Shares. Cash distributions on the TE Bond Sub Preferred Shares will be paid quarterly on each January 31, April 30, July 31 and October 31. The TE Bond Sub Preferred Shares are subject to remarketing on specified dates as indicated in the table below. On the remarketing date, the remarketing agent will seek to remarket the shares at the lowest distribution rate that would result in a resale of the TE Bond Sub Preferred Shares at a price equal to par plus all accrued but unpaid distributions. The TE Bond Sub Preferred Shares will be subject to mandatory tender on specified dates, as indicated below, and on all subsequent remarketing dates at a price equal to par plus all accrued but unpaid distributions. The following table provides a summary of certain terms of the TE Bond Sub Preferred Shares.

	Series A Preferred Shares	**Series A-1 Preferred Shares**	**Series B Preferred Shares**	**Series B-1 Preferred Shares**
Issue date	May 27, 1999	October 9, 2001	June 2, 2000	October 9, 2001
Number of shares	42	8	30	4
Par amount per share	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Dividend rate	6.875%	6.30%	7.75%	6.80%
First remarketing date	June 30, 2009	June 30, 2009	November 1, 2010	November 1, 2010
Mandatory tender date	June 30, 2009	June 30, 2009	November 1, 2010	November 1, 2010
Redemption date	June 30, 2049	June 30, 2049	June 30, 2050	June 30, 2050

NOTE 9 TAX CREDIT EQUITY GUARANTEE LIABILITY

As part of the acquisition of HCI (see Note 1), the Company is providing guarantees to Lend Lease Corporation Limited (Lend Lease) related to certain tax credit equity syndication funds where Lend Lease is providing a guarantee to investors or a third party. As a result of the guarantees, the Company is considered to have continuing involvement with the assets of the related tax credit equity funds and to have effective control over the assets in the funds. Therefore, the Company accounts for its involvement in these funds under the financing method. Under the financing method, the Company reports the net assets of the funds, consisting primarily of restricted cash and investments in partnerships, in the Company s consolidated balance sheet. In addition, the investor capital contributions are reported as a tax credit equity guarantee liability on the Company s consolidated balance sheet. The net income (loss) from the tax credit equity funds are reported in the appropriate line items of the Company s consolidated statements of income. The Company s guarantee liability may expire based on the achievement of certain targets by the underlying properties in the fund or may be outstanding for the life of the fund. When the Company s liability is relieved by the achievement of certain targets, the tax credit guarantee liability is relieved as the guarantees expire and the related underlying investment in the property partnership is de-recognized. Any difference between the carrying value of the de-recognized investment in the partnership and the guarantee liability is reflected as a gain or loss on sale and reported in the Company s consolidated statement of income. For funds where the Company s guarantee obligation remains outstanding for the life of the fund, the guarantee liability is amortized straight line over the life of the fund, which is estimated to be 15 years, and is reported in guarantee income in the Company s consolidated statement of income. The following table shows the changes in the tax credit equity guarantee liability:

(in thousands)	
Balance, January 1, 2004	$151,326
Amortization	(1,075)
Expiration of guarantees	(19,335)
Limited partner s capital contributions	5,406
Balance, March 31, 2004	$136,322

NOTE 10 GUARANTEES, COMMITMENTS AND CONTINGENCIES

For discussion of the Company s commitments and contingencies, see Note 14 to the Company s 2003 Form 10-K.

Guarantees

The following table summarizes the Company s guarantees by type at March 31, 2004. The Company s maximum exposure under its guarantee obligations is not indicative of the likelihood of the expected loss under the guarantees.

(in millions)

		March 31, 2004		
Guarantee	**Note**	**Maximum Exposure**	**Carrying Amount**	**Supporting Collateral**
Loss-sharing agreements with Fannie Mae and GNMA	(1)	$ 190.8	$	$5.4 million Letter of Credit pledged
Bank line of credit guarantees	(2)	236.6	236.6	Investment in partnership and loans totaling $250.5 million
Tax credit related guarantees	(3)	260.8	139.3	None
Other financial/payment guarantees	(4)	168.5	13.5	$3.8 million of cash and tax exempt bonds
Put options	(5)	122.5	3.5	$82.7 million of loans and tax exempt bonds
Letter of credit guarantees	(6)	53.3	40.0	$0.6 million of cash
Indemnification contracts	(7)	76.6	58.9	None
		$1,109.1	$491.8	

Notes:

(1) As a Fannie Mae and Government National Mortgage Association (**GNMA**) loan servicer, the Company may share in losses relating to underperforming real estate mortgage loans delivered to Fannie Mae and GNMA. More specifically, if the borrower fails to make a payment on a DUS loan originated by the Company and sold to Fannie Mae, of principal, interest, taxes or insurance premiums, the Company may be required to make servicing advances to Fannie Mae. Also, the Company may participate in a deficiency after foreclosure on DUS and GNMA loans. The term of the loss sharing agreement is based on the contractual requirements of the underlying loans delivered to Fannie Mae and GNMA, which varies to a maximum of 40 years.

(2) The Company provides payment or performance guarantees for certain borrowings under line of credit facilities. The amount outstanding under these lines of credit was $236.1 million at March 31, 2004. This amount is included in notes payable in the Company s consolidated balance sheet.

(3) The Company acquires and sells interests in partnerships that provide low-income housing tax credits for investors. In conjunction with the sale of these partnership interests, the Company may provide performance guarantees on the underlying properties owned by the partnerships or guarantees to the fund investors. These guarantees have various expirations to a maximum term of 18 years.

(4) The Company has entered into arrangements that require the Company to make payment in the event a specified third party fails to perform on its financial obligation. The Company typically provides these guarantees in conjunction with the sale of an asset to a third party or the Company s investment in equity ventures. The term of the guarantee varies based on loan payoff schedules or Company divestitures.

(5) The Company has entered into put option agreements with counterparties whereby the counterparty has the right to sell to the Company, and the Company has the obligation to buy, an underlying investment at a specified price. These put option agreements expire at various dates through April 1, 2007.

(6) The Company provides a guarantee of the repayment on losses incurred under letters of credit issued by third parties or to provide substitute letters of credit at a predetermined future date. In addition, the Company may provide a payment guarantee for certain assets in securitization programs. These guarantees expire at various dates through September 1, 2007.

(7) The Company has entered into indemnification contracts, which require the guarantor to make payments to the guaranteed party based on changes in an underlying investment that is related to an asset or liability of the guaranteed party. These agreements typically require the Company to reimburse the guaranteed party for legal and other costs in the event of an adverse judgment in a lawsuit or the imposition of additional taxes due to a change in the tax law or an adverse interpretation of the tax law. The term of the indemnification varies based on the underlying program life, loan payoffs, or Company divestitures. Based on the terms of the underlying contracts, the maximum exposure amount only includes amounts that can be reasonably estimated at this time. The actual exposure amount could vary significantly.

Litigation

At March 31, 2004, the Company had a litigation reserve of $1.1 million for routine litigation and administrative proceedings arising in the ordinary course of business. This litigation reserve was established in conjunction with the purchase of HCI (discussed in Note 1).

NOTE 11 SHAREHOLDERS EQUITY

Equity Offering

In March 2004, the Company sold to the public 2.0 million common shares at a price of $25.55 per share and granted the underwriters an option to purchase up to an aggregate of 195,000 common shares to cover overallotments at the same price. Net proceeds on the 2.0 million shares approximated $47.7 million. On March 8, 2004, the underwriters exercised their option to purchase 195,000 common shares, generating additional net proceeds of approximately $4.8 million. The net proceeds from this offering will be used for general corporate purposes, including funding of new investments, paying down debt and working capital.

Distributions

On January 15, 2004, the Board of Directors declared a distribution of $0.4525 for the three months ended December 31, 2003 to common shareholders of record on January 26, 2004. The payment date was February 6, 2004.

Earnings per Share

The following table reconciles the numerators and denominators in the basic and diluted earnings per share (**EPS**) calculations for common shares for the three months ended March 31, 2004 and 2003. The effect of all potentially dilutive securities was included in the calculation.

Municipal Mortgage & Equity, LLC
Reconciliation of Basic and Diluted EPS
(unaudited)

	For the three months ended March 31, 2004			**For the three months ended March 31, 2003**		
(in thousands, except share and per share data)	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**
Basic EPS						
Net income before cumulative effect of accounting change	$ 729		$ 0.02	13,945		$ 0.51
Cumulative effect of accounting change	520		0.02			
Income allocable to common shares	$ 1,249	33,301,337	$ 0.04	13,945	27,342,870	$ 0.51
Effect of Dilutive Securities						
Options and deferred shares		377,851			338,641	

Diluted EPS						
Net income before cumulative effect of accounting change	$ 729		$ 0.02	13,945		$ 0.50
Cumulative effect of accounting change	520		0.02			
Income allocable to common shares plus assumed conversions	$ 1,249	33,679,188	$ 0.04	13,945	27,681,511	$ 0.50

NOTE 12 NON-EMPLOYEE DIRECTORS SHARE PLANS AND EMPLOYEE SHARE INCENTIVE PLANS

The Company accounts for both the non-employee director share plans and the employee share incentive plans (see Note 1 and Note 17 to the Company s 2003 Form 10-K) under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Accordingly, no compensation expense was recognized for the options issued under the plans during the first quarter of 2004 or 2003. There were no options issued in the first quarter of 2004. The Company issued 7,000 options in the first quarter of 2003. The Company estimated the fair value of each option awarded during that quarter using the Black Scholes option-pricing model with the following assumptions.

	For the three months ended March 31, 2003
Risk-free interest rate	3%
Dividend yield	7.5%
Volatility	20%
Expected option life	7.5 years
Weighted average fair value of options	$ 1.40

The following table illustrates the effect on net income and earnings per share if the compensation expense had been determined based on the fair value recognition provisions of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (**FAS 123**) as amended by Financial Accounting Standards No.148, Accounting for Stock-Based Compensation-Transition and Disclosure. For the three months ended March 31, 2004, there would be no effect on net income from the fair value method of accounting under FAS 123.

(in thousands, except per share amounts)	**For the three months ended March 31, 2003**
Net income allocated to common shares, as reported	$ 13,945
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(10)
Net income, pro forma	$ 13,935
Earnings per common share:	
Basic as reported	$ 0.51
Basic pro forma	$ 0.51
Diluted as reported	$ 0.50
Diluted pro forma	$ 0.50

NOTE 13 BUSINESS SEGMENT REPORTING

Subsequent to the acquisition of HCI, the Company has three reportable business segments: (1) a mortgage banking segment consisting of subsidiaries classified as corporations for Federal income tax purposes that primarily generate taxable fee income by providing loan servicing, loan origination and other related services; (2) a tax credit segment consisting of subsidiaries that primarily generate fees by providing tax credit equity syndication and asset management fees; and (3) an investing segment consisting primarily of subsidiaries holding investments producing tax-exempt interest income. Prior to the acquisition of HCI, the tax credit equity and mortgage banking segments were combined and reported as one segment called the operating segment. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 to the Company s 2003 Form 10-K.

The following table reflects the results of the Company s business segments for the three- months ended March 31, 2004 and 2003.

Municipal Mortgage & Equity, LLC
Segment Reporting for the three months ended March 31, 2004 and 2003
(in thousands)

	For the three months ended March 31, 2004					For the three months ended March 31, 2003				
	Investing	Mortgage Banking	Tax Credit	Adjustments	Total Consolidated	Investing	Mortgage Banking	Tax Credit	Adjustments	Total Consolidated
INCOME:										
Interest income										
Interest on bonds and residual interest in bond securitizations	$19,178	$	$	$	$19,178	$15,985	$	$	$	$15,985
Interest on loans	1,126	9,157			10,283	829	8,674			9,503
Interest on short-term investments	5,910	131	243	(6,061)(1)	223	1,197		188	(1,193)(1)	192
Total interest income	26,214	9,288	243	(6,061)	29,684	18,011	8,674	188	(1,193)	25,680
Fee income										
Syndication fees			3,751		3,751			1,411		1,411
Origination fees		1,794	134	(1,011)(2)	917		836	116	(254)(2)	698
Loan servicing fees		1,881			1,881		1,909			1,909
Asset management and advisory fees		362	5,804		6,166		154	922		1,076
Guarantee fees	110		1,743		1,853	111				111
Other income	651	470	716		1,837	1,197	289	600		2,086
Total fee income	761	4,507	12,148	(1,011)	16,405	1,308	3,188	3,049	(254)	7,291

Net gain on sales	2	870	2,435		3,307		1,180	98		1,278
Total Income	26,977	14,665	14,826	(7,072)	49,396	19,319	13,042	3,335	(1,447)	34,249
Expenses:										
Interest expense	8,224	8,416	4,301	(6,061)	14,880	3,493	7,574	494	(1,193)	10,368
Interest expense on preferred shares	3,046				3,046					
Salaries and benefits	1,138	5,062	6,859		13,059	473	4,143	1,350		5,966
General and administrative	631	1,244	2,045		3,920	552	351	753		1,656
Professional fees	515	263	716		1,494	544	385	60		989
Amortization of intangibles		403	1,209		1,612		389			