

IMPAC MORTGAGE HOLDINGS INC  
Form 10-Q  
November 09, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2009

or

o **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.)

**19500 Jamboree Road, Irvine, California 92612**  
(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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a  
smaller reporting company)

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

There were 7,698,146 shares of common stock outstanding as of November 6, 2009.

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IMPAC MORTGAGE HOLDINGS, INC.

FORM 10-Q QUARTERLY REPORT

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(in thousands, except share data)

	September 30, 2009	December 31, 2008
	(Unaudited)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 37,893	\$ 46,215
Restricted cash	1,252	1,243
Short-term investments	5,014	
Trust assets		
Investment securities available-for-sale	1,049	2,068
Securitized mortgage collateral	5,767,379	5,894,424
Derivative assets	222	37
Real estate owned	170,153	599,084
Total trust assets	5,938,803	6,495,613
Assets of discontinued operations	98,257	141,053
Other assets	27,544	31,393
Total assets	\$ 6,108,763	\$ 6,715,517
<b>LIABILITIES</b>		
Trust liabilities		
Securitized mortgage borrowings	\$ 5,744,725	\$ 6,193,984
Derivative liabilities	164,835	273,584
Total trust liabilities	5,909,560	6,467,568
Long-term debt	9,399	15,403
Liabilities of discontinued operations	170,973	217,241
Other liabilities	9,141	6,053
Total liabilities	6,099,073	6,706,265
Commitments and contingencies		
<b>STOCKHOLDERS' EQUITY</b>		
Series A junior participating preferred stock, \$0.01 par value; 2,500,000 shares authorized; none issued and outstanding		
Series B 9.375% redeemable preferred stock, \$0.01 par value; liquidation value \$16,904; 2,000,000 shares authorized, 676,156 noncumulative and 2,000,000 cumulative shares issued and outstanding	7	20

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as of September 30, 2009 and December 31, 2008, respectively		
Series C 9.125% redeemable preferred stock, \$0.01 par value; liquidation value \$35,389; 5,500,000 shares authorized; 1,415,564 noncumulative and 4,470,600 cumulative shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	14	45
Common stock, \$0.01 par value; 200,000,000 shares authorized; 7,618,146 shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	76	76
Additional paid-in capital	1,179,879	1,177,697
Net accumulated deficit:		
Cumulative dividends declared	(822,520)	(815,077)
Retained deficit	(347,766)	(353,509)
Net accumulated deficit	(1,170,286)	(1,168,586)
Total stockholders' equity	9,690	9,252
Total liabilities and stockholders' equity	\$ 6,108,763	\$ 6,715,517

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>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>INTEREST INCOME</b>	\$ 341,323	\$ 397,445	\$ 1,508,230	\$ 1,077,256
<b>INTEREST EXPENSE</b>	339,417	394,431	1,499,729	1,062,637
Net interest income	1,906	3,014	8,501	14,619
<b>NON-INTEREST INCOME:</b>				
Change in fair value of net trust assets, excluding REO	46,325	7,778	234,167	145
Losses from real estate owned	(43,160)	(15,685)	(218,083)	(24,771)
Non-interest income net trust assets	3,165	(7,907)	16,084	(24,626)
Change in fair value of long-term debt	341	10,494	682	5,473
Real estate advisory fees		7,039		15,581
Mortgage and real estate services fees	13,514	2,923	32,296	7,078
Other	(107)	(1,076)	(333)	(1,791)
Total non-interest income	16,913	11,473	48,729	1,715
<b>NON-INTEREST EXPENSE:</b>				
General and administrative	4,603	4,951	15,053	13,864
Personnel expense	9,413	2,382	26,050	7,531
Total non-interest expense	14,016	7,333	41,103	21,395
Earnings (loss) from continuing operations before income taxes	4,803	7,154	16,127	(5,061)
Income tax expense from continuing operations		5,253	2,018	13,980
Earnings (loss) from continuing operations	4,803	1,901	14,109	(19,041)
Loss from discontinued operations, net of tax	(1,776)	(18,121)	(8,366)	(28,481)
Net earnings (loss)	3,027	(16,220)	5,743	(47,522)
Cash dividends on preferred stock		(3,722)	(7,443)	(11,165)
Net earnings (loss) attributable to common stockholders	\$ 3,027	\$ (19,942)	\$ (1,700)	\$ (58,687)
Earnings (loss) per common share basic and diluted:				
Earnings (loss) from continuing operations	\$ 0.60	\$ (0.24)	\$ 0.88	\$ (3.97)
Loss from discontinued operations	(0.22)	(2.38)	(1.10)	(3.74)
Earnings (loss) per share attributable to common stockholders	\$ 0.38	\$ (2.62)	\$ (0.22)	\$ (7.71)

See accompanying notes to consolidated financial statements



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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Nine Months Ended September 30,	
	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Earnings (loss) from continuing operations	\$ 14,109	\$ (19,041)
Losses from real estate owned	218,083	24,771
Amortization and impairment of deferred charge, net	1,998	13,980
Amortization and impairment of mortgage servicing rights		1,363
Change in fair value of net trust assets, excluding REO	(392,962)	(113,000)
Change in fair value of long-term debt	(682)	(5,473)
Accretion of interest income and expense	553,813	385,759
Stock-based compensation	3,297	901
Net cash provided by operating activities of discontinued operations	12,590	89,973
Net change in other assets and liabilities	(102,970)	(42,135)
<b>Net cash provided by operating activities</b>	<b>307,276</b>	<b>337,098</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Net change in securitized mortgage collateral	663,938	1,409,506
Net change in mortgages held-for-investment	406	59
Purchase of premises and equipment	(378)	357
Purchase of short-term investments	(5,041)	
Net principal change on investment securities available-for-sale	3,889	2,358
Proceeds from the sale of real estate owned	596,423	351,183
Net cash provided by investing activities of discontinued operations	14,148	13,613
<b>Net cash provided by investing activities</b>	<b>1,273,385</b>	<b>1,777,076</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Settlement of trust preferred securities	(4,275)	
Repurchase of preferred stock	(1,259)	
Preferred stock dividends paid	(7,443)	(11,165)
Repayment of securitized mortgage borrowings	(1,537,530)	(1,962,577)
Net cash used in financing activities of discontinued operations	(37,622)	(142,345)
<b>Net cash used in financing activities</b>	<b>(1,588,129)</b>	<b>(2,116,087)</b>
Net change in cash and cash equivalents	(7,468)	(1,913)
Cash and cash equivalents at beginning of period	46,228	26,462
Cash and cash equivalents at end of period Continuing Operations	37,893	24,536
Cash and cash equivalents at end of period Discontinued Operations	867	13
<b>Total cash and cash equivalents at end of period</b>	<b>\$ 38,760</b>	<b>\$ 24,549</b>



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**NON-CASH TRANSACTIONS (Continuing and Discontinued Operations):**

Transfer of loans held-for-sale and held-for-investment to real estate owned	\$	12,540	\$	3,009
Transfer of securitized mortgage collateral to real estate owned		279,368		628,779
Transfer of assets from discontinued operations to continuing operations				25,600

See accompanying notes to consolidated financial statements.

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

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings**

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

***Business Summary***

Impac Mortgage Holdings, Inc. (the Company or IMH) is a Maryland corporation incorporated in August 1995 and has the following subsidiaries: Integrated Real Estate Service Corporation (IRES), IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG), and Impac Funding Corporation (IFC), together with its wholly-owned subsidiaries Impac Secured Assets Corp. (ISAC) and Impac Commercial Capital Corporation (ICCC).

In the first quarter of 2009, the Company created a new subsidiary, Integrated Real Estate Service Corporation, which includes mortgage and real estate fee-based businesses and entities.

The Company's continuing operations include the long-term mortgage portfolio (residual interests in securitizations reflected as net trust assets and liabilities in the consolidated balance sheets) and the mortgage and real estate fee-based businesses conducted by IRES. The discontinued operations include the former non-conforming mortgage and retail operations conducted by IFC, commercial operations conducted by ICC, and warehouse lending operations conducted by IWLG.

Effective January 1, 2009, the Company revoked its election to be taxed as a real estate investment trust (REIT). As a result of revoking this election, the Company is subject to income taxes as a regular (Subchapter C) corporation. As of December 31, 2008, the Company had estimated federal and California net operating loss carryforwards of \$356.2 million and \$627.2 million, respectively.

The information contained throughout this document is presented on a continuing operations basis, unless otherwise stated.

***Financial Statement Presentation***

The accompanying unaudited consolidated financial statements of IMH and its subsidiaries (as defined above) have been prepared in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three and nine month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. These interim period condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the United States Securities and Exchange Commission (SEC).

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

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with GAAP. The items affected by such estimates and assumptions include the valuation of trust assets and trust liabilities, the valuation of repurchase liabilities related to sold loans, the valuation of long-term debt and the valuation of loans held-for-sale. Actual results could differ from those estimates and assumptions.

***Market Conditions and Status of Operations***

The economy continued to contract in the first nine months of 2009. Labor markets deteriorated rapidly as U.S. firms reduced the number of jobs driving the U.S. unemployment rate higher. Higher unemployment and weaker overall economic conditions have led to a significant increase in the number of loan defaults, while continued weak housing prices have driven a significant increase in loan loss severities. Defaults remain elevated as the economy and housing market continue to struggle. The credit performance of the Company's long-term mortgage portfolio continues to be negatively affected by these economic conditions. Delinquencies and nonperforming loans and assets increased as a percentage of loans outstanding. Additional deterioration in the overall economic environment, including continued weakening of the labor market, could cause loan delinquencies to increase beyond the Company's current expectations, resulting in additional increases in losses and reductions in fair value.

During the first quarter of 2009, the Company initiated various mortgage and real estate fee-based businesses, including loan modifications, real estate disposition, monitoring and surveillance services, real estate brokerage and lending services and escrow services. For the three and nine month periods ended September 30, 2009, mortgage and real estate services fees were \$13.5 million and \$32.3 million, respectively. However, since these businesses are newly formed and currently generate fees primarily from the Company's long-term mortgage portfolio, there remains uncertainty about their future success, including the ability to provide similar services to the marketplace.

In January 2009, the Company purchased and canceled \$25.0 million in outstanding trust preferred securities of Impac Capital Trust #2 for \$3.75 million and terminated the remaining debt.

In May 2009, the Company exchanged an aggregate of \$51.3 million in trust preferred securities of Impac Capital Trusts #1 and #3 for junior subordinated notes with an aggregate principal balance of \$62.0 million and a maturity date in March 2034. Under the terms of the exchange, the interest rate for each note was reduced from the original 8.01 percent to 2.00 percent through 2013 with increases of 1.00 percent per year through 2017. Starting in 2018, the interest rates become variable at three-month London Inter-bank Offered Rate (LIBOR) plus 375 basis points. In connection with the exchange, the Company paid a fee of \$0.5 million. Refer to Note H Long-term Debt for additional information.

In June 2009, the Company purchased and canceled \$1.0 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$150 thousand.

In August 2009, the Company purchased and canceled \$2.5 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$375 thousand, resulting in \$8.5 million in outstanding trust preferred securities. In July 2009, the Company became current and is no longer deferring interest on its remaining trust preferred securities.

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

As a result of the restructuring of \$51.3 million and purchase and cancelation of \$36.5 million in outstanding trust preferred securities, the Company reduced its annual interest expense obligation from \$7.8 million to \$2.0 million. With the restructuring and purchase and cancelations of trust preferred securities, the Company has \$8.5 million in outstanding trust preferred securities of Impac Capital Trust #4 and \$62.0 million in outstanding junior subordinated notes.

In June 2009, the Company completed the Offer to Purchase and Consent Solicitation (the "Offer to Purchase") of all of its 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock. The Series B Preferred Stock had a liquidation preference of \$50 million and the Series C Preferred Stock had a liquidation preference of \$111.8 million, for a total of \$161.8 million. Upon expiration of the Offer to Purchase, holders of approximately 68% of the Preferred Stock tendered an aggregate of 4,378,880 shares. Holders of the Company's Series B Preferred Stock tendered 1,323,844 shares at \$0.29297 per share for a total of \$388 thousand. Holders of the Company's Series C Preferred Stock tendered 3,055,036 shares at \$0.28516 per share for a total of \$871 thousand. The aggregate purchase price for the Preferred Stock was \$1.3 million. In addition, in connection with completing the Offer to Purchase, the Company paid \$7.4 million accumulated but unpaid dividends on its Preferred Stock. With the total cash payment of \$8.7 million, the Company eliminated \$109.5 million of liquidation preference on its Preferred Stock. After the completion of the Offer to Purchase, the Company has outstanding \$52.3 million liquidation preference of Series B and Series C noncumulative Preferred Stock.

With completion of the Offer to Purchase and modification to the terms of the Series B Preferred Stock and Series C Preferred Stock, the Company eliminated its \$14.9 million annual preferred dividend obligation. Refer to *Note I Preferred Stock Repurchase* for additional information.

In October 2009, the Company entered into a settlement agreement (the "Settlement Agreement") with its remaining reverse repurchase facility lender to settle the Restructured Financing. The Settlement Agreement retires the current facility and removes any further exposure associated with the line or the loans that secured the line. Pursuant to the terms of the Settlement Agreement, the Company settled the \$140.0 million balance of the reverse repurchase line by transferring the loans securing the line to the lender at their approximate carrying values, resulting in a cash payment of \$20.0 million and the Company entering into a credit agreement with the lender (the "Credit Agreement") for a \$33.9 million term loan. The borrowing under the Credit Agreement, which is to be paid over 18 months, bears interest at a rate of one-month LIBOR plus 350 basis points and requires monthly payments of \$1.5 million. In addition to the monthly payments of \$1.5 million, a \$10.0 million principal payment is due by April 2010 as part of the Credit Agreement. Refer to *Note G Restructured Financing (Discontinued Operations)* for additional information.

**2. Recent Accounting Pronouncements**

***Recently Adopted Accounting Pronouncements***

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles" a replacement of FASB Statement No 162 (SFAS 168). Under SFAS 168, The FASB Accounting Standards Codification (Codification or ASC) became the source of authoritative GAAP recognized by

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On July 1, 2009, the Codification superseded all then-existing non-SEC accounting and reporting standards for non-governmental entities. All other non-grandfathered non-SEC accounting literature not included in the Codification became non-authoritative at that time. SFAS 168 is effective for interim and annual periods ending after September 15, 2009. The adoption of SFAS 168 did not have a significant impact on the Company's consolidated financial statements.

In May 2009, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 165, "Subsequent Events" (SFAS 165), which was incorporated into FASB ASC 855-10 "Subsequent Events Overall" (FASB ASC 855-10). FASB ASC 855-10, which is effective for interim and annual periods ending after June 15, 2009, establishes general standards of and accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The adoption of FASB ASC 855-10 did not have an impact on the Company's consolidated financial statements.

In April 2009, the FASB issued three FASB Staff Positions (FSP) related to fair value measurements:

FSP No. FAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FASB ASC 820-10-65-4)

FSP No. FAS 107-1 and APB 28-1 "Interim Disclosures about Fair Value of Financial Instruments" (FASB ASC 825-10-65-1)

FSP No. FAS 115-2 and FAS 124-2 "Recognition and Presentation of Other-Than-Temporary Impairments" (FASB ASC 320-10-65-1)

FASB ASC 820-10-65-4 provides additional guidance for estimating fair value in accordance with FASB ASC 820-10 (formerly SFAS No. 157 "Fair Value Measurements" (SFAS 157)) when the volume and level of market activity for the asset or liability have significantly decreased. FASB ASC 820-10-65-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. It acknowledges that in these circumstances quoted prices may not be determinative of fair value. FASB ASC 820-10-65-4 emphasizes that even if there has been a significant decrease in the volume and level of market activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Prior to the clarifications included in FASB ASC 820-10-65-4, many companies, including the Company, interpreted FASB ASC 820-10 to emphasize the use of most recently available quoted market prices in estimating fair value, regardless of whether markets had experienced a significant decline in the volume and level of activity relative to normal conditions and/or increased frequency of transactions that are not orderly.

Under FASB ASC 820-10-65-4, quoted prices for assets or liabilities in inactive markets may require adjustment due to uncertainty as to whether the underlying transactions are orderly. There is

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

little information, if any, to evaluate if individual transactions are orderly in an inactive market. Accordingly, the Company is required to evaluate the facts and circumstances to determine whether the transaction is orderly based on the weight of the evidence. FASB ASC 820-10-65-4 does not designate a specific method for adjusting a transaction or quoted price, however, it does provide guidance for determining how much weight to give a transaction or quoted price. Price quotes derived from transactions that are not orderly are not considered to be determinative of fair value and should be given less weight, if any, when estimating fair value.

The adoption of FASB ASC 820-10-65-4 on April 1, 2009 resulted in an increase of \$13.3 million in net trust assets, which is included in change in fair value of net trust assets in the accompanying consolidated statements of operations. Offsetting this increase were decreases in the fair values of trust assets and trust liabilities as a result of the Company increasing loss assumptions for its long-term mortgage portfolio due to increases in expected defaults and loss severities related to the weak economy and housing market.

FASB ASC 825-10-65-1 requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The adoption of FASB ASC 825-10-65-1, which became effective for interim reporting periods ending after June 15, 2009, did not have a significant effect on the Company's consolidated financial statements.

FASB ASC 320-10-65-1 amends the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. For debt securities, the pronouncement requires that an entity assess whether it (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the Company would be required to recognize other-than-temporary impairment. The adoption of FASB ASC 320-10-65-1, which became effective for interim reporting periods ending after June 15, 2009, did not have a significant effect on the Company's consolidated financial statements.

Effective January 1, 2009, the Company adopted EITF No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement," which was incorporated into FASB ASC 820-10. FASB ASC 820-10-35 addresses whether issuers of liabilities should consider the effect of the third-party credit enhancement when measuring the liability at fair value. It requires that the issuer of a liability with a third-party credit enhancement that is inseparable from the liability shall not include the effect of the credit enhancement in the fair value measurement of the liability. The adoption of FASB ASC 820-10-35 did not have a significant impact on the Company's consolidated financial statements.

Effective January 1, 2009, application of FASB ASC 820-10-65 to nonfinancial assets and liabilities is required. As a result of the adoption of FASB ASC 820-10-65 for such assets and liabilities, the Company has included additional disclosures as of and for the three and nine months ended September 30, 2009 for nonrecurring fair value measurements related to its nonfinancial assets and liabilities (which include loans held for sale, REO, lease liability and deferred charge).

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

***Recently Issued Accounting Pronouncements***

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05 "Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value" (ASU 2009-05). ASU 2009-05 provides amendments to ASC Subtopic 820-10, Fair Value Measurements and Disclosures Overall of the FASB Accounting Standards Codification for the fair value measurement of liabilities. The amendments provide clarification that in circumstances in which a quoted price in an active market for an identical liability is not available, companies are required to measure value using one or more of the techniques prescribed by the standard. Valuation techniques include the quoted price of the identical liability when traded as an asset, quoted prices of similar liabilities or similar liabilities when traded as an asset, and other valuation techniques consistent with the principles of FASB ASC 820. The amendments also clarify that when estimating the fair value of a liability, companies are not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. ASU 2009-05 is effective for the first reporting period beginning after issuance. The Company does not expect the amendments to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets An Amendment of FASB Statement 140" and SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)". These statements eliminated the concept of a qualifying special purpose entity (QSPE), created more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarified other sale-accounting criteria, and changed the initial measurement of a transferor's interest in transferred financial assets. Former QSPEs will be evaluated for consolidation based on the provisions of FASB ASC 810-10-25, which changes the approach to determining a variable interest entity's (VIE) primary beneficiary and requires companies to more frequently reassess whether they must consolidate or deconsolidate VIEs. The accounting standard requires a qualitative, rather than quantitative, analysis to determine the primary beneficiary of a VIE for consolidation purposes. The primary beneficiary of a VIE is the enterprise that has (a) the power to direct the VIE activities that most significantly affect the VIE's economic performance, and (b) the right to receive benefits of the VIE that could potentially be significant to the VIE or the obligation to absorb losses of the VIE that could potentially be significant to the VIE. These statements are effective for fiscal years and interim periods ending after November 15, 2009. The Company is currently evaluating the impact of these new pronouncements on its financial statements. While management of the Company has not completed its evaluation, the Company may be required to consolidate certain trust assets and trust liabilities related to assets previously sold to QSPEs. As of September 30, 2009, the current principal balance of QSPEs to which the Company, acting as principal, had transferred assets and received sales treatment were \$547.2 million. The Company's investment in these QSPEs consists of residual interests currently accounted for as investment securities available-for-sale in its consolidated balance sheets.

**3. Income Taxes and Deferred Charge**

Effective January 1, 2009, the Company revoked its election to be taxed as a REIT. As a result of revoking this election, the Company is subject to income taxes as a regular (Subchapter C) corporation.

Prior to January 1, 2009, the Company operated as a REIT under the requirements of the Internal Revenue Code. Requirements for qualification as a REIT included various restrictions on ownership of

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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

IMH's stock, requirements concerning distribution of taxable income and certain restrictions on the nature of assets and sources of income.

As of December 31, 2008, the Company had estimated federal and California net operating loss carryforwards of \$356.2 million and \$627.2 million, respectively. As of December 31, 2008, the Company's taxable REIT subsidiary had an estimated federal net operating loss tax carryforward of \$293.4 million. The federal net operating loss carryforward of the Company's taxable REIT subsidiary, utilization of which may be limited to such subsidiary, begins to expire in the year 2027. As of December 31, 2008, the Company and the Company's taxable REIT subsidiary had federal deferred tax assets of approximately \$629 million and \$106 million, respectively, and a combined California deferred tax asset in the amount of \$181.5 million. The Company recorded a full valuation allowance against the deferred tax assets as it believes that as of September 30, 2009 it is more likely than not that the deferred tax assets will not be recoverable.

In accordance with ASC 810-10-45-8 the Company records a deferred charge representing the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is included in other assets in the accompanying consolidated balance sheets and is amortized as a component of income tax expense in the accompanying consolidated statements of operations over the estimated life of the mortgages retained in the securitized mortgage collateral. The Company recorded income tax expense of zero and \$2.0 million for the three and nine months ended September 30, 2009, respectively, compared to \$5.3 million and \$14.0 million for the three and nine months ended September 30, 2008, respectively. The income tax expense is primarily the result of the amount of the deferred charge amortized and/or impaired resulting from credit losses, which does not result in any tax liability required to be paid.

**4. Legal Proceedings**

The Company is party to litigation and claims which arise in the ordinary course of business.

In the matter of *Sharon Page v. Impac Mortgage Holdings, Inc., et al*, which was filed in the United States District Court, Central District of California and alleged breaches of fiduciary duties, conflicts of interest and fiduciary liability, a settlement was reached and confirmed by the Court. As part of the settlement, the Company agreed to (i) issue common stock to class members, (ii) make available to the class members free of charge investment training classes once per month for one year and (iii) pay certain attorneys fees. Pursuant to the settlement agreement, on October 27, 2009, the Company issued 80,000 shares of common stock.

On September 24, 2009, an action was filed in the United States district Court, Central district of California entitled *Federal Deposit Insurance Corporation as Receiver for Indymac bank, F.S.B. v. Impac Funding Corporation* as case No. CV09-6965 RC. The case claims damages for breach of contract based upon repurchase claims for loans sold to Indymac Bank. The action seeks \$2.1 million in damages plus interest and attorneys fees.

Please refer to IMH's report on Form 10-K for the year ended December 31, 2008 for a description of other litigation and claims.



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

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

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

**Note A Summary of Business, Significant Accounting Policies and Legal Proceedings (Continued)**

We believe that we have meritorious defenses to the above claims and intend to defend these claims vigorously and as such the Company believes the final outcome of such matters will not have a material adverse effect on our financial condition or results of operations. Nevertheless, litigation is uncertain and we may not prevail in the lawsuits and can express no opinion as to their ultimate resolution. An adverse judgment in any of these matters could have a material adverse effect on our financial position and results of operations.

**Note B Fair Value of Financial Instruments**

The use of fair value to measure the Company's financial instruments is fundamental to its consolidated financial statements and is a critical accounting estimate because a substantial portion of its assets and liabilities are recorded at estimated fair value.

Effective April 1, 2009, the Company adopted the provisions of FASB ASC 820-10-65-4 (formerly FSP No. FAS 157-4), which address determining fair value when there has been a significant decrease in the volume and level of activity for an asset or liability compared to normal market activity for those or similar assets or liabilities. When significant decreases in the volume and level of activity for assets and liabilities are present, transaction and quoted prices may not be indicative of fair value. In these instances, the Company performs additional analysis of the transaction and quoted prices and may apply significant adjustments to those prices in estimating fair value. In determining which adjustments may be needed, the Company considers the nature of the quote (indicative price or binding offer) when weighting the available evidence. In the absence of transaction or quoted prices based on normal market activity, the Company may use valuation techniques that reflect management's views as to the assumptions that market participants would use in pricing the assets and liabilities.

Prior to adoption of the provisions of FASB ASC 820-10-65-4, the Company used independent broker quoted prices (unadjusted and non-binding quotes) to estimate fair value for substantially all of its securitized mortgage borrowings.

For securitized mortgage collateral and securitized mortgage borrowings, the underlying Alt-A residential and commercial loans and mortgage-backed securities market have experienced significant declines in market activity, along with a lack of orderly transactions. The Company's methodology to estimate fair value of these assets and liabilities included the use of internal pricing techniques such as the net present value of future expected cash flows (with observable market participant assumptions, where available) discounted at a rate of return based on the Company's estimates of market participant requirements. The significant assumptions utilized in these internal pricing techniques, which were based on the characteristics of the underlying collateral, included estimated credit losses, estimated prepayment speeds and appropriate discount rates.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**Note B Fair Value of Financial Instruments (Continued)**

The following table presents the estimated fair value of financial instruments included in the consolidated financial statements as of the dates indicated:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets</b>				
Cash and cash equivalents	\$ 37,893	\$ 37,893	\$ 46,215	46,215
Restricted cash	1,252	1,252	1,243	1,243
Short-term investments	5,014	5,043		
Investment securities available-for-sale	1,049	1,049	2,068	2,068
Securitized mortgage collateral	5,767,379	5,767,379	5,894,424	5,894,424
Derivative assets	222	222	37	37
<b>Liabilities</b>				
Securitized mortgage borrowings	\$ 5,744,725	\$ 5,744,725	\$ 6,193,984	\$ 6,193,984
Derivative liabilities	164,835	164,835	273,584	273,584
Long-term debt	9,399	9,399	15,403	15,403

The fair value amounts above have been estimated by management using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop the estimates of fair value in both inactive and orderly markets. Accordingly, the estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The carrying amount of cash and cash equivalents and restricted cash approximates fair value. Short-term investments are recorded at amortized cost. The fair value of short-term investments is determined using quoted prices in active markets. Refer to *Recurring fair value measurements* below for a description of the valuation methods used to determine the fair value of investment securities available for sale, securitized mortgage collateral and borrowings, derivative assets and liabilities and long-term debt.

**Recurring Fair Value Measurements**

The application of fair value measurements may be on a recurring or nonrecurring basis depending on the accounting principles applicable to the specific asset or liability or whether management has elected to carry the item at its estimated fair value.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(dollars in thousands, except share and per share data or as otherwise indicated)****Note B Fair Value of Financial Instruments (Continued)**

FASB ASC 820-10-35 specifies a hierarchy of valuation techniques based on whether the inputs to those techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 Quoted prices (unadjusted) in active markets for identical instruments or liabilities that an entity has the ability to assess at measurement date.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices that are observable for an asset or liability, including interest rates and yield curves observable at commonly quoted intervals, prepayment speeds, loss severities, credit risks and default rates; and market-corroborated inputs.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when estimating fair value.

The following tables present the Company's assets and liabilities that are measured at estimated fair value on a recurring basis, including financial instruments for which the Company has elected the fair value option at September 30, 2009 and December 31, 2008, based on the fair value hierarchy:

	Recurring Fair Value Measurements					
	September 30, 2009			December 31, 2008		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Assets</b>						
Investment securities available-for-sale	\$	\$	\$ 1,049	\$	\$	\$ 2,068
Securitized mortgage collateral			5,767,379			5,894,424
Total assets at fair value	\$	\$	\$ 5,768,428	\$	\$	\$ 5,896,492
<b>Liabilities</b>						
Securitized mortgage borrowings	\$	\$	\$ 5,744,725	\$	\$	\$ 6,193,984
Derivative liabilities, net(1)			164,613			273,547
Long-term debt			9,399			15,403
Total liabilities at fair value	\$	\$	\$ 5,918,737	\$	\$	\$ 6,482,934

(1)

At September 30, 2009, derivative liabilities, net included \$222 thousand in derivative assets and \$164.8 million in derivative liabilities, included within trust assets and trust liabilities, respectively. At December 31, 2008, derivative liabilities, net included \$37 thousand in derivative assets and \$273.6 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

As a result of the lack of observable market data resulting from inactive markets, the Company has classified its investment securities available-for-sale, securitized mortgage collateral and borrowings, net derivative liabilities and long-term debt as Level 3 fair value measurements at September 30, 2009

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**Note B Fair Value of Financial Instruments (Continued)**

and December 31, 2008. Level 3 assets and liabilities were 100 percent of total assets and total liabilities measured at estimated fair value at September 30, 2009 and December 31, 2008.

The following tables present a reconciliation for all assets and liabilities measured at estimated fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2009 and 2008:

	Level 3 Recurring Fair Value Measurements				
	For the three months ended September 30, 2009				
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Derivative liabilities, net	Long-term debt
Fair value, June 30, 2009	\$ 1,332	\$ 6,018,391	\$ (6,080,637)	\$ (184,672)	\$ (9,797)
Total gains (losses) included in earnings:					
Interest income(1)		139,958			
Interest expense(1)			(312,226)		(318)
Change in fair value of net trust assets, excluding REO	1,160	(79,422)	152,960	(28,373)	
Change in fair value of long-term debt					341
Total gains (losses) included in earnings	1,160	60,536	(159,266)	(28,373)	23
Transfers in and/or out of Level 3					
Purchases, issuances and settlements	(1,443)	(311,548)	495,178	48,432	375
Fair value, September 30, 2009	\$ 1,049	\$ 5,767,379	\$ (5,744,725)	\$ (164,613)	\$ (9,399)
Unrealized gains (losses) still held(2)	\$ 709	\$ (6,748,258)	\$ 8,144,739	\$ (166,793)	\$ 61,721

(1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.9 million for the three months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.

(2) Represents the amount of unrealized gains (losses) relating to assets and liabilities classified as Level 3 that are still held at September 30, 2009.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**Note B Fair Value of Financial Instruments (Continued)**

	Level 3 Recurring Fair Value Measurements				
	For the three months ended September 30, 2008				
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Derivative liabilities, net	Long-term debt
Fair value, June 30, 2008	\$ 8,644	\$ 298,189	\$ (316,968)	\$	\$ (46,266)
Total gains (losses) included in earnings:					
Interest income(1)	466	134,377			
Interest expense(1)			(271,817)		(126)
Change in fair value of net trust assets, excluding REO	(3,092)	(2,391,349)	2,413,109	(10,890)	
Change in fair value of long-term debt					10,494
Total (losses) gains included in earnings	(2,626)	(2,256,972)	2,141,292	(10,890)	10,368
Transfers in and/or out of Level 3(2)		10,747,133	(11,180,164)	(136,471)	
Purchases, issuances and settlements	(1,162)	(534,355)	568,827	43,812	
Fair value, September 30, 2008	\$ 4,856	\$ 8,253,995	\$ (8,787,013)	\$ (103,549)	\$ (35,898)
Unrealized (losses) gains still held(3)	\$ (7,070)	\$ (6,408,849)	\$ 7,113,480	\$ (107,179)	\$ 63,346

- (1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$3.0 million for the three months ended September 30, 2008, as reflected in the accompanying consolidated statement of operations.
- (2) Transfers in and/or out of Level 3 are reflected using values as of the beginning of the period.
- (3) Represents the amount of unrealized (losses) gains relating to assets and liabilities classified as Level 3 that are still held at September 30, 2008.

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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

## Note B Fair Value of Financial Instruments (Continued)

	Level 3 Recurring Fair Value Measurements				
	For the nine months ended September 30, 2009				
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Derivative liabilities, net	Long-term debt
Fair value, December 31, 2008	\$ 2,068	\$ 5,894,424	\$ (6,193,984)	\$ (273,547)	\$ (15,403)
Total gains (losses) included in earnings:					
Interest income(1)		850,079			
Interest expense(1)			(1,403,248)		(644)
Change in fair value of net trust assets, excluding REO	2,870	(33,818)	313,827	(48,712)	
Change in fair value of long-term debt					682
Total gains (losses) included in earnings	2,870	816,261	(1,089,421)	(48,712)	38
Transfers in and/or out of Level 3					
Purchases, issuances and settlements	(3,889)	(943,306)	1,538,680	157,646	5,966
Fair value, September 30, 2009	\$ 1,049	\$ 5,767,379	\$ (5,744,725)	\$ (164,613)	\$ (9,399)

(1)

Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$8.5 million for the nine months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.

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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

## Note B Fair Value of Financial Instruments (Continued)

	Level 3 Recurring Fair Value Measurements				
	For the nine months ended September 30, 2008				
	Investment securities available-for-sale	Securitized mortgage collateral	Securitized mortgage borrowings	Derivative liabilities, net	Long-term debt
Fair value, January 1, 2008	\$ 15,248	\$ 782,574	\$ (767,704)	\$	\$ (40,952)
Total gains (losses) included in earnings:					
Interest income(1)	865	231,288			
Interest expense(1)			(617,493)		(419)
Change in fair value of net trust assets, excluding REO	(8,899)	(5,639,914)	5,743,357	(94,399)	
Change in fair value of long-term debt					5,473
Total (losses) gains included in earnings	(8,034)	(5,408,626)	5,125,864	(94,399)	5,054
Transfers in and/or out of Level 3(2)		14,919,649	(15,109,073)	(120,260)	
Purchases, issuances and settlements	(2,358)	(2,039,602)	1,963,900	111,110	
Fair value, September 30, 2008	\$ 4,856	\$ 8,253,995	\$ (8,787,013)	\$ (103,549)	\$ (35,898)

(1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$14.6 million for the nine months ended September 30, 2008, as reflected in the accompanying consolidated statement of operations.

(2) Transfers in and/or out of Level 3 are reflected using values as of the beginning of the period.



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

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

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

**Note B Fair Value of Financial Instruments (Continued)**

The following is a description of the measurement techniques for items recorded at estimated fair value on a recurring basis.

*Investment securities available-for-sale* The Company elected to carry all of its investment securities available-for-sale at fair value. The investment securities consist primarily of non-investment grade mortgage-backed securities. The fair value of the investment securities is measured based upon the Company's expectation of inputs that other market participants would use. Such assumptions include judgments about the underlying collateral, prepayment speeds, future credit losses, forward interest rates and certain other factors. Given the market disruption and lack of observable market data as of September 30, 2009 and December 31, 2008, the estimated fair value of the investment securities available-for-sale was measured using significant internal expectations of market participants' assumptions.

*Securitized mortgage collateral* The Company elected to carry all of its securitized mortgage collateral at fair value. These assets consist primarily of non-conforming mortgage loans securitized between 2002 and 2007. Fair value measurements are based on the Company's internal models used to compute the net present value of future expected cash flows, with observable market participant assumptions, where available. The Company's assumptions include its expectations of inputs that other market participants would use in pricing these assets. These assumptions include judgments about the underlying collateral, prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors. As of September 30, 2009, securitized mortgage collateral had an unpaid principal balance of \$12.5 billion, compared to an estimated fair value of \$5.8 billion. The aggregate unpaid principal balance exceeds the fair value by \$6.7 billion at September 30, 2009. As of September 30, 2009, the unpaid principal balance of loans 90 days or more past due was \$2.6 billion compared to an estimated fair value of \$0.8 billion. The aggregate unpaid principal balances of loans 90 days or more past due exceed the fair value by \$1.8 billion at September 30, 2009.

*Securitized mortgage borrowings* The Company elected to carry all of its securitized mortgage borrowings at fair value. These borrowings consist of individual tranches of bonds issued by securitization trusts and are primarily backed by non-conforming mortgage loans. Fair value measurements include the Company's judgments about the underlying collateral and assumptions such as prepayment speeds, estimated future credit losses, forward interest rates, investor yield requirements and certain other factors. As of September 30, 2009, securitized mortgage borrowings had an outstanding principal balance of \$13.9 billion compared to an estimated fair value of \$5.7 billion. The aggregate outstanding principal balance exceeds the fair value by \$8.2 billion at September 30, 2009.

*Long-term debt* The Company elected to carry all of its long-term debt (consisting of trust preferred securities and junior subordinated notes) at fair value. These securities were measured based upon an analysis prepared by management, which considered the Company's own credit risk, including recent settlements with trust preferred debt holders and discounted cash flow analysis of junior subordinated notes. As of September 30, 2009, long-term debt had an unpaid principal balance of \$71.1 million compared to an estimated fair value of \$9.4 million. The aggregate unpaid principal balance exceeds the fair value by \$61.7 million at September 30, 2009.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**Note B Fair Value of Financial Instruments (Continued)**

*Derivative assets and liabilities* For non-exchange traded contracts, fair value is based on the amounts that would be required to settle the positions with the related counterparties as of the valuation date. Valuations of derivative assets and liabilities are based on observable market inputs, if available. To the extent observable market inputs are not available, fair values measurements include the Company's judgments about future cash flows, forward interest rates and certain other factors, including counterparty risk. Additionally, these values also take into account the Company's own credit standing, to the extent applicable; thus, the valuation of the derivative instrument includes the estimated value of the net credit differential between the counterparties to the derivative contract.

The following tables present the changes in recurring fair value measurements included in net earnings (loss) for the three and nine months ended September 30, 2009 and 2008:

	<b>Recurring Fair Value Measurements</b>				
	<b>Changes in Fair Value Included in Net Earnings</b>				
	<b>For the three months ended September 30, 2009</b>				
	<b>Interest</b>	<b>Interest</b>	<b>Change in Fair Value of</b>		<b>Total</b>
	<b>Income(1)</b>	<b>Expense(1)</b>	<b>Net Trust</b>	<b>Long-term</b>	
			<b>Assets</b>	<b>Debt</b>	
Investment securities					
available-for-sale	\$	\$	\$ 1,160	\$	\$ 1,160
Securitized mortgage collateral	139,958		(79,422)		60,536
Securitized mortgage					
borrowings		(312,226)	152,960		(159,266)
Derivative instruments, net			(28,373)(2)		(28,373)
Long-term debt		(318)		341	23
<b>Total</b>	<b>\$ 139,958</b>	<b>\$ (312,544)</b>	<b>\$ 46,325</b>	<b>\$ 341</b>	<b>\$ (125,920)</b>

(1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$1.9 million for the three months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.

(2) Included in this amount is \$20.4 million in changes in the fair value of derivative instruments, offset by \$48.8 million in cash payments from the securitization trusts for the three months ended September 30, 2009.

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

**Note B Fair Value of Financial Instruments (Continued)**

	<b>Recurring Fair Value Measurements</b>				
	<b>Changes in Fair Value Included in Net Loss</b>				
	<b>For the three months ended September 30, 2008</b>				
	<b>Interest Income(1)</b>	<b>Interest Expense(1)</b>	<b>Change in Fair Value of Net Trust Assets</b>	<b>Long-term Debt</b>	<b>Total</b>
Investment securities available-for-sale	\$ 466	\$	\$ (3,092)	\$	\$ (2,626)
Securitized mortgage collateral	134,377		(2,391,349)		(2,256,972)
Securitized mortgage borrowings		(271,817)	2,413,109		2,141,292
Derivative instruments, net			(10,890)(2)		(10,890)
Long-term debt		(126)		10,494	10,368
<b>Total</b>	<b>\$ 134,843</b>	<b>\$ (271,943)</b>	<b>\$ 7,778</b>	<b>\$ 10,494</b>	<b>\$ (118,828)</b>

(1)

Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$3.0 million for the three months ended September 30, 2008, as reflected in the accompanying consolidated statement of operations.

(2)

Included in this amount is \$30.6 million in changes in the fair value of derivative instruments, offset by \$41.5 million in cash payments from the securitization trusts for the three months ended September 30, 2008.

	<b>Recurring Fair Value Measurements</b>				
	<b>Changes in Fair Value Included in Net Earnings</b>				
	<b>For the nine months ended September 30, 2009</b>				
	<b>Interest Income(1)</b>	<b>Interest Expense(1)</b>	<b>Change in Fair Value of Net Trust Assets</b>	<b>Long-term Debt</b>	<b>Total</b>
Investment securities available-for-sale	\$	\$	\$ 2,870	\$	\$ 2,870
Securitized mortgage collateral	850,079		(33,818)		816,261
Securitized mortgage borrowings		(1,403,248)	313,827		(1,089,421)
Derivative instruments, net			(48,712)(2)		(48,712)
Long-term debt		(644)		682	38
<b>Total</b>	<b>\$ 850,079</b>	<b>\$ (1,403,892)</b>	<b>\$ 234,167(3)</b>	<b>\$ 682</b>	<b>\$ (318,964)</b>

(1)

Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$8.5 million for the nine months ended September 30, 2009, as reflected in the accompanying consolidated statement of operations.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**Note B Fair Value of Financial Instruments (Continued)**

(2) Included in this amount is \$110.1 million in changes in the fair value of derivative instruments, offset by \$158.8 million in cash payments from the securitization trusts for the nine months ended September 30, 2009.

(3) For the nine months ended September 30, 2009, change in the fair value of net trust assets, excluding REO was \$234.2 million. Excluded from the \$393.0 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$158.8 million in cash payments from the securitization trusts related to the Company's net derivative liabilities.

	<b>Recurring Fair Value Measurements</b>				
	<b>Changes in Fair Value Included in Net Loss</b>				
	<b>For the nine months ended September 30, 2008</b>				
	<b>Interest</b>	<b>Interest</b>	<b>Change in Fair Value of</b>		<b>Total</b>
	<b>Income(1)</b>	<b>Expense(1)</b>	<b>Net Trust</b>	<b>Long-term</b>	
			<b>Assets</b>	<b>Debt</b>	
Investment securities available-for-sale	\$ 865	\$	\$ (8,899)	\$	\$ (8,034)
Securitized mortgage collateral	231,288		(5,639,914)		(5,408,626)
Securitized mortgage borrowings		(617,493)	5,743,357		5,125,864
Derivative instruments, net			(94,399)(2)		(94,399)
Long-term debt		(419)		5,473	5,054
<b>Total</b>	<b>\$ 232,153</b>	<b>\$ (617,912)</b>	<b>\$ 145(3)</b>	<b>\$ 5,473</b>	<b>\$ (380,141)</b>

(1) Amounts primarily represent accretion to recognize interest income and interest expense using effective yields based on estimated fair values for trust assets and trust liabilities. The total net interest income, including cash received and paid, was \$14.6 million for the nine months ended September 30, 2008, as reflected in the accompanying consolidated statement of operations.

(2) Included in this amount is \$18.5 million in changes in the fair value of derivative instruments offset by \$112.9 million in cash payments from the securitization trusts for the nine months ended September 30, 2008.

(3) For the nine months ended September 30, 2008, change in the fair value of net trust assets, excluding REO was \$0.1 million. Excluded from the \$113.0 million change in fair value of net trust assets, excluding REO, in the accompanying consolidated statement of cash flows is \$112.9 million in cash payments from the securitization trusts related to the Company's net derivative liabilities.

In connection with the fair value option election for investment securities available-for-sale and securitized mortgage collateral and borrowings, interest income and interest expense are recognized using effective yields based on estimated fair values for these instruments. As the market's expectation of future credit losses has increased between periods, market participants have demanded higher yields, which have resulted in significant reductions in the fair values of these instruments. These reductions in fair value have significantly increased the effective yields used for purposes of recognizing interest income and interest expense on these instruments.



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

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

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

**Note B Fair Value of Financial Instruments (Continued)**

The change in fair value of the asset and liabilities above, excluding derivative instruments, is primarily due to the changes in credit risk. The change in fair value for derivative instruments is primarily due to the change in the forward LIBOR curve.

***Nonrecurring Fair Value Measurements***

The Company is required to measure certain assets and liabilities at estimated fair value from time to time. These fair value measurements typically result from the application of specific accounting pronouncements under GAAP. The fair value measurements are considered nonrecurring fair value measurements under FASB ASC 820-10.

*Loans held-for-sale* Loans held-for-sale for which the fair value option was not elected are carried at the lower of cost or market (LOCOM). When available, such measurements are based upon what secondary markets offer for portfolios with similar characteristics, and are considered Level 2 measurements. If market pricing is not available, such measurements are significantly impacted by the Company's expectations of other market participants' assumptions, and are considered Level 3 measurements. The Company utilizes internal pricing processes to estimate the fair value of loans held-for-sale, which is based on recent loan sales and estimates of the fair value of the underlying collateral. Loans held-for-sale, which are primarily included in assets of discontinued operations, are considered Level 3 fair value measurements at September 30, 2009 and December 31, 2008 based on the lack of observable market inputs.

*Real estate owned* REO consists of residential real estate acquired in satisfaction of loans. Upon foreclosure, REO is adjusted to the estimated fair value of the residential real estate less estimated selling and holding costs, offset by expected mortgage insurance proceeds to be received, if any. Subsequently, REO is recorded at the lower of carrying value or estimated fair value less costs to sell. Fair values of REO are generally based on observable market inputs, and considered Level 2 measurements at September 30, 2009.

*Lease liability* In connection with the discontinuation of our non-conforming mortgage, retail mortgage, warehouse lending and commercial operations, a significant amount of office space that was previously occupied is no longer being used by the Company. The Company has subleased a significant amount of this office space. The Company has recorded a liability, included within discontinued operations, representing the present value of the minimum lease payments over the remaining life of the lease, offset by the expected proceeds from sublet revenue related to this office space. This liability is based on present value techniques that incorporate the Company's judgments about estimated sublet revenue and discount rates. Therefore, this liability is considered a Level 3 measurement at September 30, 2009.

*Deferred charge* Deferred charge represents the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is amortized as a component of income tax expense over the estimated life of the mortgages retained in the securitized mortgage collateral. The Company evaluates the deferred charge for impairment quarterly using internal estimates of estimated cash flows and lives of the related mortgages retained in the securitized mortgage collateral. Deferred charge is considered a Level 3 measurement at September 30, 2009.

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

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

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

**Note B Fair Value of Financial Instruments (Continued)**

The following tables present financial and non-financial assets and liabilities measured using nonrecurring fair value measurements at September 30, 2009 and December 31, 2008:

	Non-recurring Fair Value Measurements			Total Gains (Losses)	
	September 30, 2009			For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2009
	Level 1	Level 2	Level 3		
Loans held-for-sale(1)	\$	\$	\$ 79,505	\$	\$ (7,517)
REO(2)		116,694		(25,285)	(120,523)
Lease liability(3)			(3,924)	(28)	2,531
Deferred charge(4)			13,144		(1,998)

(1) Includes \$0.3 million and \$79.2 million of loans held-for-sale within continuing and discontinued operations, respectively, at September 30, 2009.

(2) Includes \$112.8 million and \$3.9 million in REO within continuing and discontinued operations, respectively, at September 30, 2009 which had additional impairment write-downs subsequent to the date of foreclosure. For the three months ended September 30, 2009, the \$25.3 million loss related to additional impairment write-downs during the period included \$24.5 million and \$0.8 million within continuing and discontinued operations, respectively. For the nine months ended September 30, 2009, the \$120.5 million loss related to additional impairment write-downs during the period included \$117.9 million and \$2.6 million within continuing and discontinued operations, respectively.

(3) Amounts are included in discontinued operations. For the three and nine months ended September 30, 2009, the Company recorded \$28 thousand in losses and \$2.5 million in gains resulting from changes in lease liabilities as a result of changes in our expected minimum future lease payments, respectively.

(4) Amounts are included in continuing operations. For the three and nine months ended September 30, 2009, the Company recorded zero and \$2.0 million, respectively, in income tax expense resulting from impairment writedowns based on changes in estimated cash flows and lives of the related mortgages retained in the securitized mortgage collateral .

**Non-recurring Fair Value Measurements**

	December 31, 2008			Total Losses For the Year Ended December 31, 2008
	Level 1	Level 2	Level 3	
Loans held-for-sale(1)	\$	\$	\$ 108,223	\$ 45,960

(1)



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Includes \$0.4 million and \$107.8 million of loans held-for-sale within continuing and discontinued operations, respectively, at December 31, 2008.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(dollars in thousands, except share and per share data or as otherwise indicated)****Note C Stock Options**

The fair value of stock options granted, which is amortized to expense over the service period, is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Nine Months Ended September 30,	
	2009	2008
Risk-free interest rate	2.86%	1.88% to 2.54%
Expected lives (in years)	5.50	3.25 - 3.50
Expected volatility(1)	259.16%	87.3% - 91.9%
Expected dividend yield(2)	0.00%	0.00%
Grant date fair value of share options	\$0.53	\$5.02 - 7.76

- (1) Expected volatility is based on the historical volatility of the Company's stock over the expected life of the stock option.
- (2) Expected dividend yield is zero because a dividend on the common stock was not probable over the expected life of the options granted during the nine months ended September 30, 2009 and 2008.

The following table summarizes activity, pricing and other information for the Company's stock options for the nine months ended September 30, 2009:

	Number of Shares	Weighted- Average Exercise Price (\$)
Options outstanding at January 1, 2009	1,140,186	\$ 37.18
Options granted	842,300	0.53
Options exercised		
Options forfeited / cancelled	(651,201)	34.64
Options outstanding at September 30, 2009	1,331,285	\$ 15.23
Options exercisable at September 30, 2009	240,030	\$ 67.89

As of September 30, 2009, there was approximately \$848 thousand of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Company's stock-based incentive compensation plan. This cost is expected to be recognized over a weighted average period of six months.

In April 2009, certain of the Company's officers and directors gave notice of the surrender of an aggregate of 581,000 options and the Board accepted and approved the cancellation of those options. In connection with the cancellation of these options, the Company recognized non-cash compensation expense of approximately \$1.7 million during the quarter ended June 30, 2009.

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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

**Note D Reconciliation of Earnings Per Share**

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Numerator for basic earnings per share:</b>				
Earnings (loss) from continuing operations	\$ 4,803	\$ 1,901	\$ 14,109	\$ (19,041)
Loss from discontinued operations	(1,776)	(18,121)	(8,366)	(28,481)
Less: Cash dividends on cumulative redeemable preferred stock		(3,722)	(7,443)	(11,165)
Net earnings (loss) attributable to common stockholders	\$ 3,027	\$ (19,942)	\$ (1,700)	\$ (58,687)
<b>Denominator for basic earnings per share:</b>				
Basic weighted average number of common shares outstanding during the period	7,618	7,610	7,618	7,610
<b>Denominator for diluted earnings per share:</b>				
Diluted weighted average number of common shares outstanding during the period	7,618	7,610	7,618	7,610
Net effect of dilutive stock options	384			
Diluted weighted average common shares	8,002	7,610	7,618	7,610
Earnings (loss) per common share basic and diluted:				
Earnings (loss) from continuing operations	\$ 0.60	\$ (0.24)	\$ 0.88	\$ (3.97)
Loss from discontinued operations	(0.22)	(2.38)	(1.10)	(3.74)
Earnings (loss) per share attributable to common stockholders	\$ 0.38	\$ (2.62)	\$ (0.22)	\$ (7.71)

For the three and nine months ended September 30, 2009, stock options to purchase 504 thousand and 1.3 million shares, respectively, were outstanding but not included in the above weighted average share calculations because they were anti-dilutive.

For the three and nine months ended September 30, 2008, stock options to purchase 1.2 million shares were outstanding but not included in the above weighted average share calculations because they were anti-dilutive.

Table of Contents**IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(dollars in thousands, except share and per share data or as otherwise indicated)****Note E Segment Reporting**

The Company has three reporting segments, consisting of the long-term mortgage portfolio, mortgage and real estate services and discontinued operations. The following tables present the selected financial data and operating results by reporting segment for the periods indicated:

	<b>Long-term Portfolio</b>	<b>Mortgage and Real Estate Services</b>	<b>Discontinued Operations</b>	<b>Consolidated</b>
<b>Balance sheet items as of</b>				
<b>September 30, 2009:</b>				
Securitized mortgage collateral	\$ 5,767,379	\$	\$	\$ 5,767,379
Total assets	5,981,485	29,021	98,257	6,108,763
Total liabilities	5,924,092	4,008	170,973	6,099,073
Total stockholders' equity (deficit)	57,393	25,013	(72,716)	9,690
<b>Balance sheet items as of</b>				
<b>December 31, 2008:</b>				
Securitized mortgage collateral	\$ 5,894,424	\$	\$	\$ 5,894,424
Total assets	6,574,464		141,053	6,715,517
Total liabilities	6,489,024		217,241	6,706,265
Total stockholders' equity (deficit)	85,440		(76,188)	9,252

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## IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

## Note E Segment Reporting (Continued)

	Long-term Portfolio	Mortgage and Real Estate Services	Discontinued Operations	Reclassifications(1)	Consolidated
<b>Statement of Operations Items for the three months ended September 30, 2009:</b>					
Net interest income	\$ 1,894	\$ 12	\$ 834	\$ (834)	\$ 1,906
Non-interest income net trust assets	3,165				3,165
Mortgage and real estate services fees		13,514			13,514
Other non-interest income (expense)	361	(127)	(2,148)	2,148	234
Non-interest expense and income taxes	(5,422)	(8,594)	(462)	462	(14,016)
Earnings from continuing operations	\$ (2)	\$ 4,805			4,803
Loss from discontinued operations, net of tax			\$ (1,776)		(1,776)
Net earnings					\$ 3,027
<b>Statement of Operations Items for the nine months ended September 30, 2009:</b>					
Net interest income (expense)	\$ 8,496	\$ 5	\$ (244)	\$ 244	\$ 8,501
Non-interest income net trust assets	16,084				16,084
Mortgage and real estate services fees		32,296			32,296
Other non-interest income (expense)	661	(312)	(10,928)	10,928	349
Non-interest expense and income taxes	(22,962)	(20,159)	2,806	(2,806)	(43,121)
Earnings from continuing operations	\$ 2,279	\$ 11,830			14,109
Loss from discontinued operations, net of tax			\$ (8,366)		(8,366)
Net earnings					\$ 5,743

	Long-term Portfolio	Mortgage and Real Estate Services	Discontinued Operations	Reclassifications(1)	Consolidated
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**Statement of Operations Items for the three months ended September 30, 2008:**

Net interest income	\$ 3,014	\$	\$ 158	\$	(158)	\$ 3,014
Non-interest income net trust assets	(7,907)					(7,907)
Mortgage and real estate services fees			2,923			2,923
Other non-interest income (expense)	16,124		333	(13,000)	13,000	16,457
Non-interest expense and income taxes	(12,145)		(441)	(5,279)	5,279	(12,586)

Earnings from continuing operations \$ (914) \$ 2,815 1,901

Loss from discontinued operations, net of tax \$ (18,121) (18,121)

Net loss \$ (16,220)

**Statement of Operations Items for the nine months ended September 30, 2008:**

Net interest income (expense)	\$ 14,624	\$ (5)	\$ 3,372	\$ (3,372)	\$ 14,619
Non-interest income net trust assets	(24,626)				(24,626)
Mortgage and real estate services fees			7,078		7,078
Other non-interest income (expense)	18,918		345	(12,021)	12,021
Non-interest expense and income taxes	(34,067)		(1,308)	(19,832)	19,832

Loss (earnings) from continuing operations \$ (25,151) \$ 6,110 (19,041)

Loss from discontinued operations, net of tax \$ (28,481) (28,481)

Net loss \$ (47,522)

(1) Amounts represent reclassifications of activity in the discontinued operations segment into loss from discontinued operations, net of tax as presented in the accompanying consolidated statements of operations.

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

**Note F Real Estate Owned (REO)**

The Company's REO consisted of the following:

	September 30, 2009	December 31, 2008
REO	\$ 218,107	\$ 635,285
Impairment(1)	(47,474)	(35,533)
Ending balance	\$ 170,633	\$ 599,752
REO inside trusts	\$ 170,153	\$ 599,084
REO outside trusts(2)	480	668
Total	\$ 170,633	\$ 599,752

(1) Impairment represents the cumulative write-downs of REO to estimated net realizable value subsequent to foreclosure.

(2) Amount represents REO related to former on-balance sheet securitizations, which were collapsed as a result of the Company exercising its clean-up call options. This REO is included in other assets in the accompanying consolidated balance sheets.

**Note G Restructured Financing (Discontinued Operations)**

In October 2009, the Company entered into a settlement agreement (the "Settlement Agreement") with its remaining reverse repurchase facility lender to settle the Restructured Financing. The Settlement Agreement retires the current facility and removes any further exposure associated with the line or the loans that secured the line. Pursuant to the terms of the Settlement Agreement, the Company settled the \$140.0 million balance of the reverse repurchase line by transferring the loans securing the line to the lender at their approximate carrying values, resulting in a cash payment of \$20.0 million and the Company entering into a credit agreement with the lender (the "Credit Agreement") for a \$33.9 million term loan. The borrowing under the Credit Agreement, which is to be paid over 18 months, bears interest at a rate of one-month LIBOR plus 350 basis points and requires monthly payments of \$1.5 million. In addition to the monthly payments of \$1.5 million, a \$10.0 million principal payment is due by April 2010 as part of the Credit Agreement.

The borrowing under the Credit Agreement may be prepaid by the Company at any time; provided that if the entire borrowing is repaid on or before December 31, 2009, then \$5.0 million will be deducted from the amount due. Upon any sale of assets, excluding mortgage assets, issuance of debt, excluding warehouse borrowings, or equity by the Company, then all of the proceeds therefrom are required to be applied to the borrowing under the Credit Agreement, or in the case of an equity issuance, applied to the \$10.0 million principal payment due by April 2010.

In addition to the restrictions above, the Credit Agreement requires the Company to maintain certain business and financial covenants until the borrowing is paid in full. These covenants place several restrictions on the Company and its operations, including limiting its ability to pay dividends, issue equity interests, make investments over certain amounts without prior consent or enter into any transaction to merge or consolidate. The covenants also require the Company to maintain cash and cash equivalents of \$10.0 million (based on certain calculations) and stockholders' equity greater than zero (based on certain calculations).





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

**Note G Restructured Financing (Discontinued Operations) (Continued)**

As of September 30, 2009, the Company's reverse repurchase financing, included in discontinued operations, was secured by mortgage loans held-for-sale with an unpaid principal balance of \$173.1 million, restricted cash of \$12.2 million and certain REOs. The following table presents the outstanding balance of the Company's Restructured Financing as of the dates indicated:

	Discontinued Operations	
	September 30, 2009	December 31, 2008
Reverse repurchase line(1)	\$ 151,056	\$ 188,677

(1) This line, which is guaranteed by IMH, is no longer funding loans and was restructured in 2008 as described below.

In September 2008, the Company entered into an agreement to restructure its reverse repurchase line (Restructured Financing) with its remaining lender, which was subsequently settled as described above. The agreement removed all technical defaults from financial covenant noncompliance and any associated margin calls for the term of the agreement. The agreement called for certain targets including a reduction of the borrowings balance to \$100 million by March 2010 with an advance rate of no more than 65 percent of the outstanding principal balance and \$50 million by September 2010 with an advance rate of no more than 55 percent of the outstanding principal balance. At September 30, 2009, the advance rate was 78 percent. The agreement also called for monthly payments of \$1.5 million until the earlier of the Company raising capital or the end of the agreement term. If the Company is successful in raising capital, approximately 10 percent of the gross proceeds must be remitted as an additional payment and the monthly payment would then be reduced to \$750,000. The interest rate was LIBOR plus 325 basis points.

During the three and nine months ended September 30, 2009, the Company paid an additional \$4.5 million and \$13.5 million, respectively, in payments used by the lender to offset interest and settlement shortfalls, as required under the terms of the Restructured Financing.

**Note H Long-term Debt**

The following table shows the composition of long-term debt as of the dates indicated:

	September 30, 2009	December 31, 2008
Trust preferred securities:		
Outstanding balance	\$ 8,500	\$ 88,250
Common securities	620	2,994
Fair value adjustment	(7,409)	(75,841)
<b>Total trust preferred securities</b>	<b>1,711</b>	<b>15,403</b>
Junior subordinated notes:		
Outstanding balance	62,000	
Fair value adjustment	(54,312)	
<b>Total junior subordinated notes</b>	<b>7,688</b>	
<b>Total long-term debt</b>	<b>\$ 9,399</b>	<b>\$ 15,403</b>



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

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

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

**Note H Long-term Debt (Continued)**

In January 2009, the Company purchased and canceled \$25.0 million in outstanding trust preferred securities of Impac Capital Trust #2 for \$3.75 million and terminated the remaining debt.

In May 2009, the Company exchanged an aggregate of \$51.3 million in trust preferred securities of Impac Capital Trusts #1 and #3 for junior subordinated notes with an aggregate principal balance of \$62.0 million and a maturity date of March 2034. Under the terms of the exchange, the interest rate for each note was reduced from 8.01 percent to 2.00 percent through 2013 with increases thereafter of 1.00 percent per year through 2017. Starting in 2018, the interest rates become variable at 3-month LIBOR plus 375 basis points. In connection with the exchange, the Company paid a fee of \$0.5 million.

In June 2009, the Company purchased and canceled \$1.0 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$150 thousand.

In August 2009, the Company purchased and canceled \$2.5 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$375 thousand, resulting in \$8.5 million in outstanding trust preferred securities. In July 2009, the Company became current and is no longer deferring interest on its remaining trust preferred securities.

As a result of the restructuring of \$51.3 million and purchase and cancellation of \$36.5 million in outstanding trust preferred securities, the Company reduced its annual interest expense obligation from \$7.8 million to \$2.0 million. With the restructuring and purchase and cancellations of trust preferred securities, the Company has \$8.5 million in outstanding trust preferred securities of Impac Capital Trust #4 and \$62.0 million in outstanding junior subordinated notes.

**Note I Preferred Stock Repurchase**

In June 2009, the Company completed the Offer to Purchase and Consent Solicitation (the "Offer to Purchase") of all of its 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock. The Series B Preferred Stock had a liquidation preference of \$50 million and the Series C Preferred Stock had a liquidation preference of \$111.8 million, for a total of \$161.8 million. Upon expiration of the Offer to Purchase, holders of approximately 68% of the Preferred Stock tendered an aggregate of 4,378,880 shares. Holders of the Company's Series B Preferred Stock tendered 1,323,844 shares at \$0.29297 per share for a total of \$388 thousand. Holders of the Company's Series C Preferred Stock tendered 3,055,036 shares at \$0.28516 per share for a total of \$871 thousand. The aggregate purchase price for the Preferred Stock was \$1.3 million. In addition, in connection with completing the offer to purchase the Company paid \$7.4 million accumulated but unpaid dividends on its Preferred Stock. With the total cash payment of \$8.7 million, the Company eliminated \$109.5 million of liquidation preference on its Preferred Stock. After the completion of the Offer to Purchase, the Company has outstanding \$52.3 million liquidation preference of Series B and Series C Preferred Stock.

With completion of the Offer to Purchase and modification to the terms of the Series B Preferred Stock and Series C Preferred Stock, the Company eliminated its \$14.9 million annual preferred dividend obligation.

As a condition to completing the offer to purchase, the common stockholders and preferred stockholders approved and consented to modify the terms of each of the Series B Cumulative Preferred

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

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

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

**Note I Preferred Stock Repurchase (Continued)**

Stock and Series C Preferred Stock to (i) make Preferred Stock dividends, if any, non-cumulative, (ii) eliminate the provisions prohibiting the payment of dividends on junior stock and prohibiting the purchase or redemption of junior or parity stock if full cumulative dividends for all past dividend periods are not paid or declared and set apart for payment, (iii) eliminate any premiums payable upon the liquidation, dissolution or winding up of the Company, (iv) eliminate the provision prohibiting the Company from electing to redeem Preferred Stock prior to the fifth year anniversary of the issuance of such preferred stock, (v) eliminate the provision prohibiting the Company from redeeming less than all of the outstanding Preferred Stock if full cumulative dividends for all past dividend periods have not been paid or declared and set apart for payment, (vi) eliminate the right of holders of Preferred Stock to elect two directors if dividends are in arrears for six quarterly periods and (vii) eliminate the right of holders of Preferred Stock to consent to or approve the authorization or issuance of preferred stock senior to the Preferred Stock. The holders of each series of Preferred Stock retain the right to a \$25.00/share liquidation preference in the event of a liquidation of the Company and the right to receive dividends on the Preferred Stock if any such dividends are declared.

**Note J Subsequent Events**

Subsequent events have been evaluated through November 9, 2009, the date these financial statements were issued.

In October 2009, the Company entered into a settlement agreement (the "Settlement Agreement") with its remaining reverse repurchase facility lender to settle the Restructured Financing. The Settlement Agreement retires the current facility and removes any further exposure associated with the line or the loans that secured the line. Pursuant to the terms of the Settlement Agreement, the Company settled the \$140.0 million balance of the reverse repurchase line by transferring the loans securing the line to the lender at their approximate carrying values, resulting in a cash payment of \$20.0 million and the Company entering into a credit agreement with the lender (the "Credit Agreement") for a \$33.9 million term loan. The borrowing under the Credit Agreement, which is to be paid over 18 months, bears interest at a rate of one-month LIBOR plus 350 basis points and requires monthly payments of \$1.5 million. In addition to the monthly payments of \$1.5 million, a \$10.0 million principal payment is due by April 2010 as part of the Credit Agreement. See further discussion of the settlement agreement in Note G *Restructured Financing (Discontinued Operations)*.

On October 27, 2009, the Company issued 80,000 shares of common stock and paid legal expenses in connection with the settlement of *Sharon Page v. Impac Mortgage Holdings, Inc., et al.*, which was originally filed on December 17, 2007 in the United States District Court, Central District of California against IMH and several of its senior officers and is described in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

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

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

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

**Forward-Looking Statements**

This report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements, some of which are based on various assumptions and events that are beyond our control, may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "likely," "should," "could," "anticipate," or similar terms or variations on those terms or the negative of those terms. The forward-looking statements are based on current management expectations. Actual results may differ materially as a result of several factors, including, but not limited to the following: the ongoing volatility in the mortgage industry; our ability to successfully manage through the current market environment; our ability to meet liquidity needs from current cash flows or generate new sources of revenue; management's ability to successfully manage and potentially grow the Company's mortgage and real estate fee-based businesses; the ability to make interest and dividend payments; increases in default rates and mortgage related losses; the ability to satisfy conditions (payment and covenants) in the new credit agreement; our ability to obtain additional financing and the terms of any financing that we do obtain; inability to effectively liquidate properties to mitigate losses; increase in loan repurchase requests and ability to adequately settle repurchase obligations; decreases in value of our residual interests that differ from our assumptions; the ability of our common stock to continue trading in an active market; the outcome of litigation or regulatory actions pending against us or other legal contingencies; and our compliance with applicable local, state and federal laws and regulations and other general market and economic conditions.

For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the period ended December 31, 2008, the other reports we file under the Securities and Exchange Act of 1934. This document speaks only as of its date and we do not undertake, and specifically disclaim any obligation, to publicly release the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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

The mortgage banking industry is continually vulnerable to current events that occur in the financial services industry. These events include changes in economic indicators, government regulation, interest rates, price competition, geographic shifts, disposable income, housing prices, market liquidity, market anticipation, and customer perception, as well as others. The factors that affect the industry change rapidly and can be unforeseeable.

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 attempts to present

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financial information in its Management's Discussion and Analysis of Financial Condition and Results of Operations that is the most relevant to its financial information.

**Status of Operations, Liquidity and Capital Resources**

*Mortgage and real estate services*

In 2009, the Company has sought to create an integrated services platform to provide solutions to the mortgage and real estate markets. Pursuant to that, the Company initiated various mortgage and real estate fee-based businesses, including loan modifications, real estate disposition, monitoring and surveillance services, real estate brokerage and lending services and title and closing services. The Company has been able to develop and enhance its service offerings in providing services to investors, servicers and individual borrowers primarily by focusing on loss mitigation and performance of our own long-term mortgage portfolio. The development of these businesses focuses on vertical integration of a centralized platform which we believe we can operate synergistically to maximize their success. The Company has established the following businesses:

*Loan Modification* The Company has established a loan modification business to provide outsourced loss mitigation services to investors and institutions with distressed and delinquent residential and multifamily mortgage portfolios. In addition, we provide modification solutions to individual borrowers by interacting with loan servicers on behalf of the borrowers to assist them in lowering the monthly mortgage payments to an affordable level allowing them to remain in their homes.

*Real Estate Solutions* The Company has established a real estate solutions business to provide real estate owned (REO) surveillance services to servicers and portfolio managers to assist them in maximizing loss mitigation performance in managing distressed mortgage portfolios and foreclosed real estate assets, along with disposition of such assets. In addition, we perform default surveillance and monitoring services for residential and multifamily mortgage portfolios for investors and servicers to assist them with overall portfolio performance.

*Real Estate Brokerage and Lending* The Company has established a real estate brokerage business which primarily serves the southern California area and a mortgage lending business as it seeks to re-enter the mortgage lending industry. The primary business of the real estate brokerage business is the listing and selling of REO and mortgage short sales. Our mortgage lending activities include earning fees for brokering loans to third-party lenders since 2008 and originating loans through our mortgage banking platform under the "Impac" brand name. Although we have originated only a minimal number of loans year to date, we expect to increase our loan originations over the next few quarters through retail channels focusing on originating only loans that are eligible for sale to HUD and other government-sponsored enterprises.

*Title and Escrow* The Company has established a title agent and escrow business to provide title insurance, escrow and settlement services to residential mortgage lenders, real estate agents, asset managers and REO companies in the residential market sector of the real estate industry. We deliver services through a proprietary integrated technology platform.

For the three and nine month periods ended September 30, 2009, mortgage and real estate services fees were \$13.5 million and \$32.3 million, respectively. Although the Company intends to generate more fees by providing these services to third parties in the marketplace in the near future, the revenues from these businesses have primarily been generated from the Company's long-term mortgage portfolio. Furthermore, since these businesses are newly formed there remains uncertainty about their future success.

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*Long-term mortgage portfolio*

During 2009, the Company continues to be significantly and negatively affected by the deteriorating real estate market and the weak economic environment. These factors have led to continued deterioration in the quality of the Company's long-term mortgage portfolio, as evidenced by the continued increases in delinquencies, foreclosures and credit losses. Existing conditions are unprecedented and inherently involve significant risks and uncertainty to the Company. The current market conditions have led to fewer sources of liquidity available to the Company to operate its business. These conditions continue to have an adverse effect on the performance of the Company's long-term mortgage portfolio, including significant losses on real estate owned. During 2009, the Company increased its loss assumptions for its long-term mortgage portfolio due to the increase in expected defaults and loss severities related to the weak economy and housing market.

*Liquidity and capital resources*

During the first nine months of 2009, the Company continued to fund its operations primarily from the cash flows from its long-term mortgage portfolio and mortgage and real estate fee-based businesses.

*Trust preferred securities*

In January 2009, the Company purchased and canceled all of the \$25.0 million in outstanding trust preferred securities of Impac Capital Trust #2 for \$3.75 million and terminated the remaining debt.

In May 2009, the Company exchanged an aggregate of \$51.3 million in trust preferred securities of Impac Capital Trusts #1 and #3 for junior subordinated notes with an aggregate principal balance of \$62.0 million, with a maturity date in March 2034. Under the terms of the exchange, the interest rate for each note was reduced from the original 8.01 percent to 2.00 percent through 2013 with increases of 1.00 percent per year through 2017. Starting in 2018, the interest rates become variable at 3-month LIBOR plus 375 basis points. In connection with the exchange, the Company paid a fee of \$0.5 million.

In June 2009, the Company purchased and canceled \$1.0 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$150 thousand.

In July 2009, the Company became current and is no longer deferring interest on its remaining trust preferred securities. For the three and nine months ended September 30, 2009 and 2008, the Company paid \$0.6 million and \$1.8 million, respectively in interest on trust preferred securities.

In August 2009, the Company purchased and canceled \$2.5 million in outstanding trust preferred securities of Impac Capital Trust #4 for \$375 thousand.

As a result of the restructuring of \$51.3 million and the purchase and cancelation of \$36.5 million in outstanding trust preferred securities, the Company reduced its annual interest expense obligation from \$7.8 million to \$2.0 million. With the restructuring and purchase and cancelations of trust preferred securities, the Company has \$8.5 million in outstanding trust preferred securities of Impac Capital Trust #4 and \$62.0 million in outstanding junior subordinated notes.

*Preferred stock*

In June 2009, the Company completed the Offer to Purchase and Consent Solicitation (the "Offer to Purchase") of all of its 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock. The Series B Preferred Stock had a liquidation preference of \$50 million and the Series C Preferred Stock had a liquidation preference of \$111.8 million, for a total of \$161.8 million. Upon expiration of the Offer to Purchase, holders of approximately 67.7% of the Preferred Stock tendered an aggregate of 4,378,880 shares. Stockholders of the Company's Series B Preferred Stock tendered 1,323,844 shares at \$0.29297 per share for

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\$388 thousand. Stockholders of the Company's Series C Preferred Stock tendered 3,055,036 shares at \$0.28516 per share for \$871 thousand. The aggregate purchase price for the Preferred Stock was \$1.3 million. In addition, in connection with the completion of the offer to purchase the Company paid \$7.4 million accumulated but unpaid dividends on its Preferred Stock. With the total cash payment of \$8.7 million, the Company eliminated \$109.5 million of liquidation preference on its Preferred Stock. After the completion of the Offer to Purchase, the Company has outstanding \$52.3 million liquidation preference of Series B and Series C Preferred Stock.

In connection with the Offer to Purchase, the Company filed Articles of Amendment to its charter with the State Department of Assessments and Taxation of Maryland to modify the terms of each of its 9.375% Series B Cumulative Redeemable Preferred Stock and 9.125% Series C Cumulative Redeemable Preferred Stock to (i) make dividends, if any, non-cumulative, (ii) eliminate the provisions prohibiting the payment of dividends on junior stock and prohibiting the purchase or redemption of junior or parity stock if full cumulative dividends for all past dividend periods are not paid or declared and set apart for payment, (iii) eliminate any premiums payable upon the liquidation, dissolution or winding up of the Company, (iv) eliminate the provision prohibiting the Company from electing to redeem Preferred Stock prior to the fifth year anniversary of the issuance of such Preferred Stock, (v) eliminate the provision prohibiting the Company from redeeming less than all of the outstanding Preferred Stock if full cumulative dividends for all past dividend periods have not been paid or declared and set apart for payment, (vi) eliminate the right of holders of preferred stock to elect two directors if dividends are in arrears for six quarterly periods and (vii) eliminate the right of holders of Preferred Stock to consent to or approve the authorization or issuance of Preferred Stock senior to the preferred stock.

With completion of the Offer to Purchase and modification to the terms of the Series B Preferred Stock and Series C Preferred Stock, the Company eliminated its \$14.9 million annual preferred dividend obligation.

### *Restructured Financing*

In October 2009, the Company entered into a settlement agreement (the "Settlement Agreement") with its remaining reverse repurchase facility lender to settle the Restructured Financing. The Settlement Agreement retires the current facility and removes any further exposure associated with the line or the loans that secured the line. Pursuant to the terms of the Settlement Agreement, the Company settled the \$140.0 million balance of the reverse repurchase line by transferring the loans securing the line to the lender at their a