NEW CENTURY FINANCIAL CORP
Form S-8
February 07, 2005

As filed with the Securities and Exchange Commission on February 4, 2005

Registration No.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-8

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

New Century Financial Corporation

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**56-2451736**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

18400 Von Karman Avenue, Suite 1000

Irvine, California 92612

(Address, Including Zip Code, of Principal Executive Offices)

Employee Equalization Nonqualified Stock Option Granted to Edward F. Gotschall

Director Nonqualified Stock Option Granted to Fredric J. Forster

(Full title of the plans)

Brad A. Morrice

President and Chief Operating Officer

New Century Financial Corporation

18400 Von Karman Avenue, Suite 1000

Irvine, California 92612

(949) 440-7030

(Name, Address and Telephone Number, Including Area Code, of Agent For Service)

COPY TO:

David A. Krinsky, Esq.

O Melveny & Myers LLP

610 Newport Center Drive, Suite 1700

Newport Beach, California 92660

CALCULATION OF REGISTRATION FEE

Title of securities to be registered	Amount to be registered	Proposed maximum offering price	Proposed maximum aggregate offering	Amount of registration fee

		per unit	**price**	
Common Stock, par value $0.01 per share, Issued Pursuant to the Forster Option Agreement (as identified below)	15,000(1) shares	$6.6667(3)	$100,000(3)	$11.77(3)
Common Stock, par value $0.01 per share, Issuable Pursuant to the Gotschall Option Agreement (as identified below)	60,000(1) shares	$2.3333(3)	$140,000(3)	$16.48(3)
Totals	75,000(1)(2) shares	$3.2000(3)	$240,000(3)	$28.25(3)

(1) This Registration Statement covers, in addition to the number of shares of common stock, par value $0.01 per share (the Common Stock), of New Century Financial Corporation, a Maryland corporation (the Company or the Registrant), stated above, options to purchase or acquire the shares of Common Stock covered by this Registration Statement and, pursuant to Rule 416(c) under the Securities Act of 1933, as amended (the Securities Act), an additional indeterminate number of shares and options that may be offered or issued pursuant to the Nonqualified Stock Option Agreement by and between New Century TRS Holdings, Inc., a Delaware corporation (the Predecessor Entity), and Fredric J. Forster dated as of September 30, 1998 (the Forster Option Agreement) and the Equalization Stock Option Agreement by and between the Predecessor Entity and Edward F. Gotschall dated as of April 7, 1997 (the Gotschall Option Agreement and, together with the Forster Option Agreement, the Option Agreements), as a result of one or more adjustments under the Option Agreements to prevent dilution resulting from one or more stock splits, stock dividends or similar transactions.

(2) In addition, this Registration Statement covers the resale, as described in the Reoffer Prospectus included in and filed with this Form S-8, of the shares of Common Stock being registered with respect to the Forster Option Agreement, for which no additional registration fee is required pursuant to Rule 457(h)(3).

(3) Pursuant to Rule 457(h), the maximum offering price, per share and in the aggregate, and the registration fee were calculated based upon the weighted-average exercise prices of the corresponding options.

The Exhibit Index for this Registration Statement is at page II-7.

REOFFER PROSPECTUS

This document constitutes part of a prospectus covering securities

that have been registered under the Securities Act of 1933.

15,000 Shares

NEW CENTURY FINANCIAL CORPORATION

Common Stock

(par value $0.01 per share)

NEW CENTURY FINANCIAL CORPORATION

DIRECTOR NONQUALIFIED STOCK OPTION

GRANTED TO FREDRIC J. FORSTER

This Prospectus relates to a maximum of 15,000 shares (the Shares) of common stock, par value $0.01 per share (the Common Stock), of New Century Financial Corporation (formerly known as New Century REIT, Inc.), a Maryland corporation (the Company), that may be offered and sold from time to time by Fredric J. Forster (the Selling Stockholder), who acquired the Shares pursuant to a Director Nonqualified Stock Option (the Option) granted by New Century TRS Holdings, Inc. (formerly known as New Century Financial Corporation), a Delaware corporation (the Predecessor Entity). As explained herein, each outstanding share of the Predecessor Entity s common stock has been converted into one share of the Company s Common Stock pursuant to the reorganization of the Predecessor Entity (see Prospectus Summary The Merger and Related Transactions). The Predecessor Entity is a wholly-owned subsidiary of the Company.

On February 4, 2005, the Company filed a registration statement on Form S-8 with the Securities and Exchange Commission (the Commission) to register the Shares. The Common Stock is traded on the New York Stock Exchange (NYSE) under the symbol NEW. On February 3, 2005, the closing price of the Common Stock as reported on the NYSE was $54.25 per share.

The Company will not receive any proceeds from the sale of the Shares by the Selling Stockholder. The Shares may be offered from time to time by the Selling Stockholder (and his donees and pledgees) through ordinary brokerage transactions, in sales pursuant to Rule 144 under the Securities Act of 1933, as amended (the Securities Act), in negotiated transactions or in other transactions, at such prices as the Selling

Stockholder may determine, which may relate to market prices prevailing at the time of sale or may be a negotiated price. See Plan of Distribution below. All costs, expenses and fees in connection with the registration of the Shares will be borne by the Company. Brokerage commissions and similar selling expenses, if any, attributable to the offer or sale of the Shares will be borne by the Selling Stockholder (or his donee or pledgee).

The Selling Stockholder and any broker executing selling orders on behalf of the Selling Stockholder may be deemed to be an underwriter as defined in the Securities Act. If any broker-dealers are used to effect sales, any commissions paid to broker-dealers and, if broker-dealers purchase any of the Shares as principals, any profits received by such broker-dealers on the resale of the Shares, may be deemed to be underwriting discounts or commissions under the Securities Act. In addition, any profits realized by the Selling Stockholder may be deemed to be underwriting commissions.

See Risk Factors beginning at page 7 for certain information which should be carefully considered by prospective purchasers of the Shares offered hereby.

THE SECURITIES AND EXCHANGE COMMISSION HAS NOT APPROVED

OR DISAPPROVED OF THESE SECURITIES, NOR HAS IT DETERMINED

IF THIS PROSPECTUS IS TRUTHFUL AND COMPLETE. ANY

REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is February 4, 2005

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The following documents of the Company or the Predecessor Entity, as applicable, filed with the Commission are incorporated herein by reference:

(a) The Company s Prospectus dated September 30, 2004, filed with the Commission pursuant to Securities Act Rule 424(b), which includes audited financial statements of the Predecessor Entity as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003, and the consolidated balance sheet for the Company as of August 31, 2004;

(b) The Company s Current Report on Form 8-K, filed with the Commission on October 14, 2004, which includes the supplemental consolidated financial statements of the Company and subsidiaries as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003;

(c) The Company s Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 2004, filed with the Commission on November 9, 2004;

(d) The Company s Current Reports on Form 8-K, filed with the Commission on February 3, 2005, January 13, 2005, January 7, 2005, January 5, 2005, December 29, 2004, December 23, 2004, December 22, 2004, December 7, 2004, December 2, 2004, November 17, 2004, November 4, 2004, November 2, 2004, October 26, 2004, October 8, 2004, October 6, 2004, October 5, 2004 and October 1, 2004;

(e) The Predecessor Entity s Annual Report on Form 10-K for its fiscal year ended December 31, 2003, filed with Commission on March 15, 2004, as amended by Form 10-K/A filed with the Commission on April 13, 2004;

(f) The Predecessor Entity s Quarterly Reports on Form 10-Q for its fiscal quarters ended September 20, 2004, June 30, 2004 and March 31, 2004, filed with the Commission on November 9, 2004, August 9, 2004 and May 10, 2004, respectively;

(g) The Predecessor Entity s Current Reports on Form 8-K, filed with the Commission on December 23, 2004, November 4, 2004, October 26, 2004, October 6, 2004, October 5, 2004, October 1, 2004, September 27, 2004, September 15, 2004, September 10, 2004, September 1, 2004, August 17, 2004, August 2, 2004, July 20, 2004, July 13, 2004, July 2, 2004, June 28, 2004, June 17, 2004, June 1, 2004 (as amended July 7, 2004), May 20, 2004, April 7, 2004 and January 14, 2004; and

(h) The description of the Common Stock contained in the Company s Registration Statement on Form 8-A, filed with the Commission pursuant to the Exchange Act on September 30, 2004 (which incorporates such description from the Company s Registration Statement on Form S-4, initially filed with the Commission on April 22, 2004, and as subsequently amended, including any form of the prospectus contained therein filed by the Company pursuant to Rule 424 under the Securities Act, which description is also incorporated herein by reference), and any amendment or report filed for the purpose of updating such description.

All documents subsequently filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), prior to the filing of a post-effective amendment which indicates that all securities offered hereby have been sold or which deregisters all securities then remaining unsold shall be deemed to be incorporated by reference into this registration statement and to be a part hereof from the date of filing of such documents. Any statement contained herein or in a document, all or a portion of which is incorporated or deemed to be incorporated by reference herein, shall be deemed to be modified or superseded for purposes of this registration statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or amended, to constitute a part of this registration statement.

As used herein, the terms Prospectus and herein mean this Prospectus including the documents incorporated or deemed to be incorporated herein by reference, as the same may be amended, supplemented or otherwise modified from time to time. Statements contained in this Prospectus as to the contents of any contract or other document referred to herein do not purport to be complete, and where reference is made to the particular provisions of such contract or other document, such provisions are qualified in all respects by reference to all of the provisions of such contract or other document. The Company undertakes to provide without charge to each person to whom a copy of this Prospectus has been delivered, upon the written or oral request of any such person to the Company, a copy of any or all of the documents referred to above that have been or may be incorporated into this Prospectus by reference, including exhibits to such documents (unless such exhibits are specifically incorporated by reference to such documents). Requests for such copies should be directed to New Century Financial Corporation, 18400 Von Karman Avenue, Suite 1000, Irvine, California 92612.

PROSPECTUS SUMMARY

This is only a summary and does not contain all of the information that you should consider before investing in the Shares. You should also read the entire prospectus, including Risk Factors and the other information referred to in this Prospectus, before deciding to invest in the Shares. As used in this Prospectus, except where the context otherwise requires or as otherwise indicated, the Company refers to New Century Financial Corporation and its subsidiaries, including the Predecessor Entity.

Overview

The Company is a real estate investment trust, or REIT, and one of the nation s largest subprime mortgage finance companies. The Company originates, purchases, retains, sells and services primarily first mortgage products to borrowers nationwide. The Company focuses on lending to individuals whose borrowing needs are generally not fulfilled by traditional financial institutions because they do not satisfy the customary credit, documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers, such as Fannie Mae and Freddie Mac. The Company originates and purchases these loans on the basis of the borrower s ability to repay the mortgage loan, the borrower s historical pattern of debt repayment and the amount of equity in the borrower s property (as measured by the borrower s loan-to-value ratio, or LTV). The Company has been originating and purchasing subprime loans since 1996 and believes it has developed a comprehensive and sophisticated process of credit evaluation and risk-based pricing that allows it to effectively manage the potentially higher credit risks associated with this segment of the mortgage industry.

From 1997 to 2002, the Company sold its loans through both whole loan sales and securitizations structured as sales, whereby the Company continued to manage the portfolio of mortgage loans because it retains a residual interest in the loans. In January 2003, the Company began to structure its securitization transactions as financings and, as a result, it has begun to retain a portion of its loan production on its balance sheet to build a loan portfolio to generate interest income. As the Company continues to accumulate mortgage assets in its portfolio, the Company expects that the proportion of its earnings generated by its portfolio will increase relative to earnings generated by the Company s mortgage banking operations. The Company believes that as a REIT, this strategy provides it with a more diversified earnings stream in a tax-efficient manner while allowing it to continue to operate a growing mortgage origination franchise. In addition, the Company intends to continue to retain servicing rights on a substantial percentage of the loans it sells in future periods. In the second quarter of 2004, the Company received a rating of RPS3, or average, from Fitch Ratings, Inc., or Fitch, and an average rating from Standard & Poor s, or S&P, for its servicing platform which the Company believes will allow it to expand its servicing portfolio of loans serviced for third parties more rapidly. During the fourth quarter of 2004, approximately 70% of the Company s pretax earnings were generated by its taxable REIT subsidiaries and were subject to taxation at regular corporate rates. The Company expects that this percentage will decrease over time as it continues to build its portfolio of mortgage loans held for investment. The Company expects that its taxable REIT subsidiaries will be able to retain some or all of the after-tax earnings they generate to provide for the Company s future growth and may, from time to time, distribute a portion of these earnings to the Company and, subsequently, to its stockholders, depending on, among other factors, then-current market conditions and its reinvestment opportunities.

According to Inside B&C Lending, an industry trade publication, the Company was the second largest originator of subprime loans in 2003 and for the nine months ended September 30, 2004. In 2003, the Company originated over $27 billion of mortgage loans, $8.3 billion of which were originated in the fourth quarter of 2003. The Company experienced a compounded annual growth rate in its origination volume of 87.6% from 2000 to 2003, and had a market share of 8.3% for the year ended December 31, 2003 compared to 3.0% for the year ended December 31, 2000. In the first nine months of 2004, the Company originated $30.7 billion of mortgage loans. Approximately 54% of the Company s mortgage production for the first nine months of 2004 consisted of cash-out refinancings, where the borrowers refinanced their existing mortgages and received cash representing a portion of the equity in their homes. For the same period, approximately 35% of the Company s mortgage production consisted of home purchase finance loans. The remainder of its mortgage production consisted of rate and term refinance transactions in which borrowers refinanced their existing mortgages to obtain a better interest rate or loan maturity.

The Company seeks to manage the risks associated with the subprime segment of the mortgage industry in a number of ways, including: (i) periodic updating of its underwriting criteria and processes using the latest technology available and loan performance feedback; (ii) a comprehensive quality assurance program; and (iii) a team of financial analysts who take into account the Company s database of loan performance data and the current economic and interest rate environments to seek to predict the future performance of like pools of loans.

As of September 30, 2004 and December 31, 2003, the percentage of the Company s outstanding mortgage loans that were 60 days or more past due and that it previously securitized in either on-balance sheet or off-balance sheet transactions were 2.99% and 6.18%, respectively. As the loans to which these delinquency rates relate continue to age, the Company expects that the delinquency rate will approach its historical average range of approximately 10% to 20%. Ultimately, the Company expects that approximately 7% to 10% of its loans will result in losses with a severity of approximately 30% to 40%. Loss severity represents the percentage shortfall of the expected collections on a mortgage loan versus the amount the Company actually recovered. As a result, the Company expects the cumulative pool loss rate on the loans is has securitized in off-balance sheet securitizations to range from approximately 3% to 5% and, for on-balance sheet securitizations, approximately 2.75% to 3.50%. Cumulative pool loss rates are defined as the total losses over the life of a securitization pool divided by the aggregate original principal balance of the mortgage loans in the pool.

The Company had approximately 4,900 employees as of September 30, 2004. The Company s principal executive offices are located at 18400 Von Karman Avenue, Suite 1000, Irvine, California 92612, its telephone number at that location is (949) 440-7030 and its website is *www.ncen.com*. Information contained on the Company s website does not constitute a part of this Prospectus.

Business Strategy

The Company s business objective is to pursue growth while also seeking to provide more stable, predictable earnings even when the origination environment becomes less favorable. The Company intends to execute this strategy by:

growing its portfolio of mortgage-related assets by retaining self-originated loans through on-balance sheet securitizations, which it believes will increase net interest income and reduce its reliance on its origination franchise to grow earnings;

strengthening its balance sheet by increasing its liquidity and capital position with the net proceeds from future offerings of debt and equity and by increasing available capacity under its lines of credit, which the Company believes will better protect its franchise and enable it to respond to disruptions in the market or other adverse conditions and allow it to meet the REIT distribution and other qualification requirements;

strengthening its production franchise by expanding its total loan production and increasing market share and volume on the east coast and in other metropolitan areas outside of California;

actively managing the interest rate and credit risks relating to its portfolio of mortgage-related assets in an effort to generate an attractive risk-adjusted return on its stockholders equity;

expanding its servicing platform by taking advantage of its technical capabilities, capitalization and economies of scale; and

diversifying its revenues by evaluating and executing strategic acquisitions and new business opportunities.

Competitive Advantages

The Company believes that the following competitive strengths distinguish its business model from those of other residential mortgage lenders and REITs and will enable it to implement its business strategy:

The Company is the nation s second largest subprime mortgage finance company when measured by loan production volume for the nine months ended September 30, 2004, with a wholesale network of approximately 34,000 approved independent mortgage brokers and a retail network of 74 branch offices in 29 states.

The Company s structure and business strategy provide it with the flexibility to both securitize a portion of its loan originations for its portfolio and sell the balance for cash, which it believes allows it to provide a broader product offering, better manage its cash flows and respond to changing conditions in the secondary market environment.

The Company has developed long-standing relationships with a variety of institutional loan buyers, including Bear Stearns, Credit Suisse First Boston, Deutsche Bank, Goldman Sachs, Morgan Stanley and UBS Real Estate Securities. These loan buyers regularly bid on and purchase large loan pools from the Company and the Company frequently enters into committed forward loan sale agreements with them. The Company also has lending relationships with a variety of institutional lenders, including Bank of America, Barclays Bank, Bear Stearns, CDC Mortgage Capital, Citigroup Global Markets, Credit Suisse First Boston, Morgan Stanley and UBS Real Estate Securities.

Unlike mortgage REITs without origination capabilities, the Company believes its ability to originate loans through one or more of its qualified REIT subsidiaries and purchase loans originated by one or more of its taxable REIT subsidiaries will allow it to accumulate mortgage loans at a lower cost and with greater reliability than would be available through secondary market purchases.

The Company has created a proprietary automated credit grading and pricing methodology that it believes, based upon its historical loan performance, gives it the ability to more effectively evaluate credit risk and more efficiently price its products. The Company believes this enables it to generate attractive risk-adjusted returns.

The Company believes its origination process is easier for its borrowers and brokers to use than the origination processes of most of its competitors because of its ability to provide prompt responses and consistent and clear procedures, with an emphasis on ease of use through technology, including its FastQual® system, a Web-based underwriting engine.

The members of the Company s senior management team have, on average, over 20 years of experience in the mortgage finance sector, with substantial experience addressing the challenges posed by a variety of interest rate environments, including growing an origination franchise, managing credit risk and developing strong capital market relationships.

The Company s REIT Status

The Company is a Maryland corporation formed by the Predecessor Entity on April 12, 2004 to succeed to and continue the business of the Predecessor Entity. The Company expects to qualify as a REIT for U.S. federal income tax purposes commencing with its taxable year ending December 31, 2004.

The Merger and Related Transactions

On September 15, 2004, the stockholders of the Predecessor Entity approved the restructuring of its business to allow it to operate as a REIT. The restructuring included the earlier formation of the Company, a wholly-owned subsidiary of the Predecessor Entity, and NC Merger Sub, Inc., a wholly-owned subsidiary of the Company (NC Merger Sub). The Company, NC Merger Sub and the Predecessor Entity entered into a merger agreement in connection with the REIT conversion. Pursuant to the merger agreement, on October 1, 2004, NC Merger Sub merged with and into the Predecessor Entity, and each outstanding share of the Predecessor Entity s common stock was converted into one share of the Company s Common Stock. The Company was renamed New Century Financial Corporation, became the publicly-traded parent company of the Predecessor Entity and succeeded to and continues to operate, directly or indirectly, substantially all of the prior business of the Predecessor Entity. As a consequence of the merger:

each share of the Predecessor Entity s common stock pursuant to the Option was converted into one share of Common Stock of the Company; and

each option to purchase one share of Predecessor Entity common stock was converted to an option to purchase one share of Common Stock of the Company.

The Company structured the merger to qualify as a tax-free reorganization for U.S. federal income tax purposes. If the merger so qualifies, no gain or loss will be recognized by the Company, the Predecessor Entity or NC Merger Sub as a result of the merger.

Summary Risk Factors

An investment in the Company s Common Stock involves a high degree of risk. The Risk Factors section of this Prospectus which begins on page 7 contains a detailed discussion of its most important risks, including, but not limited to, the risks summarized below.

- the Company has limited operating history as a REIT, and it cannot assure you that its management s past experience will be sufficient to manage its business as a REIT;
- the loans the Company originates and holds are subprime, rather than prime, and generally have higher delinquency and default rates than prime loans, which could result in higher loan losses;
- the geographic concentration of the Company s mortgage loan originations increases its exposure to risks in those areas, especially California, where approximately 41.3% of the aggregate principal amount of the Company s mortgage loans were secured by property located in that state;
- adverse economic conditions or declining real estate values could harm the Company s operations;
- the Company s interest only loans may have a higher risk of default that its fully-amortizing loans;
- interest rate fluctuations resulting in the Company s interest expense exceeding its interest income would result in operating losses for the Company and may limit or eliminate its ability to make distributions to you; and
- the Company may not be successful in qualifying as a REIT or maintaining its qualification as a REIT for U.S. federal income tax purposes, in which case it would be subject to U.S. federal income tax on its taxable income at regular corporate rates, thereby reducing the amount of funds available for making distributions to you.

Distribution Policy

The Company expects to make regular quarterly distributions to its stockholders. The Company s board of directors declared a cash distribution of $1.50 per share of the Company s common stock for the fourth quarter of 2004, which was paid on January 31, 2005 to stockholders of record at the close of business on January 15, 2005. The Company s board of directors declared a cash distribution of $1.55 per share of the Company s common stock for the first quarter of 2005, which will be paid on April 29, 2005 to stockholders of record at the close of business on April 15, 2005. The actual timing and amount of such distributions, however, will be as determined and declared by the Company s board of directors and will depend on the Company s financial condition, earnings, and other factors, many of which are beyond its control. In order to maintain its qualifications as a REIT under the Internal Revenue Code, the

Company is required to distribute (within a certain period after the end of each year) at least 90% of its REIT taxable income for such year (determined without regard to the dividends paid deduction and by excluding net capital gain). After-tax earnings generated by the Company s taxable REIT subsidiaries (including the Predecessor Entity) and not distributed to the Company are not subject to these distribution requirements and may be retained by such subsidiaries to provide for future growth, subject to the limitations imposed by REIT tax rules. To the extent that the Company does not distribute 100% of its REIT taxable income, it will be taxed on the undistributed amounts. In addition, the Company cannot assure you that it will have access to funds to meet the distribution and other REIT qualification requirements. The Company anticipates paying quarterly distributions during January, April, July and October of each year for the preceding quarter. The Company anticipates that distributions generally will be paid from cash available for distribution (generally equal to cash from operations and investing activities less capital expenditures and principal amortization on indebtedness); however, to the extent that cash available for distribution is insufficient to make such distributions, the Company intends to borrow funds from one of its subsidiaries or a third party in order to make distributions consistent with this policy. The Company cannot assure you as to the amount, if any, of future distributions.

Restrictions on Ownership of the Company s Common Stock

In order to assist the Company in maintaining its qualification as a REIT under the Internal Revenue Code, its charter contains restrictions on the number of shares of its capital stock that a person may own. No person may acquire or hold, directly or indirectly, in excess of 9.8% in value or in number of shares, whichever is more restrictive, of the aggregate of the outstanding shares of any class or series of the Company s capital stock. These ownership limits could delay, deter or prevent a transaction or a change in control that might involve a premium price for the Company s common stock or otherwise be in your best interest. The Company s board of directors may, in its sole discretion, waive the ownership limit with respect to a particular stockholder if it is presented with evidence satisfactory to it that the ownership of that stockholder will not then or in the future jeopardize the Company s status as a REIT.

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. Any of these risks could harm the results of operations, financial condition and business prospects of the Company. This Prospectus and the documents incorporated herein by reference also contain forward-looking statements that involve risks and uncertainties. The Company s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by the Company described below and elsewhere in this Prospectus and in documents incorporated by reference into this Prospectus. The trading price of the Company s common stock could decline due to any of these risks, and you may lose all or part of your investment.

Risks Related to the Company s Business

The Company is dependent on external sources of financing, and if it is unable to maintain adequate financing sources, its earnings and its financial position will suffer and it will jeopardize its ability to continue operations.

To qualify as a REIT under the Internal Revenue Code, the Company generally is required each year to distribute to its stockholders at least 90% of its REIT taxable income (determined without regard to the dividends paid deduction and by excluding net capital gains). After-tax earnings generated by the Company s taxable REIT subsidiaries and not distributed to the Company are not subject to these distribution requirements and may be retained by such subsidiaries to provide for future growth, subject to the limitations imposed by REIT tax rules. A substantial amount of the Company s business is conducted through its taxable REIT subsidiaries. The Company cannot assure you that it will have access to funds to meet the distribution and other REIT qualification requirements. The Company may be required to borrow funds from one of its corporate subsidiaries or a third party on a short-term basis or liquidate investments to meet the distribution requirements that are necessary to qualify as a REIT, even if management believes that it is not in the Company s best interests to do so. If the Company does not have access to the necessary funds, it may have to raise capital at inopportune times or borrow funds on unfavorable terms.

In addition, the Company requires substantial cash to support its operating activities and growth plans in its taxable REIT subsidiaries. As part of the Company s growth plan, the Company intends to obtain financing by accessing the capital markets. The Company s primary sources of cash for its loan origination activities are its warehouse and aggregation credit facilities, its asset-backed commercial paper facility and the proceeds from the sales and securitizations of its loans. From time to time, the Company finances its residual interests in securitization transactions through the sale of net interest margin securities, or NIMS; however, it has not recently relied on NIMS financing as much as it has in prior years. As of September 30, 2004, the Company had nine short-term warehouse and aggregation credit facilities and its asset-backed commercial paper facility providing it with approximately $8.7 billion of committed and $1.9 billion of uncommitted borrowing capacity to fund loan originations and purchases pending the pooling and sale of such loans. If the Company cannot maintain or replace these facilities on comparable terms and conditions, it may incur substantially higher interest expense that would reduce its profitability.

During volatile times in the capital and secondary markets, access to warehouse, aggregation and residual financing as well as access to the securitization and secondary markets for the sale of the Company s loans has been severely constricted. Subject to the limitations imposed by REIT tax rules, the Company s taxable REIT subsidiaries are permitted to retain the after-tax income they generate. The Company may, at some point in the future, borrow funds from one or more of its corporate subsidiaries upon terms that are similar to those that would be required by a third-party lender, or actually obtain a third-party loan for some portion of the required financing amount and then replicate the third-party loan terms in the intercompany borrowing. However, if the Company is unable to maintain adequate financing or other sources of capital are not available, it would be forced to suspend or curtail its operations, which would harm its results of operations, financial condition and business prospects. Similarly, the Company may be required to pursue one or more alternative strategies, such as selling assets, refinancing or restructuring its indebtedness or selling additional debt or equity securities.

The Company s management has limited experience operating a REIT and it cannot assure you that its management s past experience will be sufficient to successfully manage its business as a REIT.

The requirements for qualifying as a REIT are highly technical and complex. The Company has only recently begun to operate as a REIT and its management has limited experience in complying with the income, asset and other limitations imposed by the REIT provisions of the Internal Revenue Code. Those provisions are complex and the failure to comply with those provisions in a timely manner could prevent the Company from qualifying as a REIT or could force it to pay unexpected taxes and penalties. In such event, the Company s net income would be reduced and it could incur a loss, which could harm its results of operation, financial condition and business prospects.

If the Company is unable to accumulate sufficient REIT qualifying assets such that the value of its investment in its taxable REIT subsidiaries is not more than 20% of the value of its total assets at the close of each calendar quarter, the Company will not qualify as a REIT.

To qualify as a REIT, not more than 20% of the value of the Company s total assets may be represented by the securities of one or more taxable REIT subsidiaries at the close of any calendar quarter. As of September 30, 2004, substantially all of the Company s assets were REIT qualifying assets. However, for a variety of reasons, the Company may be unable to accumulate sufficient REIT qualifying assets such that the value of its investment in its taxable REIT subsidiaries is not more than 20% of the value of its total assets at the close of a calendar quarter. For example:

- the Company may not have enough capital, including borrowings under its credit facilities, to acquire REIT qualifying assets;
- the value of the Company s taxable REIT subsidiaries may be greater than its current expectations; or
- there may be insufficient REIT qualifying assets available for purchase on reasonable terms.

If the Internal Revenue Service determines that the value of the Company s investment in the Predecessor Entity and other taxable REIT subsidiaries is more than 20% of the value of the Company s total assets at the close of each calendar quarter, it could lose its REIT status. See also Tax risks related to the Company s status as a REIT below-The Company may not qualify as a REIT if the value of its investment in its taxable REIT subsidiaries exceeds 20% of the value of its total assets at the close of any calendar quarter.

If the Company does not have enough capital to acquire sufficient REIT qualifying assets, it may need to access the capital markets in order to raise additional capital by making additional offerings of debt and/or equity securities, including commercial paper, medium-term notes, senior or subordinated notes, preferred stock or common stock. The Company may have to raise capital at inopportune times or borrow funds on unfavorable terms. Also, the Company could become more highly leveraged as a result, resulting in an increase in debt service that could increase the risk of default on its obligations.

A prolonged economic slowdown or a lengthy or severe recession could harm the Company s operations, particularly if it results in a decline in the real estate market.

The risks associated with the Company s business are more acute during periods of economic slowdown or recession because these periods may be accompanied by decreased demand for consumer credit and declining real estate values. Declining real estate values reduce the ability of borrowers to use home equity to support borrowings because they reduce the LTV of the home equity collateral. In addition, because the Company makes a substantial number of loans to credit-impaired borrowers, the actual rates of delinquencies, foreclosures and losses on these loans could be higher during economic slowdowns. Any sustained period of increased delinquencies, foreclosures or losses could harm the Company s ability to sell loans, the prices it receives for its loans, or the values of its mortgage loans held for investment or its residual interests in securitizations, which could harm its results of operations, financial condition and business prospects.

The Company s earnings may decrease because of increases or decreases in interest rates.

The Company s profitability may be directly affected by changes in interest rates. The following are some of the risks the Company faces related to an increase in interest rates:

When the Company securitizes loans, the value of the residual interests it retains and the income it receives from the securitizations structured as financings are based primarily on the London Inter-Bank Offered Rate, or LIBOR. This is because the interest on the underlying mortgage loans is based on fixed rates payable on the underlying loans for the first two or three years from origination while the holders of the applicable securities are generally paid based on an adjustable LIBOR-based yield. Therefore, an increase in LIBOR reduces the net income the Company receives from, and the value of, these mortgage loans and residual interests.

The Company s adjustable-rate mortgage loans have periodic and lifetime interest rate caps above which the interest rate on the loans may not rise. In the event of general interest rate increases, the rate of interest on these mortgage loans could be limited, while the rate payable on the senior certificates representing interests in a securitization trust into which these loans are sold may be uncapped. This would reduce the amount of cash the Company receives over the life of the loans in securitizations structured as financings and its residual interests, and could require it to reduce the carrying value of its residual interests.

An interest rate increase may harm the Company s earnings by reducing the spread between the interest it receives on its mortgage loans and its funding costs.

A substantial and sustained increase in interest rates could harm the Company s loan origination volume because refinancings of existing loans, including cash-out refinancings and interest rate-driven refinancings, would be less attractive and qualifying for a purchase loan may be more difficult. Lower origination volume may harm the Company s earnings by reducing origination income, net interest income and gain on sale of loans.

During periods of rising interest rates, the value and profitability of the Company s loans may be harmed between the date of origination or purchase until the date it sells or securitizes the loans.

A substantial and sustained increase in interest rates could increase the delinquency and default rates on the adjustable-rate mortgage loans that the Company originates and holds because the borrowers monthly payments under such loans may increase beyond the borrowers ability to pay. High delinquencies or losses may decrease the Company s cash flows or impair its ability to sell or securitize loans in the future, which could harm its results of operations, financial condition and business prospects.

The Company is also subject to risks from decreasing interest rates. For example, a significant decrease in interest rates could increase the rate at which loans are prepaid, which also could require the Company to reduce the carrying value of its residual interests. Moreover, if prepayments are greater than expected, the cash the Company receives over the life of its residual interests would be reduced. Higher-than-expected prepayments could also harm the value of the Company s servicing portfolio. Therefore, any such changes in interest rates could harm the Company s results of operations, financial condition and business prospects.

The Company s reliance on cash-out refinancings as a significant source of its origination volume increases the risk that its earnings will be harmed if the demand for this type of refinancing declines.

During the nine months ended September 30, 2004, approximately 54% of the Company s loan production volume consisted of cash-out refinancings. The Company s reliance on cash-out refinancings as a significant source of its origination volume increases the risk that its earnings will be harmed if interest rates rise and the prices of homes decline, which would reduce the demand and production volume for this type of refinancing. A substantial and sustained increase in interest rates could significantly reduce the number of borrowers who would qualify or elect to pursue a cash-out refinancing and result in a decline in that origination source. Similarly, a decrease in home prices would reduce the amount of equity available to be borrowed against in cash-out refinancings and result in a decrease in the Company s loan production volume from that origination source. Therefore, the Company s reliance on cash-out refinancings as a significant source of its origination volume could harm its results of operations, financial condition and business prospects.

The loans the Company originates and holds are subprime, rather than prime, and generally have delinquency and default rates higher than prime loans, which could result in higher loan losses.

Subprime mortgage loans generally have higher delinquency and default rates than prime mortgage loans. Delinquency interrupts the flow of projected interest income from a mortgage loan, and default can ultimately lead to a loss if the net realizable value of the real property securing the mortgage loan is insufficient to cover the principal and interest due on the loan. Also, the Company s cost of financing and servicing a delinquent or defaulted loan is generally higher than for a performing loan. The Company bears the risk of delinquency and default on loans beginning when it originates them. In whole loan sales, the Company s risk of delinquency typically only extends to the first payment, but when it securitizes any of its loans, it continues to be exposed to delinquencies and losses through its residual interests and the loans underlying its on-balance sheet securitization transactions. The Company is required to establish reserves based on its anticipated delinquencies and losses. The Company also re-acquires the risks of delinquency and default for loans that it is obligated to repurchase. The Company attempts to manage these risks with risk-based loan pricing and appropriate underwriting policies and loan collection methods. However, the Company cannot assure you that such management policies will be successful and, if such policies and methods are insufficient to control its delinquency and default risks and do not result in appropriate loan pricing and appropriate loss reserves, the Company s business, financial condition, liquidity and results of operations could be harmed. As of September 30, 2004, the delinquency rate on mortgage loans that were 60 days or more past due and that the Company previously securitized in either on- or off-balance sheet transactions was 2.99%. The expected cumulative loss rate on these loans as of September 30, 2004 is approximately 3.87% on mortgage loans underlying the Company s residual interests in securitizations and serviced by others, and 2.98% on the Company s mortgage loans held for investment, which the Company uses to service its own platform. The expected cumulative loss rate is determined as the historical cumulative loss rates of more aged loans plus the expected cumulative loss rates on newer loans, which have experienced immaterial losses through September 30, 2004.

The geographic concentration of the Company s mortgage loan originations increases its exposure to risks in those areas, especially California.

Over-concentration of the Company s loan originations in any one geographic area increases its exposure to the economic and natural hazard risks associated with that area. For example, in the nine months ended September 30, 2003, approximately 41.3% of the aggregate principal amount of the Company s mortgage loans were secured by property located in California. Certain parts of California have experienced an economic downturn in the past and have suffered the effects of certain natural hazards. Declines in the residential real estate markets in which the Company is concentrated may reduce the values of the properties collateralizing its mortgages, increase the risk of delinquency, foreclosure, bankruptcy, or losses and could harm the Company s results of operations, financial condition and business prospects.

Furthermore, if borrowers are not insured for natural disasters, which are typically not covered by standard hazard insurance policies, then they may not be able to repair the property or may stop paying their mortgages if the property is damaged. A natural disaster that results in a significant number of delinquencies would cause increased foreclosures and decrease the

Company s ability to recover losses on properties affected by such disasters and would harm the Company s results of operations, financial condition and business prospects.

Likewise, the secondary market pricing for pools of loans that are not geographically diverse is typically less favorable than for a diverse pool. The Company s inability to originate or purchase geographically diverse pools of loans could harm the Company s results of operations, financial condition and business prospects.

An interruption or reduction in the securitization and whole loan markets would harm the Company s financial position.

The Company is dependent on the securitization market for the sale of its loans because it securitizes loans directly and many of its whole loan buyers purchase its loans with the intention to securitize them. The securitization market is dependent upon a number of factors, including general economic conditions, conditions in the securities market generally and conditions in the asset-backed securities market specifically. In addition, poor performance of the Company s previously securitized loans could harm its access to the securitization market. Accordingly, a decline in the securitization market or a change in the market s demand for the Company s loans could harm the Company s results of operations, financial condition and business prospects.

If the Company makes any acquisitions, it will incur a variety of costs and may never realize the anticipated benefits.

If appropriate opportunities become available, the Company may attempt to acquire businesses that it believes are a strategic fit with its business. The Company currently has no agreements to consummate any material acquisitions. If the Company pursues any such transaction, the process of negotiating the acquisition and integrating an acquired business may result in operating difficulties and expenditures and may require significant management attention that would otherwise be available for ongoing development of its business, whether or not any such transaction is ever consummated. Moreover, the Company may never realize the anticipated benefits of any acquisition. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities and/or amortization expenses related to goodwill and other intangible assets, which could harm the Company s results of operations, financial condition and business prospects.

The Company s earnings from holding mortgage-backed securities or government securities may be harmed by changing interest rates and/or market conditions.

From time to time, the Company may purchase mortgage-backed securities or government securities from third parties in order to comply with the income and asset tests necessary to maintain its REIT status. The value of, and return on, the mortgage-backed securities and government securities the Company holds will be affected by changes in the marketplace for such securities, as well as prepayment speeds in the case of mortgage-backed securities, and may be volatile and significantly different than projected. The securities that the Company holds may produce large losses instead of the income incorporated into its projections. The impact of changes in the marketplace for these securities on the Company s results may be magnified because these holdings could be highly leveraged. Additionally, much of the financing the Company will use to hold these securities may be cancelable by its lenders on short notice. If the Company s lenders cease providing financing to it on favorable terms, it would be forced to liquidate some or all of these securities, possibly at a substantial loss, which could harm the Company s financial condition, results of operations and business prospects.

A material difference between the assumptions used in the determination of the value of the Company s residual interests and its actual experience could harm its financial position.

As of September 30, 2004, the value on the Company s balance sheet of its residual interests from securitization transactions was $207.3 million. The value of these residuals is a function of the delinquency, loss, prepayment speed and discount rate assumptions the Company uses. It is extremely difficult to validate the assumptions the Company uses in valuing its residual interests. In the future, if the Company s actual experience differs materially from these assumptions, its cash flow, financial condition, results of operations and business prospects could be harmed.

New legislation could restrict the Company s ability to make mortgage loans, which could harm its earnings.

Several states and cities are considering or have passed laws, regulations or ordinances aimed at curbing predatory lending practices. The federal government is also considering legislative and regulatory proposals in this regard. In general, these proposals involve lowering the existing federal Homeownership and Equity Protection Act thresholds for defining a high-cost loan, and establishing enhanced protections and remedies for borrowers who receive such loans. However, many of these laws and rules extend beyond curbing predatory lending practices to restrict commonly accepted lending activities, including some of the Company s activities. For example, some of these laws and rules prohibit any form of prepayment charge or severely restrict a borrower s ability to finance the points and fees charged in connection with the borrower s loan. In addition, some of these laws and regulations provide for extensive assignee liability for warehouse lenders, whole loan buyers and securitization trusts. Because of enhanced risk and for reputational reasons, many whole loan buyers elect not to purchase any loan labeled as a high cost loan under any local, state or federal law or regulation. Accordingly, these laws and rules could severely constrict the secondary market for a significant portion of the Company s loan production. This would effectively preclude the Company from continuing to originate loans that fit within the newly defined thresholds. For example, after the October 1, 2002 effective date of the Georgia Fair Lending Act, the Company s lenders and secondary market buyers refused to finance or purchase its Georgia loans. As a result, the Company was forced to cease providing mortgages in Georgia until the law s amendment a few months later.

Similar laws have gone into effect in New Jersey, New Mexico and Massachusetts, that have impacted the Company s ability to originate loans in those states. Moreover, some of the Company s competitors who are national banks or federally chartered thrifts may not be subject to these laws and may, therefore, be able to capture market share from the Company and other lenders. For example, the Office of the Comptroller of the Currency issued regulations effective January 7, 2004 that preempt state and local laws that seek to regulate mortgage lending practices by national banks. Passage of such state and local laws could increase compliance costs and reduce fee income and origination volume, all of which would harm the Company s results of operations, financial condition and business prospects.

The Company is no longer able to rely on the Alternative Mortgage Transactions Parity Act to preempt certain state law restrictions on prepayment penalties, which could harm the Company s earnings.

The value of a mortgage loan depends, in part, upon the expected period of time that the mortgage loan will be outstanding. If a borrower pays off a mortgage loan in advance of this expected period, the holder of the mortgage loan does not realize the full value expected to be received from the loan. A prepayment penalty payable by a borrower who repays a loan earlier than expected helps offset the reduction in value resulting from the early payoff. Consequently, the value of a mortgage loan is enhanced to the extent the loan includes a prepayment penalty, and a mortgage lender can offer a lower interest rate and/or lower loan fees on a loan which has a prepayment penalty. Prepayment penalties are an important feature used to obtain value on the loans the Company originates.

Certain state laws restrict or prohibit prepayment penalties on mortgage loans and, until July 2003, the Company relied on the federal Alternative Mortgage Transactions Parity Act, or the Parity Act, and related rules issued in the past by the Office of Thrift Supervision, or OTS, to preempt state limitations on prepayment penalties. The Parity Act was enacted to extend to financial institutions, like the Company, which are not federally chartered depository institutions, federal preemption that federally chartered depository institutions enjoy. However, in September 2002, the OTS released a new rule that reduced the scope of the Parity Act preemption and, as a result, the Company is no longer able to rely on the Parity Act to preempt state restrictions on prepayment penalties. The elimination of this federal preemption has required the Company to comply with state restrictions on prepayment penalties. These restrictions prohibit the Company from charging any prepayment penalty in six states and limit the amount or other terms and conditions of its prepayment penalties in several other states. This places the Company at a competitive disadvantage relative to financial institutions that continue to enjoy federal preemption of such state restrictions. Such institutions are able to charge prepayment penalties without regard to state restrictions and, as a result, may be able to offer loans with interest rate and loan fee structures that are more attractive than the interest rate and loan fee structures that the Company is able to offer. This competitive disadvantage could harm the Company s results of operations, financial condition and business prospects.

The scope of the Company s lending operations exposes it to risks of noncompliance with an increasing and inconsistent body of complex laws and regulations at the federal, state and local levels.

Because the Company is authorized to originate mortgage loans in all 50 U.S. states, it must comply with the laws and regulations, as well as judicial and administrative decisions, for all of these jurisdictions, as well as an extensive body of federal law and regulations. The volume of new or modified laws and regulations has increased in recent years, and individual cities and counties have begun to enact laws that restrict subprime loan origination activities in those cities and counties. The laws and regulations of each of these jurisdictions are different, complex and, in some cases, in direct conflict with each other. As the Company s operations continue to grow, it may be more difficult to comprehensively identify, to accurately interpret and to properly program the Company s technology systems and effectively train its personnel with respect to all of these laws and regulations, thereby potentially increasing the Company s exposure to the risks of noncompliance with these laws and regulations.

The Company s failure to comply with these laws can lead to:

- civil and criminal liability;
- loss of licensure;
- damage to its reputation in the industry;
- inability to sell or securitize its loans;
- demands for indemnification or loan repurchases from purchasers of its loans;
- fines and penalties and litigation, including class action lawsuits; or
- administrative enforcement actions.

Any of these results could harm the Company s results of operations, financial condition and business prospects.

If warehouse lenders and securitization underwriters face exposure stemming from legal violations committed by the companies to whom they provide financing or underwriting services, this could increase the Company s borrowing costs and harm the market for whole loans and mortgage-backed securities.

In June 2003, a California jury found a warehouse lender and securitization underwriter liable in part for fraud on consumers committed by a lender to whom it provided financing and underwriting services. The jury found that the investment bank was aware of the fraud and substantially assisted the lender in perpetrating the fraud by providing financing and underwriting services that allowed the lender to continue to operate, and held the bank liable for 10% of the plaintiff s damages. This is the first case the Company knows of in which an investment bank was held partly responsible for violations committed by the bank s mortgage lender customer. If other courts or regulators adopt this theory, investment banks may face increased litigation as they are named as defendants in lawsuits and regulatory actions against the mortgage companies with which they do business. Some investment banks may exit the business, charge more for warehouse lending or reduce the prices they pay for whole loans in order to build in the costs of this potential litigation. This could, in turn, harm the Company s results of operations, financial condition and business prospects.

If lenders are prohibited from originating loans in the State of Illinois with fees in excess of 3% where the interest rate exceeds 8%, this could force the Company to curtail operations in Illinois.

In March 2004, an Illinois Court of Appeals found that the Illinois Interest Act, which caps fees at 3% for loans with an interest rate in excess of 8%, is not preempted by federal law. This ruling contradicts the view of the Federal Circuit Courts of Appeal, most state courts, the OTS and the Illinois Office of the Attorney General. In November 2004, the Illinois Supreme Court decided to consider an appeal to this case. If this ruling is not overturned, the Company may reduce operations in Illinois since it will reduce the return the Company and its investors can expect on higher risk loans. Moreover, as a result of this ruling, plaintiffs are filing actions against lenders, including the Company, seeking various forms of relief as a result of any fees

received in the past which exceeded the applicable thresholds. Any such actions, if decided against the Company, could harm its results of operations, financial condition and business prospects.

High delinquencies or losses on the mortgage loans in the Company s securitizations may decrease its cash flows or impair its ability to sell or securitize loans in the future.

Loans the Company makes to lower credit grade borrowers, including credit-impaired borrowers, entail a higher risk of delinquency and higher losses than loans it makes to borrowers with better credit. Most of the Company s loans are made to borrowers who do not qualify for loans from conventional mortgage lenders. No assurance can be given that the Company s underwriting criteria or methods will afford adequate protection against the higher risks associated with loans made to lower credit grade borrowers. The Company continues to be subject to risks of default and foreclosure following the sale of loans through securitization. To the extent such losses are greater than expected, the cash flows the Company receives through residual interests and from its securitizations structured as financings would be reduced. Increased delinquencies or losses may also reduce the Company s ability to sell or securitize loans in the future. Any such reduction in the Company s cash flows or impairment in its performance could harm its results of operations, financial condition and business prospects.

The Company s interest only loans may have a higher risk of default than its fully-amortizing loans.

During the nine months ended September 30, 2004, originations of interest only loans totaled $5.7 billion, or 18.6%, of total originations. These interest only loans require the borrowers to make monthly payments only of accrued interest for the first 24, 36 or 120 months following origination. After such interest only period, the borrower s monthly payment is recalculated to cover both interest and principal so that the mortgage loan will amortize fully prior to its final payment date. The interest only feature may reduce the likelihood of prepayment during the interest only period due to the smaller monthly payments relative to a fully-amortizing mortgage loan. If the monthly payment increases, the related borrower may not be able to pay the increased amount and may default or may refinance the related mortgage loan to avoid the higher payment. Because no principal payments may be made on such mortgage loans for an extended period following origination, if the borrower defaults, the unpaid principal balance of the related mortgage loan will be greater than otherwise would be the case, increasing the risk of loss in that situation.

The loss of the Company s exemption under the Investment Company Act would harm the Company and the market price of its shares of common stock and its ability to make distributions to its stockholders.

The Company is not currently regulated as an investment company under the Investment Company Act of 1940, as amended, or the Investment Company Act, and the Company intends to operate so as to not become regulated as an investment company under the Investment Company Act. For example, the Company intends to qualify for an exemption under the Investment Company Act that is available to companies that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Specifically, the Company intends to invest at least 55% of its assets in mortgage loans or mortgage-related assets securities that represent the entire ownership in a pool of mortgage loans and at least an additional 25% of its assets in mortgages, mortgage-related assets, securities, securities of REITs and other real estate-related assets. As of September 30, 2004, 69% of the Company s assets consisted of mortgage loans or mortgage-related assets that represent the entire ownership in a pool of mortgage loans and another 26% of its assets were invested in mortgages, mortgage-related assets, securities of REITs and other real estate-related assets.

If the Company fails to qualify for that exemption, it may be required to restructure its activities. For example, if the market value of the Company s investments in equity securities were to increase by an amount that caused less than 55% of its assets to be invested in mortgage loans or mortgage-related assets that represent the entire ownership in a pool of mortgage loans, it might have to sell equity securities in order to qualify for an exemption under the Investment Company Act. In the event the Company must restructure its activities, its results of operations, financial condition and business prospects could be harmed.

The Company s inability to realize cash proceeds from loan sales and securitizations in excess of the loan acquisition cost could harm its financial position.

The net cash proceeds received from loan sales consist of the premiums the Company receives on sales of loans in excess of the outstanding principal balance, plus the cash proceeds it receives from securitizations structured as sales, minus the discounts on loans that it has to sell for less than the outstanding principal balance. If the Company is unable to originate loans at a cost lower than the cash proceeds realized from loan sales, its results of operations, financial condition and business prospects could be harmed.

The Company s credit facilities are subject to margin calls based on the lender s opinion of the value of its loan collateral. An unanticipated large margin call could harm the Company s liquidity.

The amount of financing the Company receives under its credit facilities depends in large part on the lender s valuation of the mortgage loans that secure the financings. Each such facility provides the lender the right, under certain circumstances, to reevaluate the loan collateral that secures the Company s outstanding borrowings at any time. In the event the lender determines that the value of the loan collateral has decreased, it has the right to initiate a margin call. A margin call would require the Company to provide the lender with additional collateral or to repay a portion of the outstanding borrowings. Any such margin call could harm the Company s liquidity, results of operations, financial condition and business prospects.

The Company faces intense competition that could harm its market share and its r