

HALLIBURTON CO

Form 4

July 26, 2005

FORM 4**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Check this box
if no longer
subject to
Section 16.
Form 4 or
Form 5
obligations
may continue.
See Instruction
1(b).

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF
SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934,
Section 17(a) of the Public Utility Holding Company Act of 1935 or Section
30(h) of the Investment Company Act of 1940

OMB APPROVAL

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(Print or Type Responses)

1. Name and Address of Reporting Person *
LESAR DAVID J

(Last) (First) (Middle)

1401 MCKINNEY, SUITE 2400

(Street)

HOUSTON, TX 77010

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading
Symbol
HALLIBURTON CO [HAL]

3. Date of Earliest Transaction
(Month/Day/Year)
07/22/2005

4. If Amendment, Date Original
Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to
Issuer

(Check all applicable)

☐ Director ☐ 10% Owner
☒ Officer (give title below) ☐ Other (specify below)

Chairman, Pres. and CEO

6. Individual or Joint/Group Filing(Check
Applicable Line)
☐ Form filed by One Reporting Person
☐ Form filed by More than One Reporting
Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired or Disposed of (D) (Instr. 3, 4 and 5)	5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
Common Stock	07/22/2005		M	22,000	A \$ 22.75	793,270.98	D
Common Stock	07/22/2005		S ⁽¹⁾	22,000	D \$ 50.8	771,270.98	D
Common Stock	07/22/2005		M	71,000	A \$ 29.56	842,270.98	D
Common Stock	07/22/2005		S ⁽¹⁾	71,000	D \$ 50.8	771,270.98	D
Common Stock	07/22/2005		M	30,000	A \$ 26.43	801,270.98	D

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Common Stock	07/22/2005	S ⁽¹⁾	30,000	D	\$ 50.8	771,270.98	D	
Common Stock	07/22/2005	S ⁽¹⁾	94,357	D	\$ 50.8	676,913.98	D	
Common Stock			20,000	I				Partnership

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474
(9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(e.g., puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)
				Code	V (A) (D)	Date Exercisable Expiration Date	Title Amount of Number of Shares
Option to Buy Common Stock	\$ 22.75	07/22/2005		M	22,000	12/06/1996 12/06/2005	Common Stock 22,000
Option to Buy Common Stock	\$ 29.5625	07/22/2005		M	71,000	12/04/1997 12/04/2006	Common Stock 71,000
Option to Buy Common Stock	\$ 26.437	07/22/2005		M	30,000	02/14/1996 02/14/2006	Common Stock 30,000
Option to Buy Common Stock	\$ 44.08					03/03/2005 03/03/2015	Common Stock 100,000
Option to Buy Common Stock	\$ 38.61					12/02/2004 12/02/2014	Common Stock 69,000
	\$ 26.03					01/02/2004 01/02/2014	100,000

Option to Buy Common Stock					Common Stock	
Option to Buy Common Stock	\$ 54.5		12/03/1998	12/03/2007	Common Stock	60,000
Option to Buy Common Stock	\$ 28.125		12/02/1999	12/02/2008	Common Stock	65,000
Option to Buy Common Stock	\$ 39.5		12/02/2000	12/02/2009	Common Stock	260,100
Option to Buy Common Stock	\$ 51.5		09/14/2001	09/14/2010	Common Stock	300,000
Option to Buy Common Stock	\$ 31.55		04/01/2003	07/19/2011	Common Stock	154,408

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
LESAR DAVID J 1401 MCKINNEY SUITE 2400 HOUSTON, TX 77010	X		Chairman, Pres. and CEO	

Signatures

Bruce A. Metzinger, by Power of Attorney

07/26/2005

__Signature of Reporting Person

Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The sales were effected pursuant to a Rule 10b5-1 trading plan adopted by the Reporting Person on March 18, 2005.

(2) Options disposed of through exercise pursuant to a Rule 10b1-5 trading plan adopted by the Reporting Person on March 18, 2005.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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Obligation under payment agreement(4)

23,627 1,557 20,965 315 790

Total

\$621,147 \$326,161 \$232,933 \$24,364 \$37,689

- (1) As the master servicer for certain of the series of non-recourse securitization financing securities which we have issued, and certain loans which have been securitized but for which we are not the master servicer, we have an obligation to advance scheduled principal and interest on delinquent loans in accordance with the underlying servicing agreements should the primary servicer of the loan fail to make such advance. Such advance amounts are generally repaid in the same month as they are made, or shortly thereafter, and the contractual obligation with respect to these advances is excluded from the above table. During 2008, our average monthly servicing advance was \$0.2 million.
- (2) Amounts presented for Long-Term Debt Obligations include estimated principal and interest on the related obligations.
- (3) Securitization financing is non-recourse to us as the bonds are payable solely from loans and securities pledged as securitized mortgage loans. Payments due by period were estimated based on the principal repayments forecast for the underlying loans, substantially all of which is used to repay the associated securitization financing outstanding.
- (4) We entered an agreement to contribute to a joint venture all of the net cash flows, including principal and interest, from our interests in a pool of securitized commercial mortgage loans pursuant to a payment agreement. By agreement, the joint venture is scheduled to dissolve in 2009, unless extended by the joint venture partners. For purposes of this table, we have assumed the joint venture continues in existence indefinitely.

Off-Balance Sheet Arrangements

We do not believe that any off-balance sheet arrangements exist that are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Selected Quarterly Results

The following tables present our unaudited selected quarterly results for 2008 and 2007.

Summary of Selected Quarterly Results (unaudited)
(amounts in thousands except per share data)

Year Ended December 31, 2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Net interest income	\$ 2,421	\$ 2,501	\$ 2,787	\$ 2,838
Net interest income after (provision for) recapture of loan losses	2,395	2,180	2,338	2,643
Net income (1)	5,319	4,296	3,045	2,461
Basic net income per common share	0.36	0.27	0.17	0.12
Diluted net income per common share	0.32	0.26	0.17	0.12
Cash dividends declared per common share	0.10	0.15	0.23	0.23
Average interest-earning assets (2)	301,133	353,189	480,760	558,473
Average borrowed funds	207,151	258,435	391,354	451,744
Net interest spread on interest-earning assets	1.18%	1.50%	1.64%	1.38%
Average asset yield	8.18%	7.35%	6.38%	6.06%
Net yield on average interest-earning assets(3)	3.36%	3.19%	2.86%	2.77%
Cost of funds	7.00%	5.85%	4.74%	4.68%
Year Ended December 31, 2007	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Net interest income	\$ 2,460	\$ 2,963	\$ 2,457	\$ 2,803
Net interest income after provision for loan losses	2,983	3,665	2,584	2,732
Net income	1,942	2,702	2,686	1,569
Basic and diluted net income per common share	0.08	0.14	0.14	0.05
Cash dividends declared per common share	—	—	—	—
Average interest-earning assets (2)	359,115	343,436	324,087	306,234
Average borrowed funds	301,139	287,263	256,311	217,816
Net interest spread on interest-earning assets(4)	1.35%	2.17%	1.39%	1.79%
Average asset yield	8.32%	8.41%	8.44%	8.63%
Net yield on average interest-earning assets (3)	2.48%	3.19%	2.86%	2.77%
Cost of funds(4)	6.97%	6.24%	7.05%	6.85%

(1) The decrease in net income during the fourth quarter of 2008 relates primarily to losses incurred by a joint venture, which is accounted for under the equity method. The loss was related to \$2.2 million decreases in the fair value of CMBS owned by the joint venture.

(2) Excludes cash and cash equivalents.

(3) Computed as net interest income excluding non-interest securitization financing expenses divided by average interest-earning assets.

- (4) Second quarter 2007 net interest spread increased compared to other quarters and cost of funds decreased due to amortization of asset discounts and bond premiums resulting from the prepayment of three commercial loans that constituted 17% of outstanding unpaid principal balance.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Form 10-K that are not historical fact constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. All statements contained in this annual report addressing the results of operations, our operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to investment strategies, net interest income growth, earnings or earnings per share growth, and market share, as well as statements expressing optimism or pessimism about future operating results, are forward-looking statements. The forward-looking statements are based upon management’s views and assumptions as of the date of this report, regarding future events and operating performance and are applicable only as of the dates of such statements. Such forward-looking statements may involve factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. We caution readers not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize.

Factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements include the following:

Reinvestment. Yields on assets in which we invest now are generally lower than yields on existing assets that we may sell or which may be repaid, due to lower overall interest rates and more competition for these assets as investment assets have repaid or been sold. We have generally been unable to find investments which have acceptable risk adjusted yields. As a result, our net interest income has been declining, and may continue to decline in the future, resulting in lower earnings per share over time. In order to maintain our investment portfolio size and our earnings, we need to reinvest a portion of the cash flows we receive into new interest-earning assets. If we are unable to find suitable reinvestment opportunities, the net interest income on our investment portfolio and investment cash flows could be negatively impacted.

Economic Conditions. We are affected by general economic conditions. We may experience an increase in defaults on our loans as a result of an economic slowdown or recession. This could result in our potentially having to provide for additional allowance for loan losses. In addition, economic conditions can result in increased market volatility, as we experienced in 2008. As a result of our investments being pledged as collateral for short-term borrowings, high levels of market volatility can result in margin calls and involuntary investments sales as well as volatility in our earnings and cash flows.

Investment Portfolio Cash Flow. Cash flows from the investment portfolio fund our operations, dividends, and repayments of outstanding debt, and are subject to fluctuation due to changes in interest rates, repayment rates and default rates and related losses. We have securitized loans, which may have been pledged as collateral to support securitization financing bonds. Based on the performance of the underlying assets within the securitization structure, cash flows which may have otherwise been paid to us as a result of our ownership interest may be retained within the structure to make payments on the securitization financing bonds. Cash flows from the investment portfolio are likely to sequentially decline until we meaningfully begin to reinvest our capital. There can be no assurances that we will find suitable investment alternatives for our capital, nor can there be assurances that we will meet our reinvestment and return hurdles.

Defaults. Defaults by borrowers on loans we securitized may have an adverse impact on our financial performance, if actual credit losses differ materially from our estimates or exceed reserves for losses recorded in the financial statements. The allowance for loan losses is calculated on the basis of historical experience and management’s best estimates. Actual default rates or loss severity may differ from our estimate as a result of economic

conditions. Actual defaults on adjustable rate mortgage loans may increase during a rising interest rate environment or for other reasons, such as rising unemployment. In addition, commercial mortgage loans are generally large dollar balance loans, and a significant loan default may have an adverse impact on our financial results. Such impact may include higher provisions for loan losses and reduced interest income if the loan is placed on non-accrual.

Interest Rate Fluctuations. Our income and cash flow depends on our ability to earn greater interest on our investments than the interest cost to finance those investments. Interest rates in the markets served by us generally rise or fall with interest rates as a whole. At December 31, 2008, approximately \$179 million of our investments, including loans and

securities currently pledged as securitized mortgage loans and securities, were fixed rate and approximately \$373 million of our investments were variable rate. We financed these fixed rate assets through \$151 million of fixed rate securitization financing, \$28 million of variable rate securitization financing, and \$274 million of variable rate repurchase agreements. The net interest spread for these investments could decrease during a period of rapidly rising short-term interest rates, since the investments generally have interest rates which reset on a delayed basis and have interim interest rate caps; the related borrowing has no delayed resets or such interest rate caps.

Third-party Servicers. Our loans and loans underlying securities are serviced by third-party service providers. As with any external service provider, we are subject to the risks associated with inadequate or untimely services. Many borrowers require notices and reminders to keep their loans current and to prevent delinquencies and foreclosures. A substantial increase in our delinquency rate that results from improper servicing or loan performance in general may have an adverse effect on our earnings.

Prepayments. Prepayments on loans we securitized and Agency MBS, in which we have invested, may have an adverse impact on our financial performance. Prepayments are expected to increase during a declining interest rate or flat yield curve environment. Our exposure to rapid prepayments is primarily (i) the faster amortization of premium on our investments and, to the extent applicable, amortization of bond discount, and (ii) the replacement of investments in our portfolio with lower yielding investments.

Competition. The financial services industry is a highly competitive market in which we compete with a number of institutions with greater financial resources. In purchasing portfolio investments, we compete with other mortgage REITs, investment banking firms, savings and loan associations, commercial banks, mortgage bankers, insurance companies, federal agencies and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market and our competitors greater financial resources have adversely affected us and may continue to do so. Competition may also continue to keep pressure on spreads resulting in us being unable to reinvest our capital on an acceptable risk-adjusted basis.

Regulatory Changes. Our businesses as of and for the year ended December 31, 2008 were not subject to any material federal or state regulation or licensing requirements. However, changes in existing laws and regulations or in the interpretation thereof, or the introduction of new laws and regulations, could adversely affect us and the performance of our securitized loan pools or our ability to collect on our delinquent property tax receivables. We are a REIT and are required to meet certain tests in order to maintain our REIT status as described in the earlier discussion of "Federal Income Tax Considerations" in Item 1, Business. If we should fail to maintain our REIT status, we would not be able to hold certain investments and would be subject to income taxes.

Section 404 of the Sarbanes-Oxley Act of 2002. We are required to comply with the provisions of Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the SEC and the New York Stock Exchange. Failure to comply may result in doubt in the capital markets about the quality and adequacy of our internal controls and corporate governance. This could result in our having difficulty in, or being unable to, raise additional capital in these markets in order to finance our operations and future investments.

Other. The following risks, which are discussed in more detail in Item 1A, Risk Factors above, could also affect our results of operations, financial condition and cash flows:

- We rely on Fannie Mae and Freddie Mac as guarantors on MBS in which we invest. The federal conservatorship of Fannie Mae and Freddie Mac and related efforts may prove unsuccessful in stabilizing Fannie Mae and Freddie Mac, which may impact their ability to perform under the guaranty.
- The attempts to stabilize the U. S. housing and mortgage market may make the U.S. Treasury a direct competitor for mortgage assets and may prove unsuccessful.

- The federal conservatorship of Fannie Mae and Freddie Mac may lead to structural changes in Agency RMBS and Fannie Mae and Freddie Mac which may adversely affect our business.
- There can be no assurance that the actions taken by the U.S. and foreign governments, central banks and other governmental and regulatory bodies for the purpose of seeking to stabilize the financial markets will achieve the intended effect or benefit our business, and further government or market developments could adversely affect us.

- Our business strategy involves the use of leverage, including short-term repurchase agreements. Changes to the availability and terms of this leverage may adversely affect the return on our investments, result in losses when conditions are unfavorable, and may reduce cash available for distribution to our shareholders.
- Adverse developments involving major financial institutions or one of our lenders could result in a rapid reduction in our ability to borrow and adversely affect our business and profitability.
 - Our profitability may be limited by a reduction in our leverage.
- If we are unable to renew our borrowings at favorable rates, we may be forced to sell assets and our profitability may be adversely affected.
- If a lender to us in a repurchase transaction defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if we default on our obligations under the repurchase agreement, we would incur losses.
- Our use of repurchase agreements to borrow money may give our lenders greater rights in the event of bankruptcy.
- Our ownership of securitized mortgage loans subjects us to credit risk and we provide for loss reserves on these loans as required under GAAP.
- Our efforts to manage credit risk may not be successful in limiting delinquencies and defaults in underlying loans or losses on our investments.
- Certain investments employ internal structural leverage as a result of the securitization process and are in the most subordinate position in the capital structure, which magnifies the potential impact of adverse events on our cash flows and reported results.
- We may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may harm our results of operations.
 - Guarantors may fail to perform on their obligations to our securitization trusts.
- The commercial mortgage loans in which we have invested are subject to delinquency, foreclosure and loss, which could result in losses for us.
 - The volatility of certain mortgaged property values may adversely affect our commercial mortgage loans.
- Prepayment rates on the mortgage loans underlying our investments may adversely affect our profitability and subject us to reinvestment risk.
- Interest rate fluctuations, particularly increases in interest rates on which our borrowings are based, may have various negative effects on us and could lead to reduced earnings and/or increased earnings volatility. In addition, adjustments of interest rates on our borrowings may not be matched to interest rate indexes on our investments.
 - A flat or inverted yield curve may adversely affect Agency MBS prepayment rates and supply.
- Interest rate caps on the adjustable rate mortgage loans collateralizing our investments may adversely affect our profitability if interest rates increase.
- Because we acquire securities with a fixed-rate of interest for at least an initial period, an increase in interest rates may adversely affect our book value.
- A decline in the market value of our assets may result in margin calls that may force us to sell assets under adverse market conditions and may cause a decline in our book value.
- Our use of hedging strategies to mitigate our interest rate exposure may not be effective, may adversely affect our earnings, and may expose us to counterparty risks.
 - We may enter into Hedging Instruments that could expose us to contingent liabilities in the future.
- Competition may prevent us from acquiring new investments at favorable yields potentially negatively impacting our profitability.
- The stock ownership limit imposed by the Code for REITs and our restated articles of incorporation may restrict our business combination opportunities.
- The stock ownership limitation contained in our articles of incorporation generally does not permit ownership in excess of 9.8% of our common or capital stock, and attempts to acquire our common or capital stock in excess of these limits will be ineffective unless an exemption is granted by our Board of Directors.
- Qualifying as a REIT involves highly technical and complex provisions of the Code, and a technical or inadvertent violation could jeopardize our REIT qualification.

- If we do not qualify as a REIT or fail to remain qualified as a REIT, we may be subject to tax as a regular corporation and could face a tax liability, which would reduce the amount of cash available for distribution to our stockholders.

- Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow and our results.
 - If we fail to maintain our REIT status, our business operations may be impacted.
 - Dividends payable to REITs do not qualify for the reduced tax rates available for some dividends.
- The failure of investments subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.
- Certain of our securitization trusts, which qualify as “taxable mortgage pools,” require us to maintain equity interests in the securitization trusts.
 - Recognition of excess inclusion income by us could have adverse consequences to us or our shareholders.
 - Maintaining REIT status may reduce our flexibility to manage our operations.
- If we fail to properly conduct our operations we could become subject to regulation under the Investment Company Act of 1940.
- We may change our investment strategy, operating policies, dividend policy and/or asset allocations without shareholder consent.
 - We are dependent on certain key personnel.
- Our reported income depends on accounting conventions and assumptions about the future that may change.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 addresses reporting requirements in the financial statements of non-controlling interests to their equity share of subsidiary investments. SFAS 160 applies to reporting periods beginning after December 15, 2008. We do not believe this pronouncement will have a material effect on our financial statements.

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations” (“SFAS 141(R)”) which revised SFAS No. 141, “Business Combinations.” This pronouncement is effective as of January 1, 2009. Under SFAS No. 141, organizations utilized the announcement date as the measurement date for the purchase price of the acquired entity. SFAS 141(R) requires measurement at the date the acquirer obtains control of the acquiree, generally referred to as the acquisition date. SFAS 141(R) will have a significant impact on the accounting for transaction costs, restructuring costs, as well as the initial recognition of contingent assets and liabilities assumed during a business combination. Under SFAS 141(R), adjustments to the acquired entity’s deferred tax assets and uncertain tax position balances occurring outside the measurement period are recorded as a component of the income tax expense, rather than goodwill. As the provisions of SFAS 141(R) are applied prospectively, the impact cannot be determined until the transactions occur. We do not believe this pronouncement will have a material effect on our financial statements.

On March 20, 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133” (“SFAS 161”). SFAS 161 provides for enhanced disclosures about how and why an entity uses derivatives and how and where those derivatives and related hedged items are reported in the entity’s financial statements. SFAS 161 also requires certain tabular formats for disclosing such information. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 applies to all entities and all derivative instruments and related hedged items accounted for under SFAS 133. Among other things, SFAS 161 requires disclosures of an entity’s objectives and strategies for using derivatives by primary underlying risk and certain disclosures about the potential future collateral or cash requirements as a result of contingent credit-related features. We are currently evaluating the impact, if any, that the adoption of SFAS 161 will have on our financial statements.

On January 12, 2009, the FASB issued FASB Staff Position (“FSP”) EITF 99-20-1 “Amendments to the Impairment Guidance of EITF 99-20” (“EITF 99-20-1”), which amends the impairment guidance in EITF 99-20 to achieve more consistent determination of whether an other-than-temporary impairment has occurred for all beneficial interests

within the scope of EITF 99-20. EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008, on a prospective basis. EITF 99-20-1 eliminates the requirement that a holder's best estimate of cash flows be based

upon those that a “market participant” would use and instead requires that an other-than-temporary impairment be recognized as a realized loss through earnings when it is “probable” there has been an adverse change in the holder’s estimated cash flows from cash flows previously projected. This change is consistent with the impairment models contained in SFAS 115. EITF 99-20-1 requires that the holder consider all available information relevant to the collectability of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally should include the remaining payment terms of the security, prepayments speeds, financial condition of the issuer, expected defaults, and the value of any underlying collateral. The holder should also consider industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectability of the security. Our adoption of EITF 99-20-1 at December 31, 2008 did not have a material impact on our financial statements.

In December 2008, the FASB issued FSP SFAS 140-4 and FIN 46(R)-8, “Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities” (“FSP SFAS 140-4” and “FIN 46(R)-8”). FSP SFAS 140-4 and FIN 46(R)-8 amend SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“SFAS 140”) and FIN No. 46(R), “Consolidation of Variable Interest Entities (revised December 2003) – an interpretation of Accounting Research Bulletin No. 51” (“FIN 46(R)”) to require additional disclosures regarding transfers of financial assets and interest in variable interest entities and is effective for interim or annual reporting periods ending after December 15, 2008. The adoption of FSP SFAS 140-4 and FIN 46(R)-8 did not have a material impact on our financial statements.

In June 2008, the FASB issued FSP No. EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (“EITF 03-6-1”). EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Our adoption of EITF 03-6-1 on January 1, 2009 is not expected to have a material impact on our consolidated financial statements.

On February 20, 2008, the FASB issued FSP 140-3, “Accounting for Transfers of Financial Assets and Repurchase Financing Transactions,” (“FSP 140-3”), which provides guidance on accounting for transfers of financial assets and repurchase financings. FSP 140-3 presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (i.e., a linked transaction) under SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“SFAS 140”). However, if certain criteria, as described in FSP 140-3, are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under SFAS 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall generally be accounted for as a forward contract, as opposed to the current presentation, where the purchased asset and the repurchase liability are reflected separately on the balance sheet. FSP 140-3 is effective on a prospective basis for fiscal years beginning after November 15, 2008, with earlier application not permitted. We are currently evaluating the impact, if any, that the adoption of FSP 140-3 will have on our financial statements.

On October 10, 2008, the FASB issued FSP No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP 157-3”). FSP 157-3 clarifies the application of SFAS 157, “Fair Value Measurements” (“SFAS 157”) in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on our determination of fair value for our financial assets.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We seek to manage risks related to our investment strategy, including interest rate, prepayment, reinvestment, market value, liquidity and credit risks. We do not seek to avoid risk completely, but rather, we attempt to manage these risks while earning an acceptable risk-adjusted return for our shareholders. Below is a discussion of the current risks in our business model and investment strategy.

Prepayment and Reinvestment Risk

We are subject to prepayment risk from premiums paid on our investments and for discounts accepted on the issuance of securitization financing. In general, purchase premiums on our investments and discounts on securitization financing are amortized as a reduction in interest income or an increase in interest expense using the effective yield method under GAAP, adjusted for the prepayment activity of the investment and/or securitization financing. An increase in the rate of prepayment will typically accelerate the amortization of purchase premiums or issuance discounts, thereby reducing the yield/interest income earned on such assets or increasing the cost of such financing.

We are also subject to reinvestment risk. In the current economic climate, yields on assets in which we invest now are generally lower than yields on existing assets that we may sell or which may be repaid, due to lower overall interest rates and more competition for these assets as investment assets have repaid or been sold. We have generally been unable to find investments which have acceptable risk adjusted yields. As a result, our net interest income has been declining, and may continue to decline in the future, resulting in lower earnings per share over time. In order to maintain our investment portfolio size and our earnings, we need to reinvest a portion of the cash flows we receive into new interest-earning assets. If we are unable to find suitable reinvestment opportunities, the net interest income on our investment portfolio and investment cash flows could be negatively impacted.

Market Value Risk

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest rates and changes in the perceived risk in owning such financial instrument. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of our market risk management extends beyond derivatives to include all market risk sensitive financial instruments. Certain of our investments are classified as available for sale and as such they are reflected at fair value in our financial statements. Certain of our investments are carried at historical cost in accordance with GAAP. Regardless of whether an investment is carried at fair value in our financial statements, we will monitor the change in market value on all of our investments. In particular, we will monitor changes in the value of investments which collateralize a repurchase agreement for liquidity management and other purposes. We attempt to manage this risk by managing our exposure to factors that can impact the market value of our investments such as changes in interest rates. We may also enter into derivative transactions, which would tend to increase in value when our investment portfolio decreases in value. At December 31, 2008, we had not entered into any such derivative transactions. See the analysis in Tabular Presentation below, which presents the estimated change in our portfolio given changes in market interest rates.

Liquidity Risk

We have historically financed our investments and operations from a variety of sources, including a mix of collateral-based short-term financing sources such as repurchase agreements, collateral-based long-term financing sources such as securitization financing, equity capital, and net income. Repurchase agreement financing is recourse to both us and the assets pledged and requires us to post margin (i.e., collateral deposits in excess of the repurchase agreement financing). The repurchase agreement counterparty at any time can request that we post additional margin or repay all financing balances. Repurchase agreement financing is not committed financing, and it generally renews or rolls on a set schedule, typically a period between 30 and 90 days. The amounts advanced to us by the repurchase agreement counterparty are determined largely based on the fair value of the asset pledged to the counterparty, subject to its willingness to provide financing. Should the value of our investment securities pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Given the uncommitted nature of repurchase agreement financing and the varying collateral requirements

with regard to collateral quality and amount, we cannot assure that we will always be able to roll over our repurchase agreements as they mature. If we fail to meet margin calls or repay repurchase agreement borrowings when due, our lenders have the right to terminate these agreements and sell the underlying collateral, possibly under adverse conditions.

In order to attempt to mitigate liquidity risk, we typically pledge only Agency MBS to secure our outstanding repurchase agreements, though from time-to-time we may pledge non-Agency MBS as collateral provided repurchase agreement financing is available. Agency MBS generally are considered the most liquid security in the marketplace and is generally less subject to extreme shifts in market value. We attempt to maintain an appropriate amount of cash and unpledged investments in order to meet margin calls on our repurchase agreements and to fund our on-going operations. See also “Liquidity and Capital Resources” in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Credit Risk

Credit risk is the risk that we will not receive all contractual amounts due on investments that we have purchased as a result of a default by the borrower or guarantor and the resulting deficiency in proceeds from the liquidation of the collateral securing the obligation. All of our investments have credit risk in varying degrees.

Some of our investments including Agency MBS and certain securitized mortgage loans include guaranty of payment from third parties. For example, our Agency MBS have credit risk to the extent that Fannie Mae or Freddie Mac fail to remit payments on these MBS for which they have issued a guaranty of payment. In addition, certain of our securitized mortgage loans have “pool” guarantees where certain parties provide guarantees of repayment on pools of loans up to a limited amount.

The following table presents information at December 31, 2008 with respect to our investments and the amounts guaranteed, if applicable.

Investment (amounts in thousands)	Amortized Cost Basis	Amount of Guaranty	Guarantor	Average Credit Rating of Guarantor (1)
With Guaranty of Payment				
Agency MBS	\$ 311,576	\$ 306,592	Fannie Mae/Freddie Mac	AAA
Securitized mortgage loans:				
Commercial	65,490	6,935	American International Group	A3
Single-family	23,081	22,621	PMI/GEMICO	B3/Baa1
Defeased loans	11,144	11,118	Fully secured with cash	
Without Guaranty of Payment				
Securitized mortgage loans:				
Commercial	98,856	—		
Single-family	48,963	—		
Investment in joint venture	5,655	—		
Other investments	12,735	—		
	577,500	347,266		
Allowance for loan losses	(3,707)	—		
Total investments	\$ 573,973	\$ 347,266		

(1) Reflects lowest rating of the three nationally-recognized ratings agencies for the senior unsecured debt of the guarantor.

Aside from guaranty of payment, for our securitized mortgage loans, we have limited our credit risk through the securitization process and the issuance of securitization financing. The securitization process limits our credit risk from an economic point of view as the securitization financing is recourse only to the assets pledged. Therefore, from an economic point of view, our risk is limited to the difference between the amount of securitized mortgage loans pledged and the amount of securitization financing outstanding. This difference is referred to as “overcollateralization.” We have also attempted to minimize our credit risk through the prudent underwriting of loans at their origination, the seasoning of the loans and the close monitoring of the performance of the servicer of the loan. Where we have retained credit risk, we provide an allowance for loan loss.

The following table presents information for securitized mortgage loans at December 31, 2008.

Investment (amounts in thousands)	Amortized Cost Basis of loans	Average Seasoning (in years)	Current Loan-to-Value based on Original Appraised Value	Amortized Cost Basis of Delinquent Loans(1)	Delinquency %
Commercial mortgage loans	\$ 174,185	13	50%	\$ 3,080	1.77%
Single-family mortgage loans	71,663	15	53%	6,068(2)	8.47%

(1) Loans contractually delinquent by 30 or more days.

(2) Of the \$6,068 of delinquent single-family loans, approximately \$1,871 are pool insured and, of the remaining \$4,197, \$3,622 of the loans made a payment within the 90 days prior to December 31, 2008.

Loans secured by low-income multifamily housing tax credit (“LIHTC”) properties account for 88% of our securitized commercial loan portfolio. LIHTC properties are properties eligible for tax credits under Section 42 of the Internal Revenue Code (the “Code”). Section 42 of the Code provides tax credits to investors in projects to construct or substantially rehabilitate properties that provide housing for qualifying low income families for as much as 90% of the eligible cost basis of the property. Failure by the borrower to comply with certain income and rental restrictions required by Section 42 or, more importantly, a default on a loan financing a Section 42 property during the Section 42 prescribed tax compliance period (generally 15 years from the date the property is placed in service) can result in the recapture of previously used tax credits from the borrower. The potential cost of tax credit recapture provides an incentive to the property owner to support the property during the compliance period. The following table shows the weighted average remaining compliance period of our portfolio of LIHTC commercial loans at December 31, 2008 as a percent of the total LIHTC commercial loan portfolio.

	As a Percent of Unpaid Principal Balance
Months remaining to end of compliance period	
Compliance period already exceeded	25.9%
Up to one year remaining	21.2
Between one and three years remaining	52.0
Between four and six years remaining	0.9
Total	100.0%

There were two delinquent LIHTC commercial mortgage loans with a total unpaid principal balance of \$3.1 million at December 31, 2008. There were no delinquent LIHTC commercial mortgage loans at December 31, 2007.

Interest Rate Risk

As discussed in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” we invest in Agency MBS and securitized mortgage loans on a leveraged basis. At any given time, these investments may consist of Hybrid Agency ARMs which have a fixed rate of interest for an initial period, and Agency ARMs or adjustable-rate loans which generally have interest rates which reset annually based on a spread to an index such as LIBOR, and which are subject to interim and lifetime interest rate caps. Of our Agency ARMs and adjustable-rate loans, approximately 4% of these loans reset based upon the level of six month LIBOR, 79% reset based on the level

of one-year LIBOR and 16% reset based on the level of one-year CMT. The interest rate caps could limit the amount that the interest rate may reset. Generally the borrowings used to finance these assets will have interest rates resetting every 30-to-90 days and they will not have periodic and lifetime interest rate caps. Periodic caps ranges from 1-2% annually, and lifetime caps are generally 5%. In addition, certain of our securitized mortgage loans have a fixed rate of interest and are financed with borrowings with interest rates that adjust monthly. During a period of rising short-term interest rates, the rates on our borrowings will reset higher on a more frequent basis than the interest rates on our investments, decreasing our net interest income earned and the corresponding cash flow on our investments. Conversely, net interest income may increase following a fall in short-term

interest rates. This increase may be temporary as the yields on the adjustable-rate loans adjust to the new market conditions after a lag period. The net interest spread may also be increased or decreased by the proceeds or costs of interest rate swap, cap or floor agreements, to the extent that we have entered into such agreements.

At December 31, 2008, the interest-rates on our investments and the associated borrowings, if any, on these investments will prospectively reset based on the following time frames (not considering the impact of prepayments):

(amounts in thousands)	Investments		Borrowings	
	Amounts (1)	Percent	Amounts	Percent
Fixed-Rate Investments/Obligations	\$ 184,877	33.0%	\$ 159,121	34.5%
Adjustable-Rate Investments/Obligations:				
Less than 3 months	—	—	301,795	65.5
Greater than 3 months and less than 1 year	156,279	28.0	—	—
Greater than 1 year and less than 2 years	116,304	20.8	—	—
Greater than 2 years and less than 3 years	68,246	12.2	—	—
Greater than 3 years and less than 5 years	33,404	6.0	—	—
Total	\$ 559,110	100.0%	\$ 460,916	100.0%

(1) The investment amount represents the fair value of the related securities and amortized cost basis of the related loans, excluding any related allowance for loan losses.

At December 31, 2007, the interest-rates on our investments and the associated borrowings, if any, on these investments will prospectively reset based on the following time frames (not considering the impact of prepayments):

(amounts in thousands)	Investments		Borrowings	
	Amounts(1)	Percent	Amounts	Percent
Fixed-Rate Investments/Obligations	\$ 212,312	73.6%	\$ 187,419	83.0%
Adjustable-Rate Investments/Obligations:				
Less than 3 months	—	—	38,374	17.0
Greater than 3 months and less than 1 year	76,328	26.4	—	—
Greater than 1 year and less than 2 years	—	—	—	—
Greater than 2 years and less than 3 years	—	—	—	—
Greater than 3 years and less than 5 years	—	—	—	—
Total	\$ 288,640	100.0%	\$ 225,793	100.0%

(1) The investment amount represents the fair value of the related securities and amortized cost basis of the related loans, excluding any related allowance for loan losses.

Adjustable rate mortgage loans collateralize our Hybrid Agency and Agency ARM MBS portfolio. The interest rates on the adjustable rate mortgage loans are typically fixed for a predetermined period and then adjust annually to an increment over a specified interest rate index. The following tables present information about the lifetime and interim interest rate caps on our Hybrid Agency MBS portfolio as of December 31, 2008:

Lifetime Interest Rate Caps on ARM MBS		Interim Interest Rate Caps on ARM MBS	
	% of Total		% of Total
9.0% to 10.0%	21.68%	2.0%	41.61%

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>10.0% to 11.0%	54.01%	5.0%	58.39%
>11.0% to 12.0%	24.31%		100.00%
	100.00%		

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Interest rate caps impact a security's yield and its to reset to market rates.

In an effort to mitigate the interest-rate risk associated with the mismatch in the timing of the interest rate resets in our investments versus our borrowings, we may enter into derivative transactions, in the form of forward purchase commitments and interest rate swaps, which are intended to serve as a hedge against future interest rate increases on our repurchase agreements, which rates are typically LIBOR based. Swaps generally result in interest savings in a rising interest rate environment, while in a declining interest rate environment generally result in our paying the stated fixed rate on the notional amount for each of the swap transactions, which could be higher than the market rate.

We take into account both anticipated coupon resets and expected prepayments when measuring the sensitivity of our Agency MBS investments to changes in interest rates. In measuring our repricing gap (i.e., the weighted average time period until our Agency MBS are expected to prepay or reprice less the weighted average time period for liabilities to reprice (or "Repricing Gap")), we measure the difference between: (a) the weighted average months until the next coupon adjustment or projected prepayment on the Agency MBS investments; and (b) the months remaining until our repurchase agreements mature, applying the same projected prepayment rate and including the impact of derivative transactions, if any. A constant prepayment rate (or "CPR") is applied in order to reflect, to a certain extent, the prepayment characteristics inherent in our interest-earning assets and interest-bearing liabilities.

The following table presents information at December 31, 2008 about our Repricing Gap based on contractual maturities (i.e., 0% CPR), and applying a 15% CPR, 25% CPR and 35% CPR.

CPR	Estimated Months to Asset Reset or Expected Prepayment	Estimated Months to Liabilities Reset	Repricing Gap in Months
0% (1)	21 months	1 month	20 months
15%	18 months	1 month	17 months
25%	16 months	1 month	15 months
35%	14 months	1 month	13 months

(1) Reflects contractual maturities, which do not consider any prepayments.

TABULAR PRESENTATION

We monitor the aggregate cash flow, projected net interest income and estimated market value of our investment portfolio under various interest rate and prepayment assumptions. While certain investments may perform poorly in an increasing or decreasing interest rate environment, other investments may perform well, and others may not be impacted at all.

The information presented in the table below projects the impact of sudden changes in interest rates on our annual projected net interest income and projected portfolio value, as more fully discussed below, based on our investments at December 31, 2008, and includes all of our interest rate-sensitive assets and liabilities, except for equity securities with a carrying value of \$3.6 million. We had no hedges at December 31, 2008.

Changes in projected net interest income equals the change that would occur in the calculated net interest income for the next twenty-four months relative to the 0% change scenario if interest rates were to instantaneously parallel shift to and remain at the stated level for the next twenty-four months.

Changes in projected market value equals the change in value of our assets that we carry at fair value rather than at historical amortized cost and any change in the value of any derivative instruments or hedges, such as interest rate swap agreements, in the event of an interest rate shift as described above. We acquire interest rate-sensitive assets and fund them with interest rate-sensitive liabilities. We generally plan to retain such assets and the associated interest rate risk to maturity.

The analysis below is heavily dependent upon the assumptions used in the model. The effect of changes in future interest rates beyond the forward LIBOR curve, the shape of the yield curve or the mix of our assets and liabilities may cause actual results to differ significantly from the modeled results. In addition, certain investments which we own provide a degree of “optionality.” The most significant option affecting the portfolio is the borrowers’ option to prepay the loans. The model applies prepayment rate assumptions representing management’s estimate of prepayment activity on a projected basis for each collateral pool in the investment portfolio. The model applies the same prepayment rate assumptions for all five cases indicated below for all investments owned by us except for Agency MBS. For Agency MBS, prepayment rates are adjusted based on modeled and management estimates for each of the rate scenarios set forth below. The extent to which borrowers utilize the ability to exercise their option may cause actual results to significantly differ from the analysis. Furthermore, the projected results assume no additions or subtractions to our portfolio, and no change to our liability structure. Historically, there have been significant changes in our investment portfolio and the liabilities incurred by us in response to interest rate movement, as such changes are a tool by which we can mitigate interest rate risk in response to changed conditions. As a result of anticipated prepayments on assets in the investment portfolio, there are likely to be such changes in the future.

The table below represents immediate changes, or “shocks,” to the interest rate environment as it existed as of December 31, 2008. At that date, one-month LIBOR was 0.43% and six-month LIBOR was 1.75%. The interest rate environment at December 31, 2008 reflected elevated short-term LIBOR rates given the conditions that existed in the credit markets at that time. Modeled LIBOR rates used to determine the Base Case ranged from a low of 0.43% to a high of 3.44% during the modeled period.

Basis Point Change in Interest Rates	Percentage change in projected net interest income	Percentage change in projected market value
+200	(14.44)%	(1.44)%
+100	(5.59)%	(0.66)%
0	—	—
-100	0.39%	0.42%
-200	(3.42)%	0.68%

General

Many assumptions are made to present the information in the above table and, as such, there can be no assurance that assumed events will occur, or that other events will not occur, that would affect the outcomes; therefore, the above tables and all related disclosures constitute forward-looking statements. The analyses presented utilize assumptions and estimates based on management’s judgment and experience. Furthermore, future sales, acquisitions and restructuring could materially change the interest rate risk profile for us. The tables quantify the potential changes in net income and net asset value should interest rates be shocked. The results of interest rate shocks of plus and minus 100 and 200 basis points are presented. The cash flows associated with the portfolio of mortgage-related assets for each rate shock are calculated based on a variety of assumptions including prepayment speeds, time until coupon reset, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate-sensitive liabilities, which are repurchase agreements, include anticipated interest rates (no negative rates are utilized), collateral requirements as a percent of the repurchase agreement and amount of borrowing. Assumptions made in calculating the impact on net asset value of interest rate shocks include interest rates, prepayment rates and the yield spread of mortgage-related assets relative to prevailing interest rates purchase premiums and discounts are amortized based on the constant effective yield calculated at the purchase date. Therefore, on a tax basis, amortization of premiums and discounts will differ from those reported for financial purposes under GAAP. At December 31, 2008, the net premium on our investment securities portfolio for financial accounting purposes was \$3.5 million (1.2%

of the principal balance of our investment securities), and the net discount on our securitization financing for financial accounting purposes was \$0.6 million (0.1% of the principal balance of our investments).

In general, we believe that we will be able to reinvest proceeds from scheduled principal payments and prepayments at acceptable yields; however, no assurances can be given that, should significant prepayments occur, market conditions would be such that acceptable investments could be identified and the proceeds timely reinvested.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the related notes, together with the Report of the Independent Registered Public Accounting Firm thereon, are set forth on pages F-1 through F-29 of this annual report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of the end of the period covered by this report (the "Evaluation Date"). Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the Evaluation Date.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the fourth quarter of 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to change in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Our management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control-Integrated Framework." Based on that evaluation, our principal executive officer and principal financial officer concluded that our internal control over financial reporting was effective as of the end of the period covered by this report.

The Company's internal control over financial reporting as of December 31, 2008 has been audited by BDO Seidman, LLP, the independent registered public accounting firm that also audited the Company's consolidated financial statements included in this Form 10-K. BDO Seidman, LLP's attestation report on the effectiveness of the Company's internal control over financial reporting appears on page F-4 hereof.

ITEM 9B.

OTHER INFORMATION

At a meeting held on February 6, 2009, the Compensation Committee of the Company's Board of Directors approved the 2008 bonus award to Thomas B. Akin, the Company's Chairman and Chief Executive Officer, under the Company's ROAE Bonus Pool. Pursuant to Mr. Akin's employment agreement, Mr. Akin was entitled to a cash bonus of up to 100% of his base salary based 50% on the Company's annual return on adjusted equity for 2008 and 50% on Mr. Akin's 2008 performance with respect to certain objectives established by the Compensation Committee. The Compensation Committee determined that Mr. Akin earned an award of \$203,125 for 2008 performance under the ROAE Bonus Pool, which equated to approximately 75% of his 2008 base salary. Mr. Akin was paid \$101,562 in cash on February 27, 2009 and the remainder was paid in cash prior to March 15, 2009.

At the same meeting, the Compensation Committee also determined to award a 2008 performance bonus to Stephen J. Benedetti, the Company's Executive Vice President, Chief Operating Officer and Chief Financial Officer, and Byron L. Boston, the Company's Chief Investment Officer, applying a similar approach to that used for Mr. Akin's bonus award under the ROAE Bonus Pool. The Compensation Committee determined that the Company's and Mr. Benedetti's performance for 2008 warranted an award of \$177,000, which equated to approximately 75% of his 2008 base salary. Mr. Benedetti was paid \$127,000 in cash on February 27, 2009 and the remainder was paid in cash prior to March 15, 2009. The Compensation Committee determined that the Company's and Mr. Boston's performance for 2008 warranted an award of \$189,063, which equated to approximately 75% of his base compensation and amounts earned as a consultant, prior to becoming an employee, and was paid in cash on February 27, 2009.

On March 16, 2009, we entered into a Sales Agreement (the "Sales Agreement") with Cantor Fitzgerald & Co., as sales agent (the "Sales Agent"). In accordance with the terms of the Sales Agreement, we may offer and sell up to 3,000,000 shares of common stock, par value \$0.01 per share (the "Shares"), from time to time through the Sales Agent. Sales of the Shares, if any, may be made in negotiated transactions or transactions that are deemed to be "at the market offerings" as defined in Rule 415 under the Securities Act of 1933, as amended, including sales made directly on the New York Stock Exchange or sales made to or through a market maker other than on an exchange. The Sales Agent will make all sales on a best efforts basis using commercially reasonable efforts consistent with its normal trading and sales practices on mutually agreed terms between us and the Sales Agent. The compensation payable to the Sales Agent for sales of the Shares sold pursuant to the Agreement shall be equal to up to three percent (3.0%) of the gross sales price per share for any shares of common stock sold under the Sales Agreement. The Sales Agreement is filed as Exhibit 10.8 to this annual report on Form 10-K.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is included in the proxy statement for our 2009 Annual Meeting of Shareholders (the "2009 Proxy Statement") under the captions "Election of Directors," "Committees of the Board," "Code of Ethics" and "Section 16(a) Beneficial Ownership Reporting Compliance," and is incorporated herein by reference.

The information concerning executive officers of the Company is included in Part I of this Form 10-K under the caption "Executive Officers of the Registrant."

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is included in the 2009 Proxy Statement under the captions "Executive Compensation" and "Directors' Compensation," and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is included in the 2009 Proxy Statement under the captions "Ownership of Stock" and "Equity Compensation Plan Information," and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is included in the 2009 Proxy Statement under the captions “Related Person Transactions” and “Director Independence,” and is incorporated herein by reference.

ITEM 14.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is included in the 2009 Proxy Statement under the caption “Audit Information,” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

1. and 2. Financial Statements and Schedules

The information required by this section of Item 15 is set forth in the Consolidated Financial Statements and Reports of Independent Registered Public Accounting Firm beginning at page F-1 of this annual report on Form 10-K. The index to the Financial Statements is set forth at page F-2 of this annual report on Form 10-K.

3. Exhibits

Number Exhibit

3.1 Restated Articles of Incorporation, effective July 9, 2008 (incorporated herein by reference to Exhibit 3.1 to Dynex's Current Report on Form 8-K filed July 11, 2008).

3.2 Amended and Restated Bylaws, effective March 26, 2008 (incorporated herein by reference to Exhibit 3.2 to Dynex's Current Report on Form 8-K filed April 1, 2008).

8.1 Opinion of Troutman Sanders, LLP with respect to certain tax matters (filed herewith).

10.1* Dynex Capital, Inc. 2004 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2004).

10.1.1* 409A Amendment to Dynex Capital, Inc. 2004 Stock Incentive Plan, dated December 31, 2008 (filed herewith).

10.2* Form of Stock Option Agreement for Non-Employee Directors under the Dynex Capital, Inc. 2004 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 to Dynex's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).

10.3* Form of Stock Appreciation Rights Agreement for Senior Executives under the Dynex Capital, Inc. 2004 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.3 to Dynex's Quarterly Report on Form 10-Q for the quarter ended June 30,

2005).

- 10.4 Limited Liability Company Agreement of Copperhead Ventures, LLC dated September 8, 2006 (portions of this exhibit have been omitted pursuant to a request for confidential treatment) (incorporated herein by reference to Exhibit 10.1 to Dynex's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006).

Number	Exhibit
10.5*	Severance Agreement between Dynex Capital, Inc. and Stephen J. Benedetti dated June 11, 2004 (incorporated herein by reference to Exhibit 10.5 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2007).
10.5.1*	409A Amendment to Severance Agreement between Dynex Capital, Inc. and Stephen J. Benedetti, dated December 31, 2008 (filed herewith).
10.6*	Employment Agreement, dated as of March 31, 2008, between Dynex Capital, Inc. and Thomas B. Akin (incorporated herein by reference to Exhibit 10.6 to Dynex's Current Report on Form 8-K filed April 4, 2008).
10.7*	Dynex Capital, Inc. 401(k) Overflow Plan, effective July 1, 1997 (incorporated herein by reference to Exhibit 10.7 to Dynex's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008).
10.8	Sales Agreement, dated as of March 16, 2009, between Dynex Capital, Inc. and Cantor Fitzgerald & Co. (filed herewith)
21.1	List of consolidated entities of Dynex (filed herewith).
23.1	Consent of BDO Seidman, LLP (filed herewith).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

* Denotes management contract.

(b) Exhibits: See Item 15(a)(3) above.

(c) Financial Statement Schedules: None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DYNEX CAPITAL, INC.
(Registrant)

March 16, 2009

/s/ Stephen J. Benedetti
Stephen J. Benedetti, Executive Vice
President, Chief Operating Officer and Chief
Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Thomas B. Akin Thomas B. Akin	Chairman and Chief Executive Officer and Director (Principal Executive Officer)	March 16, 2009
/s/ Stephen J. Benedetti Stephen J. Benedetti	Executive Vice President, Chief Operating Officer and Chief Financial Officer (Principal Financial Officer)	March 16, 2009
/s/ Jeffrey L. Childress Jeffrey L. Childress	Vice President and Controller (Principal Accounting Officer)	March 16, 2009
/s/ Leon A. Felman Leon A. Felman	Director	March 16, 2009
/s/ Barry Igdaloff Barry Igdaloff	Director	March 16, 2009
/s/ Daniel K. Osborne	Director	March 16, 2009

Explanation of Responses:

Daniel K. Osborne

/s/ James C. Wheat, III
James C. Wheat, III

Director

March 16, 2009

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DYNEX CAPITAL, INC.
CONSOLIDATED FINANCIAL STATEMENTS AND
REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
For Inclusion in Form 10-K
Annual Report Filed with
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DYNEX CAPITAL, INC.
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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia

We have audited the accompanying consolidated balance sheets of Dynex Capital, Inc. (Dynex) as of December 31, 2008 and 2007 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of Dynex's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dynex at December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the consolidated financial statements, Dynex adopted FASB Statement of Financial Accounting Standards No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" effective January 1, 2008.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Dynex's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 13, 2009 expressed an unqualified opinion thereon.

BDO SEIDMAN, LLP

Richmond, Virginia
March 13, 2009

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia

We have audited Dynex Capital, Inc.'s (Dynex) internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Dynex's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on Dynex's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Dynex maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Dynex Capital, Inc. as of December 31, 2008 and 2007 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated March 13, 2009 expressed an unqualified opinion thereon.

BDO SEIDMAN, LLP

Explanation of Responses:

Richmond, Virginia
March 13, 2009

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CONSOLIDATED BALANCE SHEETS
DYNEX CAPITAL, INC.

December 31, 2008 and 2007
(amounts in thousands except share data)

	2008	2007
ASSETS		
Agency MBS:		
Pledged to counterparties, at fair value	\$ 300,277	\$ —
Unpledged, at fair value	11,299	7,456
	311,576	7,456
Securitized mortgage loans, net	243,827	278,463
Investment in joint venture	5,655	19,267
Other investments	12,735	28,549
	573,793	333,735
Cash and cash equivalents	24,335	35,352
Restricted cash	2,974	—
Other assets	6,089	5,671
	\$ 607,191	\$ 374,758
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Repurchase agreements	\$ 274,217	\$ 4,612
Securitization financing	178,165	204,385
Obligation under payment agreement	8,534	16,796
Other liabilities	5,866	7,029
	466,782	232,822
Commitments and Contingencies (Note 15 and 16)		
SHAREHOLDERS' EQUITY		
Preferred stock, par value \$.01 per share, 50,000,000 shares authorized:		
9.5% Cumulative Convertible Series D, 4,221,539 shares issued and outstanding		
outstanding (\$43,218 aggregate liquidation preference)	41,749	41,749
Common stock, par value \$.01 per share, 100,000,000 shares authorized, 12,169,762 and 12,136,262 shares issued and outstanding, respectively	122	121
Additional paid-in capital	366,817	366,716
Accumulated other comprehensive (loss) income	(3,949)	1,093
Accumulated deficit	(264,330)	(267,743)
	140,409	141,936
	\$ 607,191	\$ 374,758

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME
DYNEX CAPITAL, INC.

Years ended December 31, 2008, 2007 and 2006
(amounts in thousands except share data)

	2008	2007	2006
Interest income:			
Securitized mortgage loans	\$ 20,886	\$ 26,424	\$ 46,240
Agency MBS	6,731	110	198
Other investments	1,351	1,633	1,996
Cash and cash equivalents	685	2,611	2,015
	29,653	30,778	50,449
Interest expense:			
Securitization financing	13,416	14,999	33,172
Repurchase agreements	4,079	3,546	5,933
Obligation under payment agreement	1,608	1,525	489
Other	3	25	(232)
Interest expense	19,106	20,095	39,362
Net interest income	10,547	10,683	11,087
(Provision for) recapture of loan losses	(991)	1,281	15
Net interest income after (provision for) recapture of loan losses	9,556	11,964	11,102
Equity in (loss) income of joint venture, net	(5,733)	709	(852)
Loss on capitalization of joint venture	—	—	(1,194)
Gain (loss) on sale of investments, net	2,316	755	(183)
Fair value adjustments, net	7,147	—	—
Other income (expense)	7,467	(533)	557
General and administrative expenses			
Compensation and benefits	(2,341)	(1,921)	(2,140)
Other general and administrative expenses	(3,291)	(2,075)	(2,381)
Net income	15,121	8,899	4,909
Preferred stock dividends	(4,010)	(4,010)	(4,044)
Net income to common shareholders	\$ 11,111	\$ 4,889	\$ 865
Net income per common share:			
Basic and diluted	\$ 0.91	\$ 0.40	\$ 0.07

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
DYNEX CAPITAL, INC.

Years ended December 31, 2008, 2007, and 2006
(amounts in thousands except share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Compre-hen- sive (Loss) Income	Accumulated Deficit	Total
Balance at January 1, 2006	\$ 55,666	\$ 122	\$ 366, 903	\$ 140	\$ (273,497)	\$ 149,334
Net income	—	—	—	—	4,909	4,909
Other comprehensive income:						
Change in market value of securities	—	—	—	891	—	891
Reclassification adjustment for net gains included in net income	—	—	—	(368)	—	(368)
Total comprehensive income						5,432
Redemption of preferred stock	(13,917)	—	(155)	—	—	(14,072)
Conversion of preferred stock for common stock	—	—	4	—	—	4
Dividends on preferred stock	—	—	—	—	(4,044)	(4,044)
Repurchase of common stock	—	(1)	(219)	—	—	(220)
Stock option issuance	—	—	104	—	—	104
Balance at December 31, 2006	41,749	121	366,637	663	(272,632)	136,538
Net income	—	—	—	—	8,899	8,899
Other comprehensive income:						
Change in market value of securities	—	—	—	1,256	—	1,256
Reclassification adjustment for net (gains) included in net income	—	—	—	(826)	—	(826)
Total comprehensive income						9,329
Dividends on preferred stock	—	—	—	—	(4,010)	(4,010)
Stock option exercise	—	—	37	—	—	37
Stock option issuance	—	—	42	—	—	42
Balance at December 31, 2007	41,749	121	366,716	1,093	(267,743)	141,936
Cumulative effect of adoption of SFAS 159	—	—	—	—	943	943

Explanation of Responses:

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Net income	–	–	–	–	15,121	15,121
Other comprehensive income:						
Change in market value of securities	–	–	–	(2,725)	–	(2,725)
Reclassification adjustment for net (gains) included in net income	–	–	–	(2,317)	–	(2,317)
Total comprehensive income						10,079
Dividends on common stock	–	–	–	–	(8,641)	(8,641)
Dividends on preferred stock	–	–	–	–	(4,010)	(4,010)
Stock option issuance	–	–	13	–	–	13
Grant and vesting of restricted stock	–	1	88	–	–	89
Balance at December 31, 2008	\$ 41,749	\$ 122	\$ 366,817	\$ (3,949)	\$ (264,330)	\$ 140,409

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
DYNEX CAPITAL, INC.

Years ended December 31, 2008, 2007 and 2006
(amounts in thousands except share data)

	2008	2007	2006
Operating activities:			
Net income	\$ 15,121	\$ 8,899	\$ 4,909
Adjustments to reconcile net income to cash provided by operating activities:			
Provision for (recapture of) loan loss	991	(1,281)	(15)
Equity in loss (earnings) of joint venture	5,733	(709)	852
Distribution of joint venture earnings	—	1,125	—
Loss on capitalization of joint venture	—	—	1,194
(Gain) loss on sale of investments	(2,316)	(755)	183
Amortization and depreciation	(1,585)	(583)	(538)
Fair value adjustments, net	(7,147)	—	—
Stock based compensation (benefit) expense	(271)	306	244
Net change in other assets and other liabilities	(3,735)	1,023	596
Net cash and cash equivalents provided by operating activities	6,791	8,025	7,425
Investing activities:			
Principal payments received on securitized mortgage loans	33,614	68,787	93,945
Purchase of Agency MBS and other investments	(375,425)	(27,882)	(17,221)
Payments received on Agency MBS and other investments	36,548	9,871	28,819
Proceeds from sales of Agency MBS and other investments	51,423	3,762	3,348
Distributions received from joint venture	4,183	17,095	—
Other	(816)	1,035	(385)
Net cash and cash equivalents (used in) provided by investing activities	(250,473)	72,668	108,506
Financing activities:			
Principal payments on securitization financing	(24,114)	(40,547)	(48,283)
Proceeds from sale of securitization financing bonds	—	35,289	—
Borrowings under (repayment of) repurchase agreements, net	269,605	(92,990)	(37,337)
Increase in restricted cash	(2,974)	—	—
Redemption of preferred stock	—	—	(14,068)
Proceeds from issuance of common stock	—	37	—
Repurchase of common stock	—	—	(220)
Dividends paid	(9,852)	(4,010)	(4,378)
Net cash and cash equivalents provided by (used in) financing activities	232,665	(102,221)	(104,286)
Net (decrease) increase in cash and cash equivalents	(11,017)	(21,528)	11,645
Cash and cash equivalents at beginning of year	35,352	56,880	45,235
Cash and cash equivalents at end of year	\$ 24,335	\$ 35,352	\$ 56,880

See notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

December 31, 2008, 2007, and 2006
(amounts in thousands except share and per share data)

NOTE 1 – ORGANIZATION

Dynex Capital, Inc., together with its subsidiaries (the “Company”), was incorporated in the Commonwealth of Virginia in 1987 and is currently based in Glen Allen, Virginia. The Company has elected to be treated as a real estate investment trust (“REIT”) for federal income tax purposes. In order to maintain its status as a REIT, the Company must comply with several requirements under the Internal Revenue Code (the “Code”). The Company believes it has complied with the requirements for qualification as a REIT under the Code.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with the generally accepted accounting principles in the United States (“GAAP”) and the instructions to the Form 10-K. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The consolidated financial statements include the accounts of the Company, its qualified REIT subsidiaries and its taxable REIT subsidiary. All intercompany balances and transactions have been eliminated in consolidation.

Certain prior period amounts have been reclassified to conform to the current year presentation.

Consolidation of Subsidiaries

The consolidated financial statements represent the Company’s accounts after the elimination of inter-company transactions. The Company consolidates entities in which it owns more than 50% of the voting equity and control does not rest with others and variable interest entities in which it is determined to be the primary beneficiary in accordance with Financial Interpretation No. 46(R) (“FIN 46(R)"). The Company follows the equity method of accounting for investments with greater than 20% and less than a 50% interest in partnerships and corporate joint ventures or when it is able to influence the financial and operating policies of the investee but owns less than 50% of the voting equity.

Federal Income Taxes

The Company believes it has complied with the requirements for qualification as a REIT under the Code. As such, the Company believes that it qualifies as a REIT for federal income tax purposes, and it generally will not be subject to federal income tax on the amount of its income or gain that is distributed as dividends to shareholders. The Company uses the calendar year for both tax and financial reporting purposes. There may be differences between taxable income and income computed in accordance with GAAP.

Investments

Explanation of Responses:

The Company's investments include Agency mortgage backed securities ("MBS"), securitized mortgage loans, investment in joint venture and other investments.

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Agency MBS. Agency MBS are MBS issued or guaranteed by a federally chartered corporation, such as Federal National Mortgage Corporation, or Fannie Mae, or Federal Home Loan Mortgage Corporation, or Freddie Mac, or an agency of the U.S. government, such as Government National Mortgage Association, or Ginnie Mae. MBS issued or guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are commonly referred to as “Agency MBS”. The Company’s Agency MBS are comprised primarily of Hybrid Agency ARMs and Agency ARMs and, to a lesser extent, fixed-rate Agency MBS. Hybrid Agency ARMs are MBS securities collateralized by hybrid adjustable mortgage loans. Hybrid adjustable rate mortgage loans are loans which have a fixed rate of interest for a specified period (typically three to ten years) and which then adjust their interest rate at least annually to an increment over a specified interest rate index as further discussed below. Agency ARMs are MBS securities collateralized by adjustable rate mortgage loans which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index. Agency ARMs also include Hybrid Agency ARMs that are past their fixed rate periods.

Interest rates on the adjustable rate loans collateralizing the Hybrid Agency ARMs or Agency ARMs are based on specific index rates, such as the one-year constant maturity treasury, or CMT rate, the London Interbank Offered Rate, or LIBOR, the Federal Reserve U.S. 12-month cumulative average one-year CMT, or MTA, or the 11th District Cost of Funds Index, or COFI. These loans will typically have interim and lifetime caps on interest rate adjustments, or interest rate caps, limiting the amount that the rates on these loans may reset in any given period.

All of the Company’s Agency MBS are classified as available-for-sale, and substantially all of the Company’s Agency MBS are pledged as collateral against repurchase agreements.

Securitized Mortgage loans. Securitized mortgage loans consist of loans pledged to support the repayment of securitization financing bonds issued by the Company. Securitized mortgage loans are reported at amortized cost. An allowance has been established for currently existing estimated losses on such loans. Securitized mortgage loans can only be sold subject to the lien of the respective securitization financing indenture.

Investment in Joint Venture. The Company accounts for its investment in joint venture using the equity method as it does not exercise control over significant asset decisions such as buying, selling or financing nor is it the primary beneficiary under FIN 46(R). Under the equity method, the Company increases its investment for its proportionate share of net income and contributions to the joint venture and decreases its investment balance by recording its proportionate share of net loss and distributions.

The Company periodically reviews its investment in joint venture for other than temporary declines in market value. Any decline that is not expected to be recovered in the next twelve months is considered other than temporary, and an impairment charge is recorded as a reduction to the carrying value of the investment.

Other Investments. Other investments include non-Agency MBS and equity securities, unsecuritized delinquent property tax receivables, and unsecuritized single-family and commercial mortgage loans. The unsecuritized delinquent property tax receivables and mortgage loans are carried at amortized cost. Non-agency MBS and equity securities are considered available-for-sale and are reported at fair value, with unrealized gains and losses excluded from earnings and reported as accumulated other comprehensive income.

Other investments also include real estate owned acquired through, or in lieu of, foreclosure in connection with the servicing of the delinquent tax lien receivables portfolio. Such investments are considered held for sale and are initially recorded at fair value less cost to sell (net realizable value) at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations and adjusts the property to the lower of cost or net realizable value. Revenue and expenses related to and changes in the valuation of the real estate owned are included in other income (expense).

Interest Income. Interest income is recognized when earned according to the terms of the underlying investment and when, in the opinion of management, it is collectible. For loans, the accrual of interest is discontinued when, in the opinion of management, the interest is not collectible in the normal course of business, when the loan is significantly past due or when the primary servicer of the loan fails to advance the interest and/or

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principal due on the loan. For securities and other investments, the accrual of interest is discontinued when, in the opinion of management, it is probable that all amounts contractually due will not be collected. Loans are considered past due when the borrower fails to make a timely payment in accordance with the underlying loan agreement, inclusive of all applicable cure periods. All interest accrued but not collected for investments that are placed on a non-accrual status or are charged-off is reversed against interest income. Interest on these investments is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Investments are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Premiums, Discounts, Debt Issuance Costs and Hedging Basis Adjustments

Premiums and discounts on investments and obligations are amortized into interest income or expense, respectively, over the life of the related investment or obligation using the effective yield method in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 91, “Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.”

Repurchase Agreements

The Company uses repurchase agreements to finance certain of its investments. Under these repurchase agreements, the Company sells the securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing, in accordance with the provision of SFAS 140, under which the Company pledges its securities as collateral to secure a loan, which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender or, with the consent of the lender, the Company may renew the agreement at the then prevailing financing rate. These repurchase agreements may require the Company to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivative Financial Instruments

The Company may enter into interest rate swap agreements, interest rate cap agreements, interest rate floor agreements, financial forwards, financial futures and options on financial futures (“Interest Rate Agreements”) to manage its sensitivity to changes in interest rates. These interest rate agreements are intended to provide income and cash flow to offset potential reduced net interest income and cash flow under certain interest rate environments. At the inception of an Interest Rate Agreement, these instruments are designated as either hedge positions or trading positions using criteria established in SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (as amended). If, at the inception of an Interest Rate Agreement, formal documentation is prepared that describes the risk being hedged, identifies the hedging instrument and the means to be used for assessing the effectiveness of the hedge and if it can be demonstrated that the hedging instrument will be highly effective at hedging the risk exposure, the derivative instrument will be designated as a cash flow hedge position. Otherwise, an Interest Rate Agreement will be classified as a trading position.

For Interest Rate Agreements designated as cash flow hedges, the Company evaluates the effectiveness of these hedges against the financial instrument being hedged. The effective portion of the hedge relationship on an interest rate agreement designated as a cash flow hedge is reported in accumulated other comprehensive income, and the ineffective portion of such hedge is reported in income. Amounts in accumulated other comprehensive income are reclassified into earnings in the same period during which the hedged transaction affects earnings. Derivative

instruments are carried at fair value in the financial statements of the Company.

As a part of the Company's interest rate risk management process, the Company may be required periodically to terminate hedge instruments. Any basis adjustments or changes in the fair value of hedges recorded in other comprehensive income are recognized into income or expense in conjunction with the original hedge or hedged exposure.

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If the underlying asset, liability or commitment is sold or matures, the hedge is deemed partially or wholly ineffective, or the criteria that was executed at the time the hedge instrument was entered into no longer exists, the interest rate agreement no longer qualifies as a designated hedge. Under these circumstances, such changes in the market value of the Interest Rate Agreement are recognized in current income.

For Interest Rate Agreements classified as a trading position, realized and unrealized changes in fair value of these instruments are recognized in the consolidated statements of operations as trading income or loss in the period in which the changes occur or when such trade instruments are settled. Amounts receivable from counter-parties, if any, are included on the consolidated balance sheets in other assets.

Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

Net Income Per Common Share

Net income per common share is presented on both a basic net income per common share and diluted net income per common share basis. Diluted net income per common share assumes the conversion of the convertible preferred stock into common stock, using the two-class method, and stock options, using the treasury stock method, but only if these items are dilutive. Each share of preferred stock is convertible into one share of common stock.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying consolidated financial statements are discussed below.

Fair Value. On January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, provides a framework for measuring fair value and sets forth the disclosures required with respect to fair value measurements. Pursuant to SFAS 157, the fair value is the exchange price in an orderly transaction, that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset/liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset/liability. SFAS 157 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. In addition, SFAS 157 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

The three levels of valuation hierarchy established by SFAS 157 are as follows:

- Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. The Company's investments included in Level 1 fair value generally are equity securities listed in active markets.
-

Level 2 — Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life. Fair valued assets and liabilities that are generally included in this category are Agency MBS, which are valued based on the average of multiple dealer quotes that are active in the Agency MBS market.

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- Level 3 — Inputs reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Generally, assets and liabilities carried at fair value and included in this category are non-agency mortgage-backed securities, delinquent property tax receivables and the obligation under payment agreement liability.

Estimates of fair value for financial instruments are based primarily on management’s judgment. Since the fair value of the Company’s financial instruments is based on estimates, actual fair values recognized may differ from those estimates recorded in the consolidated financial statements. The fair value of all financial instruments is presented in Note 11.

The Company accounts for its Agency MBS and non-Agency MBS in accordance with SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” which requires that investments in debt and equity securities be designated as either “held-to-maturity,” “available-for-sale” or “trading” at the time of acquisition. All of the Company’s securities are designated as available-for-sale and are carried at their fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive (loss)/income, a component of Shareholders’ Equity. The Company determines the fair value of its investment securities based upon prices obtained from a third-party pricing service and broker quotes. The Company applies the guidance prescribed in Financial Accounting Standards Board Staff Position SFAS 115-1 and SFAS 124-1, “The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments” in determining whether an other than temporary impairment has occurred.

Although the Company generally intends to hold its investment securities until maturity, it may, from time to time, sell any of its securities as part of the overall management of its business. The available-for-sale designation provides the Company with the flexibility to sell any of its investment securities. Upon the sale of an investment security, any unrealized gain or loss is reclassified out of accumulated other comprehensive (loss)/income to earnings as a realized gain or loss using the specific identification method.

Allowance for Loan Losses. An allowance for loan losses has been estimated and established for currently existing probable losses for loans in the Company’s investment portfolio that are considered impaired. Factors considered in establishing an allowance include current loan delinquencies, historical cure rates of delinquent loans, and historical and anticipated loss severity of the loans as they are liquidated. The factors differ by loan type (e.g., single-family versus commercial) and collateral type (e.g., multifamily versus office property). The allowance for losses is evaluated and adjusted periodically by management based on the actual and estimated timing and amount of probable credit losses, using the above factors, as well as industry loss experience. Where loans are considered homogeneous, the allowance for losses are established and evaluated on a pool basis. Otherwise, the allowance for losses is established and evaluated on a loan-specific basis. Provisions made to increase the allowance are charged as a current period expense. Single-family loans are considered impaired when they are 60 days past due. Commercial mortgage loans are evaluated on an individual basis for impairment. Commercial mortgage loans are secured by income-producing real estate and are evaluated for impairment when the debt service coverage ratio on the loan is less than 1:1 or when the loan is delinquent. Certain of the commercial mortgage loans are covered by loan guarantees that limit the Company’s exposure on these loans.

Loans secured by low-income housing tax credit properties account for 88% of the Company’s securitized commercial mortgage loan portfolio. Section 42 of the Code provides tax credits to investors in projects to construct or substantially rehabilitate properties that provide housing for qualifying low income families. Failure to comply with certain income and rental restrictions required by Section 42 or default on a loan financing a Section 42 property during the compliance period can result in the recapture of previously received tax credits. The potential cost of tax credit recapture provides an incentive to the property owner to support the property during the compliance period.

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Other-than-Temporary Impairments. The Company evaluates all securities in its investment portfolio for other-than-temporary impairments. A security is generally defined to be other-than-temporarily impaired if, for a period of three consecutive quarters, the carrying value of such security exceeds its estimated fair value, and the Company estimates, based on projected future cash flows or other fair value determinants, that the fair value will remain below the carrying value for the foreseeable future. If an other-than-temporary impairment is deemed to exist, the Company records an impairment charge to adjust the carrying value of the security down to its estimated fair value. In certain instances, as a result of the other-than-temporary impairment analysis, the recognition or accrual of interest will be discontinued and the security will be placed on non-accrual status. Securities normally are not placed on non-accrual status if the servicer continues to advance on the impaired loans in the security.

The Company considers an investment to be impaired if the fair value of the investment is less than its recorded cost basis. Impairments of other investments are generally considered to be other-than-temporary when the fair value remains below the carrying value for three consecutive quarters. If the impairment is determined to be other-than-temporary, an impairment charge is recorded in order to adjust the carrying value of the investment to its estimated value.

Mortgage Servicing Rights. The Company retains the primary servicing rights for certain of its loans originated in prior years and subcontracts the performance of the primary servicing to unrelated third parties. The Company adopted SFAS No. 156, "Accounting for Servicing of Financial Assets – An Amendment of FASB Statement No. 140" on January 1, 2007, and now accounts for its mortgage servicing rights at fair value with changes in fair value reported in earnings.

Contingencies. In the normal course of business, there are various lawsuits, claims, and contingencies pending against the Company. In accordance with SFAS No. 5, "Accounting for Contingencies," we evaluate whether to establish provisions for estimated losses from pending claims, investigations and proceedings. Although the ultimate outcome of the various matters cannot be ascertained at this point, it is the opinion of management, after consultation with counsel, that the resolution of the foregoing matters will not have a material adverse effect on the financial condition of the Company, taken as a whole, such resolution may, however, have a material effect on the results of operations or cash flows in any future period, depending on the level of income for such period.

Securitization Transactions

The Company has securitized mortgage loans in a securitization transaction by transferring financial assets to a wholly owned trust, and the trust issues non-recourse securitization financing bonds pursuant to an indenture. Generally, the Company retains some form of control over the transferred assets, and/or the trust is not deemed to be a qualified special purpose entity. In instances where the trust is deemed not to be a qualified special purpose entity, the trust is included in the consolidated financial statements of the Company. For accounting and tax purposes, the loans and securities financed through the issuance of bonds in a securitization financing transaction are treated as assets of the Company (presented as securitized mortgage loans), and the associated bonds issued are treated as debt of the Company as securitization financing. The Company may retain certain of the bonds issued by the trust, and the Company has generally transferred collateral in excess of the bonds issued. This excess is typically referred to as over-collateralization. Each securitization trust generally provides the Company the right to redeem, at its option, the remaining outstanding bonds prior to their maturity date.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 addresses reporting requirements in the financial statements of non-controlling interests to their equity share of subsidiary

investments. SFAS 160 applies to reporting periods beginning after December 15, 2008. The Company does not believe this pronouncement will have a material effect on its financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)") which revised SFAS No. 141, "Business Combinations." This pronouncement is effective as of January 1, 2009. Under SFAS No. 141, organizations utilized the announcement date as the measurement date for the purchase price of the

acquired entity. SFAS 141(R) requires measurement at the date the acquirer obtains control of the acquiree, generally referred to as the acquisition date. SFAS 141(R) will have a significant impact on the accounting for transaction costs, restructuring costs, as well as the initial recognition of contingent assets and liabilities assumed during a business combination. Under SFAS 141(R), adjustments to the acquired entity's deferred tax assets and uncertain tax position balances occurring outside the measurement period are recorded as a component of the income tax expense, rather than goodwill. As the provisions of SFAS 141(R) are applied prospectively, the impact cannot be determined until the transactions occur. The Company does not believe this pronouncement will have a material effect on its financial statements.

On March 20, 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 provides for enhanced disclosures about how and why an entity uses derivatives and how and where those derivatives and related hedged items are reported in the entity's financial statements. SFAS 161 also requires certain tabular formats for disclosing such information. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 applies to all entities and all derivative instruments and related hedged items accounted for under SFAS 133. Among other things, SFAS 161 requires disclosures of an entity's objectives and strategies for using derivatives by primary underlying risk and certain disclosures about the potential future collateral or cash requirements as a result of contingent credit-related features. The Company is currently evaluating the impact, if any, that the adoption of SFAS 161 will have on the Company's financial statements.

On January 12, 2009, the FASB issued FASB Staff Position ("FSP") EITF 99-20-1 "Amendments to the Impairment Guidance of EITF 99-20" ("EITF 99-20-1"), which amends the impairment guidance in EITF 99-20 to achieve more consistent determination of whether an other-than-temporary impairment has occurred for all beneficial interests within the scope of EITF 99-20. EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008, on a prospective basis. EITF 99-20-1 eliminates the requirement that a holder's best estimate of cash flows be based upon those that a "market participant" would use and instead requires that an other-than-temporary impairment be recognized as a realized loss through earnings when it is "probable" there has been an adverse change in the holder's estimated cash flows from cash flows previously projected. This change is consistent with the impairment models contained in SFAS 115. EITF 99-20-1 requires that the holder consider all available information relevant to the collectability of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally should include the remaining payment terms of the security, prepayments speeds, financial condition of the issuer, expected defaults, and the value of any underlying collateral. The holder should also consider industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectability of the security. The Company's adoption of EITF 99-20-1 at December 31, 2008 did not have a material impact on the Company's financial statements.

In December 2008, the FASB issued FSP SFAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" ("FSP SFAS 140-4" and "FIN 46(R)-8"). FSP SFAS 140-4 and FIN 46(R)-8 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140") and FIN No. 46(R), "Consolidation of Variable Interest Entities (revised December 2003) – an interpretation of Accounting Research Bulletin No. 51" ("FIN 46(R)") to require additional disclosures regarding transfers of financial assets and interest in variable interest entities and is effective for interim or annual reporting periods ending after December 15, 2008. The adoption of FSP SFAS 140-4 and FIN 46(R)-8 did not have a material impact on the Company's financial statements.

In June 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("EITF 03-6-1"). EITF 03-6-1 provides that unvested share-based

payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The Company's adoption of EITF 03-6-1 on January 1, 2009 is not expected to have a material impact on the Company's consolidated financial statements.

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On February 20, 2008, the FASB issued FSP 140-3, “Accounting for Transfers of Financial Assets and Repurchase Financing Transactions,” (“FSP 140-3”), which provides guidance on accounting for transfers of financial assets and repurchase financings. FSP 140-3 presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (i.e., a linked transaction) under SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“SFAS 140”). However, if certain criteria, as described in FSP 140-3, are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under SFAS 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall generally be accounted for as a forward contract, as opposed to the current presentation, where the purchased asset and the repurchase liability are reflected separately on the balance sheet. FSP 140-3 is effective on a prospective basis for fiscal years beginning after November 15, 2008, with earlier application not permitted. The Company is currently evaluating the impact, if any, that the adoption of FSP 140-3 will have on the Company’s financial statements.

On October 10, 2008, the FASB issued FSP No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP 157-3”). FSP 157-3 clarifies the application of SFAS 157, “Fair Value Measurements” (“SFAS 157”) in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company’s determination of fair value for its financial assets.

NOTE 3 – AGENCY MBS

The following table presents the components of the Company’s investment in Agency MBS as of December 31, 2008 and December 31, 2007:

	December 31, 2008	December 31, 2007
Principal/par value	\$ 307,548	\$ 7,400
Purchase premiums	3,585	14
Purchase discounts	(59)	(4)
Amortized cost	311,074	7,410
Gross unrealized gains	1,355	46
Gross unrealized losses	(853)	–
Fair value	\$ 311,576	\$ 7,456
Weighted average coupon	5.06%	5.43%

Principal/par value includes principal payments receivable on Agency MBS of \$956 and none as of December 31, 2008 and 2007, respectively.

The Company purchased approximately \$365,438 of Agency MBS during the year ended December 31, 2008 and financed the purchases with repurchase agreements of \$349,695. Of the Agency MBS balances at December 31, 2008 and December 31, 2007, Agency MBS with a fair value of \$300,277 and none were pledged as collateral under the repurchase agreements, respectively. The Company also sold \$29,869 of Agency MBS during the period at a net loss of \$125.

At December 31, 2008, the Company’s Agency MBS had a weighted average of 21 months to reset.

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NOTE 4 – SECURITIZED MORTGAGE LOANS, NET

The following table summarizes the components of securitized mortgage loans as of December 31, 2008 and 2007.

	2008	2007
Securitized mortgage loans:		
Commercial	\$ 164,032	\$ 185,998
Single-family	70,607	86,088
	234,639	272,086
Funds held by trustees, including funds held for defeasance	11,267	7,225
Accrued interest receivable	1,538	1,940
Unamortized discounts and premiums, net	90	(67)
Loans, at amortized cost	247,534	281,184
Allowance for loan losses	(3,707)	(2,721)
	\$ 243,827	\$ 278,463

All of the securitized mortgage loans are encumbered by securitization financing bonds (see Note 9).

Commercial mortgage loans were originated principally in 1996 and 1997 and are collateralized by first deeds of trust on income producing properties. Approximately 88% of commercial mortgage loans are secured by multifamily properties and approximately 12% by office, health-care, hospital, retail, warehouse and mixed-used properties. There were two delinquent commercial mortgage loans with a total unpaid principal balance of \$3,098 as of December 31, 2008.

Single-family mortgage loans are secured by first deeds of trust on residential real estate and were originated principally from 1992 to 1997. Single-family mortgage loans includes \$167 of real estate owned, \$404 of loans in foreclosure and \$1,756 of loans more than 90 days delinquent, on which the Company continues to accrue interest.

Funds held by trustees includes \$11,118 of cash and cash equivalents held by the trust for defeased loans. These defeased funds represent replacement collateral for the defeased mortgage loan, which replicates the contractual cash flows of the defeased mortgage loan and will be used to service the debt for which the underlying mortgage on the property has been released.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is included in securitized mortgage loans, net in the accompanying consolidated balance sheets. The following table summarizes the aggregate activity for the allowance for loan losses for the years ended December 31, 2008, 2007 and 2006.

	2008	2007	2006
Allowance at beginning of year	\$ 2,721	\$ 4,495	\$ 19,035
Provision for (recapture of) loan losses	991	(1,281)	(15)
Credit losses, net of recoveries	(5)	(493)	(4,172)
Loans sold/transferred	—	—	(10,353)
Allowance at end of year	\$ 3,707	\$ 2,721	\$ 4,495

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The following table presents certain information on impaired securitized commercial mortgage loans.

	Investment in Impaired Loans	Reserves on Impaired Loans	Investment in Excess of Reserves
2006	\$ 13,266	\$ 4,107	\$ 9,159
2007	13,792	2,590	11,202
2008	17,253	3,527	13,726

NOTE 6 – INVESTMENT IN JOINT VENTURE

The Company, through a wholly-owned subsidiary, holds a 49.875% interest in Copperhead Ventures, LLC, a joint venture primarily between the Company and DBAH Capital, LLC, an affiliate of Deutsche Bank, A.G.

The Company accounts for its investment in the joint venture using the equity method, under which it recognizes its proportionate share of the joint venture's earnings or loss and changes in accumulated other comprehensive income or loss.

The joint venture owns interests in commercial mortgage backed securities ("CMBS") and an investment in a payment agreement from the Company (see Note 10). Under the payment agreement amounts received, after payment on the associated securitization financing bonds outstanding, monthly by the Company on certain securitized commercial mortgage loans, which includes any defeased loans, are paid to the joint venture (see Note 10). During the year ended December 31, 2008, the joint venture received \$1.6 million of payments under this payment agreement.

The Company reported equity in the loss of the joint venture of \$5,733, which includes \$360 of amortization expense, and a decrease of \$3,316 in accumulated other comprehensive income of the joint venture for the year ended December 31, 2008 resulting from the venture's ownership of CMBS. The Company also recorded an adjustment to the opening balance of accumulated deficit of approximately \$380 related to the joint venture's adoption of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). The decline in the joint venture's equity is partially attributable to an \$8,387 distribution of excess cash received during 2008, along with the comprehensive net loss for the year.

The following table presents the condensed results of operations for the joint venture for the years ended December 31, 2008 and 2007 and the financial condition as of December 31, 2008 and 2007.

Condensed Statement of Operations	2008	2007
Interest income	\$ 3,956	\$ 5,819
Impairment	(7,278)	—
Fair value adjustments, net	(7,391)	(3,275)
General and administrative expense	(59)	—
Net (loss) income	\$ (10,772)	\$ 2,318

Condensed Balance Sheet	2008	2007
Total assets	\$ 11,240	\$ 37,972
Total liabilities	21	—
Total equity	\$ 11,219	\$ 37,972

The impairment of \$7,278 in 2008 resulted from an other-than-temporary impairment on CMBS owned by the joint venture. The net negative fair value adjustments of \$7,391 resulted from adjustments to the payment agreement discussed above. The instrument is accounted for under SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities," and accordingly, changes in value of this investment are recorded in the statement of operations.

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NOTE 7 – OTHER INVESTMENTS

The following table summarizes the amortized cost basis and fair value of the Company's other investments and the related average effective interest rates at December 31, 2008 and 2007:

	December 31, 2008		December 31, 2007	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Other securities:				
Non-Agency MBS	\$ 6,959	8.02%	\$ 7,684	6.85%
Corporate debt securities	–	–%	4,722	11.75%
Equity securities of publicly traded companies	3,441		7,704	
	10,400		20,110	
Gross unrealized gains	802		2,361	
Gross unrealized losses	(1,335)		(696)	
	9,867		21,775	
Other loans and investments	2,868		6,774	
	\$ 12,735		\$ 28,549	

The non-Agency MBS consist principally of fixed rate securities collateralized by single-family residential loans originated in 1994.

The Company sold approximately \$14,243 of equity securities during the year ended December 31, 2008, on which it recognized a gain of \$2,637, and purchased approximately \$9,988 of equity securities during 2008. The Company also sold the corporate debt security during the second quarter of 2008, on which it recognized a loss of \$187. The Company received dividends of \$1,180 and \$343 on equity securities during 2008 and 2007, respectively, which are included in "Other income (expense)" in the consolidated statement of operations. The Company recognized a net gain of \$759 and a net loss of \$207 on the sale of other investments for the years ended December 31, 2007 and 2006, respectively.

NOTE 8 – REPURCHASE AGREEMENTS

The Company uses repurchase agreements, which are recourse to the Company, to finance certain of its investments. The Company had repurchase agreements of \$274,217 at December 31, 2008, which were collateralized by Agency MBS with a fair value of \$300,277, and \$4,612 at December 31, 2007, which were collateralized by securitization financing bonds with a fair value of \$42,975.

At December 31, 2008 and December 31, 2007, the repurchase agreements had a weighted average interest rate of 2.70% and 5.07%, respectively. At December 31, 2008 and December 31, 2007, all repurchase agreements had the following original maturities:

Original Maturity	2008	2007
30 days or less	\$ 38,617	\$ 4,612
31 to 60 days	187,960	–
61 to 90 days	47,640	–
	\$ 274,217	\$ 4,612

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NOTE 9 – SECURITIZATION FINANCING

The Company, through limited-purpose finance subsidiaries, has issued bonds pursuant to indentures in the form of non-recourse securitization financing. Each series of securitization financing may consist of various classes of bonds, either at fixed or variable rates of interest and having varying repayment terms. The Company, on occasion, may retain bonds or redeem bonds and hold such bonds outstanding for possible future resale or reissuance. Payments received on securitized mortgage loans and any reinvestment income earned thereon are used to make payments on the bonds.

The obligations under the securitization financings are payable solely from the securitized mortgage loans and are otherwise non-recourse to the Company. The stated maturity date for each class of bonds is generally calculated based on the final scheduled payment date of the underlying collateral pledged. The actual maturity of each class will be directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption at the Company's option according to specific terms of the respective indentures. As a result, the actual maturity of any class of a series of securitization financing is likely to occur earlier than its stated maturity.

The Company has three series of bonds remaining outstanding pursuant to three separate indentures. One series with a principal amount of \$28,186 is collateralized by \$70,607 in single-family mortgage loans. The two remaining series with principal amounts of \$18,256 and \$131,343, respectively, are collateralized by commercial mortgage loans with unpaid principal balances at December 31, 2008 of \$22,912 and \$141,120, respectively.

The components of securitization financing along with certain other information at December 31, 2008 and 2007 are summarized as follows:

	2008		2007	
	Bonds Outstanding	Range of Interest Rates	Bonds Outstanding	Range of Interest Rates
Fixed rate classes	\$ 149,598	6.6% - 8.8%	\$ 167,398	6.6% - 8.8%
Variable rate class	28,186	1.7%	34,500	5.1%
Accrued interest payable	1,008		1,186	
Unamortized net bond premium and deferred costs	(627)		1,301	
	\$ 178,165		\$ 204,385	
Range of stated maturities	2024-2027		2024-2027	
Estimated weighted average life	2.6 years		3.3 years	
Number of series	3		3	

At December 31, 2008, the weighted-average effective rate of the fixed rate classes was 6.9%. The variable-rate bonds pay interest based on one-month LIBOR plus 30 basis points. The average effective rate of interest for securitization financing was 6.1%, 7.2%, and 8.1%, for the years ended December 31, 2008, 2007, and 2006, respectively.

On June 15, 2008, the Company redeemed one fixed rate bond outstanding at par for \$39 as permitted by the related securitization trust's indenture. This bond had an unamortized premium of \$1,247 on the redemption date, which the Company recognized as income and reported in "Other income (expense)" in the consolidated statement of operations for the year ended December 31, 2008. The Company has the right to redeem an additional \$18,288 in bonds held at December 31, 2008 at their current unpaid principal balance.

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NOTE 10 – OBLIGATION UNDER PAYMENT AGREEMENT

On January 1, 2008, the Company adopted the provisions of SFAS 159, which permits entities to choose to measure financial instruments at fair value. The Company adopted SFAS 159 to enhance the transparency of its financial condition. The effect of the adoption of SFAS 159 was to decrease beginning accumulated deficit by \$1,323. Obligation under payment agreement represents the fair value of estimated future payments due to the joint venture discussed in Note 6. The amounts due under the payment agreement are based on the amounts received monthly by the Company on certain outstanding securitized commercial mortgage loans and defeased commercial mortgage loans with an unpaid principal balance of \$152,238 at December 31, 2008, after payment of the associated securitization financing bonds outstanding with an unpaid principal balance of \$131,343 at December 31, 2008. The present value of the payment agreement was determined based on the total estimated future payments discounted at a weighted average rate of 36.5%. Factors which significantly impact the valuation of the payment agreement include the credit performance of the underlying securitized mortgage loans, estimated prepayments on the loans and the weighted average discount rate used on the cash flows.

During the year ended December 31, 2008, the Company made payments under the payment agreement of \$1,608, all of which was recorded as interest expense in the Company's financial statements.

NOTE 11 – FAIR VALUE AND ADDITIONAL INFORMATION ABOUT FINANCIAL INSTRUMENTS

On January 1, 2008, the Company adopted the provisions of SFAS 157 for all assets that are measured at fair value and for its obligation under payment agreement liability. Fair value is defined as the exchange price in an orderly transaction, that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset/liability. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments or market and the instruments' complexity.

Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by SFAS 157 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities carried at Level 1 fair value generally are equity securities listed in active markets.

Level 2 — Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life. Fair valued assets and liabilities that are generally included in this category are Agency MBS.

Level 3 — Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Generally, assets and liabilities carried at fair value and included in this category are non-agency mortgage-backed securities, delinquent property tax receivables and the obligation under payment agreement liability.

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The following table presents the Company's assets and liabilities at December 31, 2008, which are carried at fair value, segregated by the hierarchy level of the fair value estimate:

	Fair Value	Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Agency MBS	\$ 311,576	\$ –	\$ 311,576	\$ –
Non-agency MBS	6,259	–	–	6,259
Equity securities	3,607	3,607	–	–
Other	211	–	–	211
Total assets carried at fair value	\$ 321,653	\$ 3,607	\$ 311,576	\$ 6,470
Liabilities:				
Obligation under payment agreement	\$ 8,534	\$ –	\$ –	\$ 8,534
Total liabilities carried at fair value	\$ 8,534	\$ –	\$ –	\$ 8,534

The following tables present the reconciliations of the beginning and ending balances of the Level 3 fair value estimates for the year ended December 31, 2008:

	Level 3 Fair Values				Obligation under payment agreement
	Non-Agency MBS	Corporate debt securities	Other	Total assets	
Balance at January 1, 2008	\$ 7,726	\$ 4,347	\$ 2,127	\$ 14,200	\$ (15,473)
Total realized and unrealized gains (losses)					
Included in the statement of operations in fair value adjustments, net	–	(187)	(9)	(195)	6,939
Included in other comprehensive income (loss)	(742)	375	15	(351)	–
Purchases, sales, issuances and other settlements, net	(725)	(4,535)	(1,922)	(7,184)	–
Transfers in and/or out of Level 3	–	–	–	–	–
Balance at December 31, 2008	\$ 6,259	\$ –	\$ 211	\$ 6,470	\$ (8,534)

There were no assets or liabilities which were measured at fair value on a non-recurring basis during the year ended December 31, 2008.

SFAS No. 107, “Disclosures about Fair Value of Financial Instruments” requires the disclosure of the estimated fair value of financial instruments. The following table presents the recorded basis and estimated fair values of the Company’s financial instruments as of December 31, 2008 and 2007:

	2008		2007	
	Recorded Basis	Fair Value	Recorded Basis	Fair Value
Assets:				
Agency MBS	\$ 311,576	\$ 311,576	\$ 7,456	\$ 7,456
Securitized mortgage loans, net	243,827	201,252	278,463	282,242
Investment in joint venture	5,655	5,595	19,267	18,847
Other investments	12,735	12,358	28,549	32,182
Liabilities:				
Repurchase agreements	274,217	274,217	4,612	4,612
Securitization financing	178,165	153,370	204,385	212,327
Obligation under payment agreement	8,534	8,534	16,796	15,473

The fair value of securitized mortgage loans and securitization financing decreased below their respective carrying values during 2008 as market volatility increased the discount rates used in calculating the fair values, which are calculated by discounting the estimated future cash flows.

NOTE 12 – EARNINGS PER SHARE

The following table reconciles the numerator and denominator for both the basic and diluted earnings per share for the years ended December 31, 2008, 2007, and 2006.

	2008		2007		2006	
	Income	Weighted Average Common Shares	Income	Weighted Average Common Shares	Income	Weighted Average Common Shares
Net income	\$ 15,121		\$ 8,899		\$ 4,909	
Preferred stock dividends	(4,010)		(4,010)		(4,044)	
Net income available to common shareholders	\$ 11,111	12,166,558	\$ 4,889	12,135,495	\$ 865	12,140,452
Net income per share:						
Basic and diluted		\$ 0.91		\$ 0.40		\$ 0.07
Net effect of dilutive stock options						
	–	3,053	–	2,593	–	–
	\$ 11,111	12,169,611	\$ 4,889	12,138,088	\$ 865	12,140,452

Potentially antidilutive securities excluded from the calculation of diluted earnings per share are as follows:

	Year ended December 31,		
	2008	2007	2006
Shares issuable under stock option awards	118,053	92,407	70,000
Convertible preferred shares	4,221,539	4,221,539	4,256,237

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NOTE 13 – PREFERRED AND COMMON STOCK

The Company is authorized to issue up to 50,000,000 shares of preferred stock. For all series issued, dividends are cumulative from the date of issue and are payable quarterly in arrears. The dividends are equal, per share, to the greater of (i) the per quarter base rate of \$0.2375 for Series D, or (ii) the quarterly dividend declared on the Company's common stock. One share of Series D preferred stock is convertible at any time at the option of the holder into one share of common stock. The series is redeemable by the Company at any time, in whole or in part, (i) at a rate of one share of preferred stock for one share of common stock, plus accrued and unpaid dividends, provided that for 20 trading days within any period of 30 consecutive trading days, the closing price of the common stock equals or exceeds the issue price, or (ii) for cash at the issue price, plus any accrued and unpaid dividends.

In the event of liquidation, the holders of this series of preferred stock will be entitled to receive out of the Company's assets, prior to any such distribution to the common shareholders, the issue price per share in cash, plus any accrued and unpaid dividends. If the Company fails to pay dividends for two consecutive quarters or if the Company fails to maintain consolidated shareholders' equity of at least 200% of the aggregate issue price of the Series D preferred stock, then these shares automatically convert into a new series of 9.50% senior notes. The Company paid dividends of \$0.95 per share of Series D Preferred Stock for each of the years ended December 31, 2008, 2007 and 2006.

The following table presents the changes in the number of preferred and common shares outstanding:

	Shares	
	Preferred Series D	Common
January 1, 2006	5,628,737	12,163,391
Redeemed	(1,406,767)	-
Converted	(431)	431
Repurchased	-	(32,560)
December 31, 2006	4,221,539	12,131,262
Shares issued for stock option exercise	-	5,000
December 31, 2007	4,221,539	12,136,262
Restricted shares granted	-	33,500
December 31, 2008	4,221,539	12,169,762

In 2008, the Company issued 33,500 shares of restricted common stock in a share-based compensation award as discussed further in Note 14. The Company repurchased 32,560 shares of common stock in 2006, under a stock repurchase plan authorized by its Board of Directors in 2005. The Company has made no additional purchases since that time. Any future repurchases of common stock will be made at times and in amounts as deemed appropriate by the Company, and the plan may be suspended or discontinued at any time.

The following table presents the preferred and common dividends declared from January 1, 2008 through December 31, 2008:

Declaration Date	Record Date	Payment Date	Dividend per Share	
			Common	Preferred
Common Stock				
February 5, 2008	February 15, 2008	February 29, 2008	\$ 0.10	—
May 12, 2008	May 22, 2008	May 30, 2008	0.15	—
August 18, 2008	August 29, 2008	September 30, 2008	0.23	—
December 10, 2008	December 22, 2008	January 30, 2009	0.23	—
Preferred Stock				
March 19, 2008	March 31, 2008	April 30, 2008	— \$	0.2375
June 18, 2008	June 30, 2008	July 31, 2008	—	0.2375
September 18, 2008	September 30, 2008	October 31, 2008	—	0.2375
December 22, 2008	December 31, 2008	February 2, 2009	—	0.2375

Shelf Registration

On February 29, 2008, the Company filed a shelf registration statement on Form S-3, which became effective on April 17, 2008. The shelf registration permits the Company to sell up to \$1,000,000 of securities, including common stock, preferred stock, debt securities and warrants. No shares had been sold or otherwise issued under this shelf registration as of December 31, 2008.

NOTE 14 – EMPLOYEE BENEFITS

Stock Incentive Plan

Pursuant to the Company's 2004 Stock Incentive Plan, as approved by the shareholders at the Company's 2005 annual shareholders' meeting (the "Stock Incentive Plan"), the Company may grant to eligible officers, directors and employees stock options, stock appreciation rights ("SARs") and restricted stock awards. An aggregate of 1,500,000 shares of common stock may be granted pursuant to the Stock Incentive Plan. The Company may also grant dividend equivalent rights ("DERs") in connection with the grant of options or SARs.

On February 4, 2008, the Company granted 33,500 shares of restricted common stock to certain of its employees and officers under the Stock Incentive Plan. Of the restricted stock granted, 3,500 shares vested 25% per quarter in 2008. The remaining 30,000 shares of restricted stock vest 25% per year (on the grant date anniversary) over the next four years. The weighted average grant date fair value of the restricted stock grants was \$8.80 per share for a total compensation cost of \$294, which will be recognized evenly over the vesting period. The Company recognized expense related to the restricted stock granted of \$89 for the year ended December 31, 2008.

On May 16, 2008, the Company granted options to acquire an aggregate of 25,000 shares of common stock to its directors under the Stock Incentive Plan for which the Company recognized an expense of approximately \$13. The options granted expire on May 16, 2013 and have an exercise price of \$9.81 per share, which was 110% of the closing price of the Company's common stock on the grant date. Of the options granted, 5,000 options were issued to a new director and had a one year vesting term. The remaining options granted vested immediately. The weighted average grant-date fair value of the options granted was \$0.50 per share on the grant date.

The fair value of each SAR or option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the table below. Expected volatilities are based on the historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model. SARs are assumed to be exercised at the midpoint between the later of their vesting date and the current reporting date and the expiration date. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

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As required by SFAS 123(R), stock options, which are settleable only in shares of common stock, have been treated as equity awards, with their fair value measured at the grant date, and SARs, which are settleable in cash, have been treated as liability awards, with their fair value measured at the grant date and remeasured at the end of each reporting period.

The following table describes the weighted average of assumptions used for calculating the fair value of SARs outstanding at December 31, 2008, 2007 and 2006.

	SARs Fair Value December 31,		
	2008	2007	2006
Expected volatility	21.3%-26.6%	15.0%-20.0%	17.2%-22.9%
Weighted-average volatility	24.4%	16.2%	19.4%
Expected dividends	14.1%	0%	0%
Expected term (in months)	43	49	45
Weighted-average risk-free rate	1.89%	3.5%	4.7%
Range of risk-free rates	1.73%-2.08%	3.3%-3.6%	4.7%

The following table presents a summary of the SAR activity for the year ended December 31, 2008.

	Year Ended December 31, 2008	
	Number of Shares	Weighted- Average Exercise Price
SARs outstanding at beginning of period	278,146	\$ 7.27
SARs granted	—	—
SARs forfeited or redeemed	—	—
SARs exercised	—	—
SARs outstanding at end of period	278,146	\$ 7.27
SARs vested and exercisable	149,860	\$ 7.41

The weighted average remaining contractual term on the SARs shares outstanding and exercisable is 43 months and 42 months, respectively.

The following table presents a summary of the option activity for the Stock Incentive Plan:

	Year Ended December 31, 2008	
	Number of Shares	Weighted- Average Exercise Price
Options outstanding at beginning of period	90,000	\$ 8.27
Options granted	25,000	9.81
Options forfeited or redeemed	(5,000)	9.81
Options exercised	—	—
Options outstanding at end of period	110,000	\$ 8.61

Options vested and exercisable	110,000	\$	8.61
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The Company incurred a (benefit)/expense of \$(360), \$306 and \$244 for SARs and options related to the Stock Incentive Plan during 2008, 2007 and 2006, respectively. The total compensation cost related to non-vested SAR awards was \$6 at December 31, 2008 and will be recognized as the awards vest. The weighted average period over which the total compensation cost related to the SARs at December 31, 2008 is expected to be recognized is 43 months.

Employee Savings Plan

The Company provides an Employee Savings Plan under Section 401(k) of the Code. The Employee Savings Plan allows eligible employees to defer up to 25% of their income on a pretax basis. The Company matches the employees' contribution, up to 6% of the employees' eligible compensation. The Company may also make discretionary contributions based on the profitability of the Company. The total expense related to the Company's matching and discretionary contributions in 2008, 2007, and 2006 was \$64, \$65 and \$78, respectively. The Company does not provide post employment or post retirement benefits to its employees.

NOTE 15 – COMMITMENTS AND CONTINGENCIES

As of December 31, 2008, the Company is obligated under non-cancelable operating leases with expiration dates through in December 2013. Required rental payments are as follows:

2009	\$	145
2010		149
2011		154
2012		158
2013 and thereafter		163
	\$	769

Rent and lease expense under leases which expired in previous years was \$181, \$143, and \$136, respectively in 2008, 2007, and 2006.

NOTE 16 – LITIGATION

The Company and its subsidiaries may be involved in certain litigation matters arising in the ordinary course of business. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, the Company believes, based on current knowledge, that the resolution of these matters arising in the ordinary course of business will not have a material adverse effect on the Company's financial position or results of operations. Information on litigation arising out of the ordinary course of business is described below.

One of the Company's subsidiaries, GLS Capital, Inc. ("GLS"), and the County of Allegheny, Pennsylvania are defendants in a class action lawsuit ("Pentlong") filed in 1997 in the Court of Common Pleas of Allegheny County, Pennsylvania (the "Court of Common Pleas"). Between 1995 and 1997, GLS purchased delinquent county property tax receivables for properties located in Allegheny County. Pentlong Plaintiffs allege that GLS did not enjoy the same rights as its assignor, Allegheny County, to recover from delinquent taxpayers certain attorney fees, costs and expenses and interest in the collection of the tax receivables. Class action status has been certified in this matter, but a motion to reconsider is pending. The Pentlong litigation was stayed pending the outcome of similar litigation before the Pennsylvania Supreme Court in a case in which GLS was not a defendant. The plaintiff in that case had disputed

the application of curative legislation enacted in 2003 but retroactive to 1996 which specifically set forth the right to collect reasonable attorney fees, costs, and interest which were properly taxable as part of the tax debt owed. The Pennsylvania Supreme Court subsequently issued an opinion in favor of the defendants in that matter, which the Company believes will favorably impact the Pentlong litigation by substantially reducing Pentlong Plaintiffs' universe of actionable claims against GLS in connection with the collection of the tax receivables. No timetable has been set by the Court of Common Pleas for the recommencement of the litigation. Pentlong Plaintiffs have not enumerated their damages in this matter.

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Dynex Capital, Inc. and Dynex Commercial, Inc. (“DCI”), a former affiliate of the Company and now known as DCI Commercial, Inc., are appellees (or respondents) in the Supreme Court of Texas related to the matter of Basic Capital Management, Inc. et al. (collectively, “BCM” or the “Plaintiffs”) versus DCI et al. The appeal seeks to overturn the trial court’s judgment, and subsequent affirmation by the Fifth Court of Appeals at Dallas, in the Company’s and DCI’s favor which denied recovery to Plaintiffs. Plaintiffs are seeking reversal of the trial court’s judgment and sought rendition of judgment against the Company for alleged breach of loan agreements for tenant improvements in the amount of \$253.

They also seek reversal of the trial court’s judgment and rendition of judgment against DCI in favor of BCM under two mutually exclusive damage models, for \$2,200 and \$25,600, respectively, related to the alleged breach by DCI of a \$160,000 “master” loan commitment. Plaintiffs also seek reversal and rendition of a judgment in their favor for attorneys’ fees in the amount of \$2,100. Alternatively, Plaintiffs seek a new trial. Even if Plaintiffs were to be successful on appeal, DCI is a former affiliate of the Company, and the Company believes that it would have no obligation for amounts, if any, awarded to the Plaintiffs as a result of the actions of DCI.

Dynex Capital, Inc. and MERIT Securities Corporation, a subsidiary, were defendants in a putative class action complaint alleging violations of the federal securities laws in the United States District Court for the Southern District of New York (“District Court”) by the Teamsters Local 445 Freight Division Pension Fund (“Teamsters”). The complaint was filed on February 7, 2005, and purported to be a class action on behalf of purchasers between February 2000 and May 2004 of MERIT Series 12 and MERIT Series 13 securitization financing bonds, which are collateralized by manufactured housing loans. After a series of rulings by the District Court and an appeal by the Company and MERIT, on February 22, 2008, the United States Court of Appeals for the Second Circuit dismissed the litigation against the Company and MERIT. Teamsters filed an amended complaint on August 6, 2008 with the District Court which essentially restated the same allegations as the original complaint and added the Company’s former president and its current Chief Operating Officer as defendants. The Company is seeking to have the amended complaint dismissed and intends to vigorously defend itself in this matter.

Although no assurance can be given with respect to the ultimate outcome of the above litigation, the Company believes the resolution of these lawsuits will not have a material effect on its consolidated balance sheet but could materially affect its consolidated results of operations in a given year or period.

NOTE 17 – SUPPLEMENTAL CONSOLIDATED STATEMENTS OF CASH FLOWS INFORMATION

	Years ended December 31,		
	2008	2007	2006
Cash paid for interest	\$ 19,817	\$ 20,082	\$ 40,932
Supplemental disclosure of non-cash activities:			
Formation of joint venture with Deutsche Bank	\$ –	\$ –	\$ 38,248
Conversion of preferred shares to common shares	\$ –	\$ –	\$ 4

NOTE 18 – RELATED PARTY TRANSACTIONS

As discussed in Note 16, the Company and DCI have been jointly named in litigation regarding the activities of DCI while it was an operating subsidiary of an affiliate of the Company. The Company and DCI entered into a Litigation Cost Sharing Agreement whereby the parties set forth how the costs of defending against litigation would be shared, and whereby the Company agreed to fund all costs of such litigation, including DCI’s portion. DCI’s cumulative portion of costs associated with litigation and funded by the Company is \$3,299 and is secured by the proceeds of any counterclaims that DCI may receive in the litigation. DCI costs funded by the Company are loans and bear simple interest at the rate of Prime plus 8.0% per annum. At December 31, 2008, the total amount due the Company under

the Litigation Cost Sharing Agreement, including interest, was \$6,102, which has been fully reserved by the Company. DCI is currently wholly owned by ICD Holding, Inc. An executive of the Company is the sole shareholder of ICD Holding.

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NOTE 19 – NON-CONSOLIDATED AFFILIATES

The Company holds a 1% limited partnership interest in a partnership that owns a low-income housing tax credit multifamily housing property located in Texas. The Company has loaned the partnership \$931, \$50 of which was advanced to the partnership during 2008. These advances and the accrued interest thereon are due on demand. The Company, through a subsidiary, has made a first mortgage loan to the partnership secured by the property, with a current unpaid principal balance of \$1,464. Because the Company does not have control or exercise significant influence over the operations of this partnership, its investment in the partnership is accounted for using the cost method.

NOTE 20 – SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

The following tables present the Company's unaudited selected quarterly results for 2008 and 2007.

Year Ended December 31, 2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Net interest income	\$ 2,421	\$ 2,501	\$ 2,787	\$ 2,838
Net interest income after provision for loan losses	2,395	2,180	2,338	2,643
Net income	5,319	4,296	3,045	2,461
Basic net income per common share	0.36	0.27	0.17	0.12
Diluted net income per common share	0.32	0.26	0.17	0.12
Cash dividends declared per common share	0.10	0.15	0.23	0.23

Year Ended December 31, 2007	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Net interest income	\$ 2,460	\$ 2,963	\$ 2,457	\$ 2,803
Net interest income after provision for loan losses	2,983	3,665	2,584	2,732
Net income	1,942	2,702	2,686	1,569
Basic and diluted net income per common share	0.08	0.14	0.14	0.05
Cash dividends declared per common share	–	–	–	–

