DYCOM INDUSTRIES INC
Form S-8
November 26, 2002

As filed with the Securities and Exchange Commission on November 26, 2002
Registration No. 333-[ ]

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-8
REGISTRATION STATEMENT
UNDER THE
SECURITIES ACT OF 1933

DYCOM INDUSTRIES, INC.
(Exact name of Registrant as specified in its charter)

Florida
(State or other jurisdiction of incorporation or organization)

59-1277135
(I.R.S. Employer Identification Number)

4440 PGA Boulevard, Suite 500
Palm Beach Gardens, Florida 33410
(Address of Principal Executive Offices)

DYCOM INDUSTRIES, INC.
2002 DIRECTORS RESTRICTED STOCK PLAN
(Full title of the plan)

RICHARD L. DUNN
Senior Vice President & Chief Financial Officer
Dycom Industries, Inc.
4440 PGA Boulevard, Suite 500
Palm Beach Gardens, Florida 33410
(Name and address of agent for service)

(561) 627-7171
(Telephone number, including area code, of agent for service)

CALCULATION OF REGISTRATION FEE

Title of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share	Proposed Maximum Aggregate Offering Price (1)
Common Stock par value $0.3333 1/3 per	100,000	$13.08	$1,308,000

share

(1) Pursuant to Rule 457(c) and 457(h), the offering price is based on the average of the high and low prices of the Registrant's common stock on the New York Stock Exchange consolidated reporting system on November 22, 2002, and is estimated solely for the purpose of calculating the registration fee.

Part I

INFORMATION REQUIRED IN THE SECTION 10(a) PROSPECTUS

Item 1. Plan Information.*

Item 2. Registrant Information and Employee Plan Annual Information.*

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* Information required by Part I to be contained in the Section 10(a)

prospectus is omitted from this Registration Statement in accordance with Rule 428 under the Securities Act of 1933, as amended (hereinafter, the "Securities Act"), and the "Note" to Part I of Form S-8.

Part II

INFORMATION REQUIRED IN THE REGISTRATION STATEMENT

Item 3. Incorporation of Documents by Reference.

The following documents which have been filed or will be filed by the Registrant with the Securities and Exchange Commission (the "Commission") pursuant to the Securities Act or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are incorporated as of their respective dates in this Registration Statement by reference and shall be deemed to be a part hereof:

(i) the Registrant's Annual Report on Form 10-K for the fiscal year ending July 27, 2002;

(ii) the description of the common stock, par value $0.3333 1/3 per share under the heading "Description of Capital Stock," contained in the Registrant's Amended Registration Statement on Form S-4 filed with the Commission on February 12, 2002.

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

Item 4. Description of Securities.

Not applicable.

Item 5. Interests of Named Experts and Counsel.

Not applicable.

Item 6. Indemnification of Directors and Officers.

Florida Business Corporation Act ("FBCA"). Section 607.0850(1) of the FBCA provides that a Florida corporation, such as Dycom, shall have the power to indemnify any person who was or is a party to any proceeding (other than an action by, or in the right of, the corporation), by reason of the fact that he is or was a director or officer of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise against liability incurred in connection with such proceeding, including any

appeal thereof, if he or she acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of the corporation and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful.

Section 607.0850(2) of the FBCA provides that a Florida corporation shall have the power to indemnify any person, who was or is a party to any proceeding by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he or she is or was a director or officer of the corporation or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses and amounts paid in settlement not exceeding, in the judgment of the board of directors, the estimated expense of litigating the proceeding to conclusion, actually and reasonably incurred in connection with the defense or settlement of such proceeding, including any appeal thereof. Such indemnification shall be authorized if such person acted in good faith and in a

manner he or she reasonably believed to be in, or not opposed to, the best interests of the corporation, except that no indemnification shall be made under this subsection in respect of any claim, issue, or matter as to which such person shall have been adjudged to be liable unless, and only to the extent that, the court in which such proceeding was brought, or any other court of competent jurisdiction, shall determine upon application that, despite the adjudication of liability but in view of all circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper.

Section 607.850 of the FBCA further provides that: (i) to the extent that a director or officer of a corporation has been successful on the merits or otherwise in defense of any proceeding referred to in subsection (1) or subsection (2), or in defense of any proceeding referred to in subsection (1) or subsection (2), or in defense of any claim, issue, or matter therein, he or she shall be indemnified against expenses actually and reasonably incurred by him or her in connection therewith; (ii) indemnification provided pursuant to Section 607.0850 is not exclusive; and (iii) the corporation shall have the power to purchase and maintain insurance on behalf of a director or officer of the corporation against any liability asserted against him or her or incurred by him or her in any such capacity or arising out of his or her status as such, whether or not the corporation would have the power to indemnify him or her against such liabilities under Section 607.0850.

Notwithstanding the foregoing, Section 607.0850 of the FBCA provides that indemnification or advancement of expenses shall not be made to or on behalf of any director or officer if a judgment or other final adjudication establishes that his or her actions, or omissions to act, were material to the cause of action so adjudicated and constitute: (i) a violation of the criminal law, unless the director or officer had reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe his or her conduct was unlawful; (ii) a transaction from which the director or officer derived an improper personal benefit; (iii) in the case of a director, a circumstance under which the liability provisions regarding unlawful distributions are applicable; or (iv) willful misconduct or a conscious disregard for the best interests of the corporation in a proceeding by or in the right of the corporation to procure a judgment in its favor or in a proceeding by or in the right of a shareholder.

Section 607.0831 of the FBCA provides that a director of a Florida corporation, such as Dycom, is not personally liable for monetary damages to the corporation or any other person for any statement, vote,

decision, or failure to act, regarding corporate management or policy, by a director, unless: (i) the director breached or failed to perform his or her duties as a director; and (ii) the director's breach of, or failure to perform, those duties constitutes: (A) a violation of criminal law, unless the director had reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe his conduct was unlawful; (B) a transaction from which the director derived an improper personal benefit, either directly or indirectly; (C) a circumstance under which the liability provisions regarding unlawful distributions are applicable; (D) in a proceeding by or in the right of the corporation to procure a judgment in its favor or by or in the right of a shareholder, conscious disregard for the best interest of the corporation, or willful misconduct; or (E) in a proceeding by or in the right of someone other than the corporation or a shareholder, recklessness or an act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

By-laws. Dycom's by-laws provide that, except as prohibited under Florida law, it shall indemnify any person who was or is made a party to any proceeding by reason of the fact that he or she was or is a director or officer of the corporation, or a director or officer of the corporation serving as a trustee or fiduciary of an employee benefit plan of the corporation, against liability incurred in connection with such proceeding, including any appeal thereof. Dycom maintains insurance policies insuring its directors and officers against certain liabilities they may incur in their capacity as directors and officers.

Item 7. Exemption from Registration Claimed.

Not applicable.

Item 8. Exhibits

See attached Exhibit list.

Item 9. Undertakings.

(a) The undersigned Registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement to include any material information with respect to the plan of distribution not previously disclosed in this registration statement or any material change to such information in this registration statement;

(2) That, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof; and

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(b) The undersigned Registrant hereby undertakes that, for

purposes of determining any liability under the Securities Act, each filing of the Registrant's annual report pursuant to Section 13(a) or 15(d) of the Exchange Act (and, where applicable, each filing of an employee benefit plan's annual report pursuant to section 15(d) of the Exchange Act) that is incorporated by reference in this registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Commission, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-8 and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Palm Beach Gardens, State of Florida, on November 25, 2002.

DYCOM INDUSTRIES, INC.

By: /s/ Steven E. Nielsen

Name: Steven E. Nielsen
Title: President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven E. Nielsen, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for him and in his name, place and stead, in any and all capacities, to sign and file (1) any and all amendments (including

post-effective amendments) to this Registration Statement, with all exhibits thereto, and other documents in connection therewith and (2) a registration statement, and any and all amendments thereto, relating to the offering covered hereby filed pursuant to Rule 462(b) under the Securities Act, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact, agent or their substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act, this Registration Statement has been signed by the following persons in the capacities indicated.

Signature	Title	Date
/s/ Steven E. Nielsen ---------------------------- Steven E. Nielsen	Principal Executive Officer and Director	November 25, 2002
/s/ Richard L. Dunn ---------------------------- Richard L. Dunn	Principal Financial and Accounting Officer	November 25, 2002
/s/ Charles M. Brennan, III ---------------------------- Charles M. Brennan, III	Director	November 25, 2002
/s/ Kristina M. Johnson ---------------------------- Kristina M. Johnson	Director	November 25, 2002
/s/ Joseph M. Schell ---------------------------- Joseph M. Schell	Director	November 25, 2002
/s/ Tony G. Werner ---------------------------- Tony G. Werner	Director	November 25, 2002
/s/ Ronald P. Younkin ---------------------------- Ronald P. Younkin	Director	November 25, 2002

Exhibit Index

Exhibit No.	Description of Document
4.1	Articles of Incorporation (incorporated by reference to Exhibit 3.01 of the Registrant's Registration Statement on

	Form S-1 filed with the Commission on October 29, 1986, File No. 033-09820).
4.2	Articles of Amendment to the Articles of Incorporation (incorporated by reference to Exhibit 3.01 of the Registrant's Registration Statement on Form S-1 filed with the Commission on October 29, 1986, File No. 033-09820).
4.3	Articles of Amendment to the Articles of Incorporation (incorporated by reference to Exhibit 3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended April 22, 2001 filed with the Commission on June 11, 2001, File No. 001-10613).
4.4	Articles of Amendment to the Articles of Incorporation (incorporated by reference to Exhibit 3.1(i)(3) of the Registrant's Registration Statement on Form S-4 filed with the Commission on January 23, 2002, File No. 333-81268).
4.5	Amended Bylaws of the Registrant (incorporated by reference to Exhibit 3(ii) of the Registrant's Registration Statement on Form S-4 filed with the Commission on January 23, 2002, File No. 333-81268).
4.6	Description of the Registrant's Capital Stock (incorporated by reference to the Registrant's Amended Registration Statement on Form S-4 filed with the Commission on February 12, 2002, File No. 333-81268).
4.7	Shareholder Rights Agreement, dated April 4, 2001, between the Registrant and the Rights Agent which includes the Form of Rights Certificate, as Exhibit A, the Summary of Rights to Purchase Preferred Stock, as Exhibit B, and the Form of Articles of Amendment to the Articles of Incorporation for Series A Preferred Stock, as Exhibit C (incorporated by reference to Exhibit 1 of the Registrant's Form 8-A, filed with the Commission on April 6, 2001, File No. 001-10613).
4.8	2001 Directors Restricted Stock Plan (incorporated herein by reference to Exhibit A to the Registrant's Proxy Statement (No. 001-10613), filed with the Commission on October 22, 2002).
5*	Opinion and consent of Akerman, Senterfitt & Eidson, P.A., as to the legality of the securities registered hereby.
23.1*	Consent of Deloitte & Touche LLP.
23.2	Consent of Akerman, Senterfitt & Eidson, P.A. (included in Exhibit 5).
24	Power of Attorney (included on the signature pages to this Registration Statement).

* Filed herewith.

9pt">Federal Home Loan Bank stock 277,570 292,118

Premises and equipment, net	219,243	200,789
Mortgage servicing rights, net	173,288	315,678
Other assets	126,509	195,743
Total assets	$ 15,497,205	$ 15,075,430
Liabilities and Stockholders Equity		
Liabilities		
Deposits	$ 7,379,295	$ 7,979,000
Federal Home Loan Bank advances	5,407,000	4,225,000
Security repurchase agreements	990,806	1,060,097
Long term debt	207,472	207,497
Total interest-bearing liabilities	13,984,573	13,471,594
Accrued interest payable	46,302	41,288
Undisbursed payments on loans serviced for others	147,417	407,104
Escrow accounts	144,462	219,028
Liability for checks issued	21,623	23,222
Federal income taxes payable	29,674	75,271
Secondary market reserve	24,200	17,550
Payable for securities purchased	249,694	
Other liabilities	37,026	48,490
Total liabilities	14,684,971	14,303,547
Commitments and Contingencies - Note 21		
Stockholders Equity		
Common stock $0.01 par value, 150,000,000 shares authorized, 63,604,590 shares issued and outstanding at December 31, 2006; 63,208,038 shares issued and outstanding at December 31, 2005	636	632
Additional paid in capital	63,223	57,304
Accumulated other comprehensive income		

	5,182	7,834
Retained earnings	743,193	706,113
Total stockholders equity	812,234	771,883
Total liabilities and stockholders equity	$ 15,497,205	$ 15,075,430

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

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Flagstar Bancorp, Inc.
Consolidated Statements of Earnings
(In thousands, except per share data)

	For the Years Ended December 31,		
	2006	**2005**	**2004**
Interest Income			
Loans	$ 711,037	$ 688,791	$ 559,902
Mortgage-backed securities	77,607	19,019	1,459
Interest-bearing deposits	4,183		
Securities available for sale	3,041		
Other	4,998	853	2,076
Total interest income	800,866	708,663	563,437
Interest Expense			
Deposits	331,516	253,292	167,765
FHLB advances	187,756	182,377	143,914
Security repurchase agreements	52,389	7,953	
Other	14,258	18,771	28,467
Total interest expense	585,919	462,393	340,146
Net interest income	214,947	246,270	223,291
Provision for loan losses	25,450	18,876	16,077
Net interest income after provision for loan losses	189,497	227,394	207,214
Non-Interest Income			
Loan fees and charges	7,440	12,603	18,003
Deposit fees and charges	20,893	16,918	12,125
Loan administration	13,032	8,761	30,097
Net gain on loan sales	42,381	63,580	77,819
Net gain on sales of mortgage servicing rights	92,621	18,157	91,740
Net loss on securities available for sale	(6,163)		
Other fees and charges	31,957	39,429	26,337
Total non-interest income	202,161	159,448	256,121
Non-Interest Expense			
Compensation and benefits	140,438	126,139	112,512
Occupancy and equipment	70,225	69,007	64,692
Communication	4,320	4,840	6,975
Other taxes	320	7,844	12,999
General and administrative	60,334	55,057	45,827
Total non-interest expense	275,637	262,887	243,005

Earnings before federal tax provision	116,021	123,955	220,330
Provision for federal income taxes	40,819	44,090	77,592
Net Earnings	$ 75,202	$ 79,865	$ 142,738
Earnings per share			
Basic	$ 1.18	$ 1.29	$ 2.34
Diluted	$ 1.17	$ 1.25	$ 2.22

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

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Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders Equity and Comprehensive Income
(In thousands, except per share data)

	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders Equity
Balance at January 1, 2004	$ 607	$ 35,394	$ 2,173	$ 600,627	$ 638,801
Net earnings				142,738	142,738
Net realized gain on swap extinguishment			2,650		2,650
Change in net unrealized gain on swaps used in cash flow hedges			520		520
Total comprehensive income					145,908
Stock options exercised and grants issued, net	7	3,311			3,318
Tax benefit from stock-based compensation		2,049			2,049
Dividends paid ($1.00 per share)				(61,122)	(61,122)
Balance at December 31, 2004	614	40,754	5,343	682,243	728,954
Net earnings				79,865	79,865
Reclassification of gain on swap extinguishment			(1,335)		(1,335)
Change in net unrealized gain on swaps used in cash flow hedges			3,328		3,328
Change in net unrealized gain on securities available for sale			498		498
Total comprehensive income					82,356
Stock options exercised	18	7,426			7,444
Stock-based compensation		745			745
Tax benefit from stock-based compensation		8,379			8,379
Dividends paid ($0.90 per share)				(55,995)	(55,995)
Balance at December 31, 2005	632	57,304	7,834	706,113	771,883
Net earnings				75,202	75,202
Reclassification of gain on swap extinguishment			(1,167)		(1,167)
Change in net unrealized loss on swaps used in cash flow hedges			(1,874)		(1,874)
Change in net unrealized gain on securities available for sale			389		389

Total comprehensive income					72,550
Stock options exercised	4	2,201			2,205
Stock-based compensation		2,718			2,718
Tax benefit from stock-based compensation		1,000			1,000
Dividends paid ($0.60 per share)				(38,122)	(38,122)
Balance at December 31, 2006	$ 636	$ 63,223	$ 5,182	$ 743,193	$ 812,234

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

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Flagstar Bancorp, Inc.
Consolidated Statements of Cash Flows
(In thousands)

	For the Years Ended December 31,		
	2006	**2005**	**2004**
Operating Activities			
Net earnings	$ 75,202	$ 79,865	$ 142,738
Adjustments to net earnings to net cash used in operating activities			
Provision for loan losses	25,450	18,876	16,077
Depreciation and amortization	100,710	125,978	106,124
Increase in valuation allowance in mortgage servicing rights	599		
FHLB stock dividends		(5,035)	(9,909)
Stock-based compensation expense	2,718	745	
Net gain on the sale of assets	(2,328)	(1,623)	(2,608)
Net gain on loan sales	(42,381)	(63,580)	(77,819)
Net gain on sales of mortgage servicing rights	(92,621)	(18,157)	(91,740)
Net loss on securities available for sale	6,163		
Proceeds from sales of loans available for sale	16,386,194	23,445,645	29,497,773
Origination and repurchase of mortgage loans available for sale, net of principal repayments	(16,807,310)	(24,558,415)	(30,463,805)
Increase in accrued interest receivable	(4,359)	(13,352)	(7,013)
Decrease (increase) in other assets	66,348	45,379	(117,956)
Increase in accrued interest payable	5,014	13,143	7,817
Net tax benefit for stock grants issued	(1,000)		
Increase (decrease) liability for checks issued	(1,599)	4,281	(8,555)
(Decrease) increase in federal income taxes payable	(44,367)	49,696	(39,780)
Increase in payable for securities purchased	249,694		
(Decrease) increase in other liabilities	(4,814)	(16,656)	12,099
Net cash used in operating activities	(82,687)	(893,210)	(1,036,557)
Investing Activities			
Net change in other investments	(2,078)	(3,566)	(4,247)
Repayment of mortgage backed securities held to maturity	404,073	71,478	9,968
Purchase of mortgage backed securities held to maturity	(118,025)		
Purchase of investment securities available for sale	(574,999)		
Origination of portfolio loans, net of principal repayments	119,263	(666,145)	(1,476,858)
Purchase of Federal Home Loan Bank stock	(6,762)	(52,238)	(26,580)
Redemption of Federal Home Loan Bank stock	21,310		
Investment in unconsolidated subsidiary		3,095	3,102
Proceeds from the disposition of repossessed assets	52,812	39,078	42,845
Acquisitions of premises and equipment, net of proceeds	(45,493)	(51,337)	(49,112)
Decrease in mortgage servicing rights	(223,934)	(328,954)	(318,028)

Proceeds from the sale of mortgage servicing rights		388,784		124,860		405,864
Net cash provided by (used in) investing activities		14,951		(863,729)		(1,413,046)
Financing Activities						
Net (decrease) increase in deposit accounts		(599,705)		599,345		1,699,488
Net (decrease) increase in security repurchase agreements		(69,291)		1,060,097		
Issuance of junior subordinated debt				100,000		25,000
Redemption of preferred securities						(74,750)
Net increase in Federal Home Loan Bank advances		1,182,000		135,000		844,000
Payment on other long term debt		(25)		(25)		(25)
Net (disbursement) receipt of payments of loans serviced for others		(259,687)		(89,106)		20,949
Net (disbursement) receipt of escrow payments		(74,566)		24,521		2,224
Proceeds from the exercise of stock options		2,205		7,444		3,318
Net tax benefit for stock grants issued		1,000		8,379		2,049
Dividends paid to stockholders		(38,122)		(55,995)		(61,122)
Net cash provided by financing activities		143,809		1,789,660		2,461,131
Net increase in cash and cash equivalents		76,073		32,721		11,528
Beginning cash and cash equivalents		201,163		168,442		156,914
Ending cash and cash equivalents	$	277,236	$	201,163	$	168,442
Supplemental disclosure of cash flow information:						
Loans held for investment transferred to repossessed assets	$	102,446	$	47,416	$	39,692
Total interest payments made on deposits and other borrowings	$	580,905	$	449,250	$	347,964
Federal income taxes paid	$	86,953	$		$	119,500
Recharacterization of loans held for investment to mortgage-backed securities held to maturity	$	558,732	$	1,466,477	$	
Mortgage loans held for investment transferred to available for sale	$	1,329,032	$	452,949	$	
	$	354,662	$	883,119	$	2,297,091

Mortgage loans available for sale transferred to held for investment

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

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements

Note 1 Nature of Business

Flagstar Bancorp, Inc. (Flagstar or the Company), is the holding company for Flagstar Bank, FSB (the Bank), a federally chartered stock savings bank founded in 1987. With $15.5 billion in assets at December 31, 2006, Flagstar is the largest savings institution and second largest banking institution headquartered in Michigan.

The Company s principal business is obtaining funds in the form of deposits and borrowings and investing those funds in single-family mortgages and other types of loans. The acquisition or origination of single-family mortgage loans is the Company s primary lending activity. The Company also originates consumer loans, commercial real estate loans, and non-real estate commercial loans.

The Company sells or securitizes most of the mortgage loans that it originates. The Company generally retains the right to service the mortgage loans that it sells. These mortgage-servicing rights (MSRs) are occasionally sold by the Company in transactions separate from the sale of the underlying mortgages. The Company may also invest in a significant amount of its loan production in order to maximize the Company s leverage ability and to receive the interest spread between earning assets and paying liabilities. The Company also acquires funds on a wholesale basis from a variety of sources and services a significant volume of loans for others.

The Bank is a member of the Federal Home Loan Bank System (FHLB) and is subject to regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC). The Bank s deposits are insured by the FDIC through the Deposit Insurance Fund (DIF).

Note 2 Summary of Significant Accounting Policies

The following significant accounting policies of the Company, which are applied in the preparation of the accompanying consolidated financial statements, conform to accounting principles generally accepted in the United States of America (U.S. GAAP).

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries. All significant intercompany balances and transactions have been eliminated. In accordance with current accounting principles, our trust subsidiaries are not consolidated. Certain prior period amounts have been reclassified to conform to the current period presentation.

Accounting Research Bulletin 51 (ARB 51), *Consolidated Financial Statements,* requires a company s consolidated financial statements to include subsidiaries in which the company has a controlling financial interest. This requirement usually has been applied to subsidiaries in which a company has a majority voting interest. Currently, all of the Company s subsidiaries are wholly-owned.

The voting interest approach defined in ARB 51 is not applicable in identifying controlling financial interests in entities that are not controllable through voting interests or in which the equity investors do not bear the residual economic risks. In such instances, Financial Accounting Standards Board Interpretation 46 (FIN 46), *Consolidation of Variable Interest Entities* (VIE) and FIN 46R Implicit Variable Interests under FIN 46, Consolidation of Variable Interest Entities , provide guidance on when a company should include in its financial statements the assets, liabilities, and activities of another entity. In general, a VIE is a corporation, partnership, trust, or any other legal structure used

for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46R requires a VIE to be consolidated by a company if that company is subject to a majority of the risk of loss from the VIE s activities or entitles it to receive a majority of the

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entity s residual returns or both. A company that consolidates a VIE is called the primary beneficiary of that entity. The Company has no consolidated VIE s.

The Company uses special-purpose entities (SPE s), primarily securitization trusts, to diversify its funding sources. SPE s are not operating entities, generally have no employees, and usually have a limited life. The basic SPE structure involves the Bank transferring assets to the SPE. The SPE funds the purchase of those assets by issuing asset-backed securities to investors. The legal documents governing the SPE describe how the cash received on the assets held in the SPE must be allocated to the investors and other parties that have rights to these cash flows.

The Bank structures these SPEs to be bankruptcy remote, thereby insulating investors from the impact of the creditors of other entities, including the transferor of the assets.

Where the Bank is a transferor of assets to an SPE, the assets sold to the SPE generally are no longer recorded on the statement of financial condition and the SPE is not consolidated when the SPE is a qualifying special-purpose entity (QSPE). Statement of Financial Accounting Standards (SFAS) 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* provides specific criteria for determining when an SPE meets the definition of a QSPE. In determining whether to consolidate non-qualifying SPEs where assets are legally isolated from the Bank s creditors, the Company considers such factors as the amount of third-party equity, the retention of risks and rewards, and the extent of control available to third parties. The Bank currently services certain home equity loans and lines that were sold to securitization trusts.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Cash and Cash Equivalents

Cash on hand, cash items in the process of collection, and amounts due from correspondent banks and the Federal Reserve Bank are included in cash and cash equivalents and overnight deposits.

Securities

Investments in debt securities and certain equity securities with readily determinable fair values are accounted for under SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS 115 requires investments to be classified within one of three categories, trading, held to maturity or available for sale based on the type of security and management s intent with regards to selling the security.

Certain mortgage-backed securities are classified as held to maturity because management has the positive intent and ability to hold these securities to maturity. Securities held to maturity are carried at amortized cost. Unrealized losses that are deemed to be other-than-temporary are reported in the consolidated statement of earnings.

Securities available for sale are carried at fair value with unrealized gains and unrealized losses deemed to be temporary being reported in other comprehensive income, net of tax. Any gains or losses realized upon the sale of a

security or unrealized losses that are deemed to be other-than-temporary are reported in the consolidated statement of earnings. The securities available for sale represent certain mortgage-backed securities and the non-investment grade residual interests in the Company s private securitizations.

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Other investments, which include certain investments in mutual funds that by their nature cannot be held to maturity, are carried at fair value. Increases or decreases in fair value are recorded in earnings.

Interest on securities, including the amortization of premiums and the accretion of discounts using the effective interest method over the period of maturity, is included in interest income. Realized gains and losses on the sale of securities and other-than-temporary impairment charges on securities are determined using the specific-identification method.

Loans

Loans are designated as held for investment or available for sale or securitization during the origination process. Loans held for investment are carried at amortized cost. The Company has both the intent and the ability to hold all loans held for investment for the foreseeable future. Loans available for sale are carried at the lower of aggregate cost or estimated market value. Loans are stated net of deferred loan origination fees or costs. Interest income on loans is recognized on the accrual basis based on the principal balance outstanding. Loan origination fees and certain direct origination costs associated with loans are deferred and amortized over the expected life of the loans as an adjustment to the yield using the interest method. Net unrealized losses on loans available for sale are recognized in a valuation allowance that is charged to earnings. Gains or losses recognized upon the sale of loans are determined using the specific identification method.

Delinquent Loans

Loans are placed on non-accrual status when any portion of principal or interest is 90 days delinquent, or earlier when concerns exist as to the ultimate collection of principal or interest. When a loan is placed on non-accrual status, the accrued and unpaid interest is reversed and interest income is recorded as collected. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Loan Sales and Securitizations

Our recognition of gain or loss on the sale or securitization of loans is accounted for in accordance with SFAS 140. SFAS 140 requires that a transfer of financial assets in which we surrender control over the assets be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The carrying value of the assets sold is allocated between the assets sold and the retained interests based on their relative fair values.

SFAS 140 requires, for certain transactions, a true sale analysis of the treatment of the transfer under state law if the company was a debtor under the bankruptcy code. The true sale analysis includes several legal factors including the nature and level of recourse to the transferor and the nature of retained servicing rights. The true sale analysis is not absolute and unconditional but rather contains provisions that make the transferor bankruptcy remote . Once the legal isolation of financial assets has been met and is satisfied under SFAS 140, other factors concerning the nature of the extent of the transferor s control over the transferred financial assets are taken into account in order to determine if the de-recognition of financial assets is warranted, including whether the special purpose entity (SPE) has complied with rules concerning qualifying special purpose entities.

The Bank is not eligible to become a debtor under the bankruptcy code. Instead, the insolvency of the Bank is generally governed by the relevant provisions of the Federal Deposit Insurance Act and the FDIC s regulations. However, the true sale legal analysis with respect to the Bank is similar to the true sale analysis that would be done if the Bank were subject to the bankruptcy code.

The Bank obtains a legal opinion regarding the legal isolation of the transferred financial assets as part of the securitization process. The true sale opinion provides reasonable assurance that the transferred assets would not be characterized as property of the transferor in the event of insolvency and also states the

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transferor would not be required to substantively consolidate the assets and liabilities of the purchaser SPE with those of the transferor upon such event.

The securitization process involves the sale of loans to our wholly-owned bankruptcy remote special purpose entity which then sells the loans to a separate, transaction-specific trust in exchange for considerations generated by the sale of the securities issued by the securitization trust. The securitization trust issues and sells debt securities to third party investors that are secured by payments on the loans. We have no obligation to provide credit support to either the third party investors or the securitization trust. Neither the third party investors nor the securitization trust generally have recourse to our assets or us and have no ability to require us to repurchase their securities other than through enforcement of the standard representations and warranties. We do make certain representations and warranties concerning the loans, such as lien status, and if we are found to have breached a representation and warranty, we may be required to repurchase the loan from the securitization trust. We do not guarantee any securities issued by the securitization trust. The securitization trust represents a qualifying special purpose entity , which meets the certain criteria of SFAS 140, and therefore is not consolidated for financial reporting purposes.

In addition to the cash we receive from the sale or securitization of loans, we retain certain interests in the securitized assets. The retained interests include mortgage servicing rights (MSR s), residual interest and an over collateralization account. The residuals are included in securities available for sale on the consolidated statement of financial condition.

We retain the servicing function for securitized loans. As a servicer, we are entitled to receive a servicing fee equal to a specified percentage of the outstanding principal balance of the loans. We may also be entitled to receive additional servicing compensation, such as late payment fees.

Transaction costs associated with the securitization process are recognized as a component of the gain or loss at the time of sale.

Allowance for Loan Losses

The allowance for loan losses represents management s estimate of probable losses inherent in the Company s loans held for investment portfolio as of the date of the consolidated financial statements. The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be inherent in the loan portfolio but that have not been specifically identified.

The Company performs a detailed credit quality review annually on large commercial loans as well as selected other smaller balance commercial loans and may allocate a specific portion of the allowance to such loans based upon this review. Commercial and commercial real estate loans that are determined to be substandard and exceed $1.0 million are treated as impaired and given an individual evaluation to determine the necessity of a specific reserve in accordance with the provisions of SFAS 114, *Accounting by Creditors for Impairment of a Loan*. This pronouncement requires an allowance to be established as a component of the allowance for loan losses when it is probable that all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of the expected future cash flows discounted at the loan s effective interest rate, the observable market price of the loan, or the fair value of the collateral if the loan is collateral dependent, reduced by estimated disposal costs. In estimating the fair value of collateral, we typically utilize outside fee-based appraisers to evaluate various factors such as occupancy and rental rates in our real estate markets and the level of obsolescence that may exist on assets acquired from commercial business loans.

A portion of the allowance is allocated to the remaining commercial loans by applying projected loss ratios, based on numerous factors identified below, to the loans within the different risk ratings.

Additionally, management has sub-divided the homogeneous portfolios, including consumer and residential mortgage loans, into categories that have exhibited greater loss exposure (such as sub-prime loans and

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loans that are not salable on the secondary market because of collateral or documentation issues). The portion of the allowance allocated to other consumer and residential mortgage loans is determined by applying projected loss ratios to various segments of the loan portfolio. Projected loss ratios incorporate factors such as recent charge-off experience, current economic conditions and trends, and trends with respect to past due and nonaccrual amounts, and are supported by underlying analysis.

Management maintains an unallocated allowance to recognize the uncertainty and imprecision underlying the process of estimating expected loan losses.

As the process for determining the adequacy of the allowance requires subjective and complex judgment by management about the effect of matters that are inherently uncertain, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses. In estimating the amount of credit losses inherent in the Company s loan portfolio, various assumptions are made. For example, when assessing the condition of the overall economic environment, assumptions are made regarding current economic trends and their impact on the loan portfolio. In the event the national economy were to sustain a prolonged downturn, the loss factors applied to our portfolios may need to be revised, which may significantly impact the measurement of the allowance for loan losses. For impaired loans that are collateral dependent, the estimated fair value of the collateral may deviate significantly from the proceeds received when the collateral is sold.

Repossessed Assets

Repossessed assets include one-to-four family residential property, commercial property, and one-to-four family homes under construction that were acquired through foreclosure. Repossessed assets are initially recorded at estimated fair value, less estimated selling costs. Subsequently, properties are evaluated and any additional declines in value are recorded in current period earnings. The amount the Company ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Company s control.

Federal Home Loan Bank Stock

The Bank owns stock in the Federal Home Loan Bank (FHLB). No ready market exists for the stock and it has no quoted market value. The stock is redeemable at par and is carried at cost. The investment is required to permit the Bank to borrow from the Federal Home Loan Bank of Indianapolis (FHLBI).

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Land is carried at historical cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets as follows:

Office buildings 31.5 years
Computer hardware and software 3 to 5 years
Furniture, fixtures and equipment 5 to 7 years
Automobiles 3 years

Repairs and maintenance costs are expensed in the period they are incurred, unless they are covered by a maintenance contract, which is expensed equally over the stated term of the contract. Repairs and maintenance costs are included as

part of occupancy and equipment expenses.

Mortgage Servicing Rights

In March 2006, FASB issued SFAS 156*, Accounting for Servicing of Financial Assets an amendment of FASB Statement 140*. SFAS 156 requires an entity to recognize a servicing asset or liability each time it

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undertakes an obligation to service a financial asset by entering into a servicing contract. It requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value and permits an entity to choose either an amortization or fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. It also permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights. Lastly, it requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value and additional disclosures for all separately recognized servicing assets and servicing liabilities. Effective January 1, 2006, the Company adopted SFAS 156, as permitted. Adoption of this pronouncement allowed the Company to initially recognize its MSRs at fair value. The Company elected to retain the amortization method for subsequently accounting for the MSRs. There was no material effect on the Company s consolidated financial statements from the adoption of this pronouncement.

The Company purchases and originates mortgage loans for sale to the secondary market and sells the loans on either a servicing-retained or servicing-released basis. MSRs are recognized as assets at the time a loan is sold on a servicing-retained basis. The capitalized cost of retained MSRs is amortized in proportion to, and over the period of, estimated net future servicing revenue. The expected period of the estimated net servicing income is based, in part, on the expected prepayment period of the underlying mortgages.

MSRs are periodically evaluated for impairment. For purposes of measuring impairment, MSRs are stratified based on predominant risk characteristics of the underlying serviced loans. These risk characteristics include loan type (fixed or adjustable rate), term (15 year, 20 year, 30 year or balloon) and interest rate. Impairment represents the excess of amortized cost of an individual stratum over its estimated fair value, and is recognized through a valuation allowance.

Fair values for individual stratum are based on the present value of estimated future cash flows using a discount rate commensurate with the risks involved. Estimates of fair value include assumptions about prepayment, default and interest rates, and other factors, which are subject to change over time. Changes in these underlying assumptions could cause the fair value of MSRs, and the related valuation allowance, to change significantly in the future.

The Company occasionally sells a certain portion of its MSRs to investors. At the time of the sale the Company records a gain or loss on such sale based on the selling price of the MSRs less the carrying value and transaction costs. The MSRs are sold in separate transactions from the sale of the underlying loans.

Financial Instruments and Derivatives

In seeking to protect its financial assets and liabilities from the effects of changes in market interest rates, the Company has devised and implemented an asset/liability management strategy that seeks, on an economic and accounting basis, to mitigate significant fluctuations in our financial position and results of operations. Loans held for investment generate interest income and MSRs generate fee income. With regard to the pipeline of mortgage loans held for sale, in general, the Company hedges these assets with forward commitments to sell Fannie Mae or Freddie Mac securities with comparable maturities and weighted- average interest rates. Further, the Company occasionally enters into swap agreements to hedge the cash flows on certain liabilities.

SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended and interpreted, requires that we recognize all derivative instruments on the statement of financial condition at fair value. If certain conditions are met, special hedge accounting may be applied and the derivative instrument may be specifically designated as:

(a) a hedge of the exposure to changes in the fair value of a recognized asset, liability or unrecognized firm commitment, referred to as a fair value hedge, or

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(b) a hedge of the exposure to the variability of cash flows of a recognized asset, liability or forecasted transaction, referred to as a cash flow hedge.

In the case of a qualifying fair value hedge, changes in the value of the derivative instruments that are highly effective (as defined in SFAS 133) are recognized in current earnings along with the changes in value of the designated hedged item. In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that are highly effective are recognized in accumulated other comprehensive income (OCI), until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value is recognized through earnings. Upon the occasional termination of a cash flow hedge, the remaining cost of the hedge is amortized over the remaining life of the hedged item in proportion to the change in the hedged forecasted transaction. We have derivatives in place to hedge the exposure to the variability in future cash flows for forecasted transactions. Derivatives that are non-designated hedges, as defined in SFAS 133 are adjusted to fair value through earnings. We formally document all qualifying hedge relationships, as well as our risk management objective and strategy for undertaking each hedge transaction. We are not a party to any foreign currency hedge relationships. During the fourth quarter of 2005, we derecognized all fair value hedges and have no fair value hedges outstanding at either December 31, 2006 or 2005.

Security Repurchase Agreements

Securities sold under agreements to repurchase are generally accounted for as collateralized financing transactions and are recorded at the amounts at which the securities were sold plus accrued interest. Securities, generally mortgage-backed securities, are pledged as collateral under these financing arrangements. The fair value of collateral provided to a party is continually monitored and additional collateral is obtained or requested to be returned, as appropriate.

Trust Preferred Securities

As of December 31, 2006, the Company sponsored seven trusts, of which 100% of the common equity is owned by the Company. Each of the trusts has issued trust preferred securities to third party investors and loaned the proceeds to the Company in the form of junior subordinated notes, which are included in long term debt in these consolidated financial statements. The notes held by each trust are the sole assets of that trust. Distributions on the trust preferred securities of each trust are payable quarterly at a rate equal to the interest being earned by the trust on the notes held by these trusts.

The trust preferred securities are subject to mandatory redemption upon repayment of the notes. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the trust preferred securities subject to the terms of each of the guarantees. The securities are not subject to a sinking fund requirement and are not convertible into any other securities of the Company.

The trusts are VIEs under U.S. GAAP (i.e., FIN 46R) and are not consolidated. The Company s investment in the common stock of these trusts is included in other assets in the Company s consolidated statement of financial condition. The trust preferred securities held by the trusts qualify as Tier 1 capital under current banking regulations.

Income Taxes

The Company accounts for income taxes on the asset and liability method. Deferred tax assets and liabilities are recorded based on the difference between the tax bases of assets and liabilities and their carrying amounts for financial

reporting purposes. Current taxes are measured by applying the provisions of enacted tax laws to taxable income to determine the amount of taxes receivable or payable. The Company files a consolidated federal income tax return on a calendar year basis.

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Secondary Market Reserve

We sell most of the residential mortgage loans that we originate into the secondary mortgage market. When we sell mortgage loans we make customary representations and warranties to the purchasers about various characteristics of each loan, such as the manner of origination, the nature and extent of underwriting standards applied and the types of documentation being provided. If a defect in the origination process is identified, we may be required to either repurchase the loan or indemnify the purchaser for losses it sustains on the loan. If there are no such defects, we have no liability to the purchaser for losses it may incur on such loan. We maintain a secondary market reserve to account for the expected losses related to loans we might be required to repurchase (or the indemnity payments we may have to make to purchasers). The secondary market reserve takes into account both our estimate of expected losses on loans sold during the current accounting period, as well as adjustments to our previous estimates of expected losses on loans sold. In each case these estimates are based on our most recent data regarding loan repurchases, actual credit losses on repurchased loans and recovery history, among other factors. Increases to the secondary market reserve for current loan sales reduce our net gain on loan sales. Adjustments to our previous estimates are recorded as an increase or decrease in our other fees and charges.

Advertising Costs

Advertising costs are expensed in the period they are incurred and are included as part of general and administrative expenses. Advertising expenses totaled $9.4 million, $7.5 million, and $10.2 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Stock-Based Compensation

On January 1, 2006, the Company adopted SFAS 123R, *Accounting for Stock-Based Compensation* (SFAS 123R). SFAS 123R requires all share-based payment to employees, including grants of employee stock options, to be recognized as expense in the statement of earnings based on their fair values. Prior to SFAS 123R, only certain pro forma disclosures of fair value were required. The amount of compensation is measured at the fair value of the options when granted and this cost is expensed over the required service period, which is normally the vesting period of the options. SFAS 123R applies to awards granted or modified after January 1, 2006 or any unvested awards outstanding at December 31, 2005. The effect of the adoption of the new accounting principle on results of operations depends on the level of option grants, the vesting period for those grants, and the fair value of the options granted at such date. Existing options that vested after the adoption date resulted in additional compensation expense of approximately $1.2 million in 2006. The Company utilized the disclosure requirements permitted by SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123), for transactions entered into during 1996 and thereafter. For the periods prior to January 1, 2006, the Company elected to remain with the former method of accounting under *Accounting Principles Board Opinion 25* (APB 25) and has made the pro forma disclosures in Note 30 of net earnings and earnings per share as if the fair value method provided for in SFAS 123 had been adopted.

At December 31, 2006, the Company has a stock-based employee compensation plan, which is described more fully in Note 30.

Recently Issued Accounting Standards

In February 2006, the FASB issued SFAS 155 *Accounting for Certain Hybrid Financial Instruments*. SFAS 155 amends SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS 155 permits the fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation. Further, it clarifies which interest-only strips and principal-only strips are not subject to SFAS 133 requirements. It also establishes a requirement to evaluate interests in securitized

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financial assets to identify interest in freestanding derivatives and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. Last, it eliminates the prohibition on a qualifying special purpose entity from holding a derivative financial instrument pertaining to a beneficial interest other than another derivative financial instrument. The Company will be required to adopt this standard in 2007. The adoption of SFAS 155 is not expected to have a material impact on the Company s financial condition, results of operations or liquidity.

In June 2006, the FASB issued FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109,* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with SFAS 109, *Accounting for Income Taxes.* This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is required to be adopted by the Company on January 1, 2007. Management does not expect that the impact of this Interpretation will be material to the Company s financial condition, results of operation or liquidity.

In September 2006, the FASB issued SFAS 157 *Fair Value Measurements.* SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. SFAS 157 clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. SFAS 157 emphasizes that fair value is a market-based measurement and not an entity-specific measurement. It also establishes a fair value hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value. The Company will be required to adopt this statement beginning in 2008. The adoption of this standard is not expected to have a material impact on the Company s financial condition, results of operation or liquidity.

In September 2006, the FASB issued SFAS 158 *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans.* SFAS 158 amends SFAS Statements 87, 88, 106 and 132®. SFAS 158 requires employers to recognize in their statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status. Secondly, it requires employers to measure the plans assets and obligations that determine its funded status as of the end of the fiscal year. Lastly, employers are required to recognize changes in the funded status of a defined benefit postretirement plan in the year that the changes occur with the changes reported in comprehensive income. SFAS 158 is required to be adopted by entities having fiscal years ending after December 15, 2006. Because the Company does not have any defined benefit plans or other post retirement plans this standard is not expected to have an impact on the Company s financial condition, results of operation or liquidity.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 108 (SAB 108). SAB 108 expresses the views of the SEC regarding the process of quantifying financial statement misstatements to determine if any restatement of prior financial statements is required. SAB 108 addresses the two techniques commonly used in practice in accumulating and quantifying misstatements, and requires that the technique with the most severe result be used in determining whether a misstatement is material. SAB 108 was adopted by the Company on December 31, 2006. The adoption of SAB 108 did not have a material impact on the Company s financial condition, results of operation or liquidity.

In February 2007, the FASB issued SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities* . SFAS 159 permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The decision to elect the fair value option may be applied instrument by instrument, is irrevocable and is applied to the entire instrument and not to only specified risks, specific

cash flows or portions of that instrument. An entity is restricted in choosing the dates to elect the fair value option for an eligible item. Adoption of SFAS 159 is effective for the

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Company on January 1, 2008. Early adoption is permitted, provided the entity also elects to apply the provisions of SFAS 157 *Fair Value Measurements* . Management of the Company is currently evaluating the potential impact of SFAS 159 on the Company s financial condition, results of operation or liquidity.

Note 3 Fourth Quarter Event

In the fourth quarter of 2006, the Company recorded an $8.7 million charge, before taxes, as a result of a federal judge s dismissal of the Company s lawsuit against an insurance company in a fidelity bond coverage dispute. In March 2004, the Company discovered that a series of warehouse loans it made totaling $22.4 million to two related borrowers were fraudulently obtained. Upon discovery of the fraud and through subsequent collections activities, the Company seized cash and real property with an estimated value of $12.7 million. The cash, real property and other assets are the subject of competing claims from another mortgage company that was also defrauded and from the United States Government through a forfeiture action. The Company had filed a fidelity bond claim that we maintain would cover losses from fraud.

In 2004, the Company reclassified the loans to other assets. The Company believed, in conjunction with external counsel, that the portion of the receivable that would not have been liquidated with the cash and real properties that were held in escrow would be collected through the fidelity bond claim and no loss was probable. Upon dismissal of the lawsuit, the Company believed it appropriate to write off the portion of the receivable related to the fidelity bond coverage. The charge was recorded to general and administrative expense.

Note 4 Mortgage-Backed Securities Held to Maturity

The following table summarizes the amortized cost and estimated fair value of mortgage-backed securities classified as held to maturity (in thousands):

	December 31,	
	2006	2005
Amortized cost	$ 1,565,420	$ 1,414,986
Gross unrealized holding gains	17,382	
Gross unrealized holding losses	(4,420)	(4,346)
Estimated fair value	$ 1,578,382	$ 1,410,640

The mortgage-backed securities have contractual maturities ranging from 2007 through 2036. Actual maturities will differ from contractual maturities because the underlying mortgages may be prepaid without penalties.

At December 31, 2006 and 2005, no securities had been in a continuous unrealized loss position for more than a twelve month period.

At December 31, 2006 and 2005, $1.0 billion and $1.2 billion of these mortgage-backed securities were pledged as collateral for interest rate swaps and security repurchase agreements.

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Note 5 Securities Available for Sale

Securities available for sale were comprised of the following (in thousands):

	December 31, 2006	December 31, 2005
AAA-rated non-agency securities	$ 497,089	$
AAA-rated agency securities	77,910	
Non-investment grade residual securities	42,451	26,148
Total Securities available for sale	$ 617,450	$ 26,148

Contractual maturities of the securities generally range from 2035 to 2037. Expected weighted average lives of these securities generally range from several months to six years due to borrower prepayments occurring prior to the contractual maturity.

The following table summarizes the amortized cost and estimated fair value of securities classified as available for sale (in thousands):

	December 31, 2006	December 31, 2005
Amortized cost	$ 615,878	$ 25,381
Gross unrealized holding gains	1,572	767
Gross unrealized holding losses		
Estimated fair value	$ 617,450	$ 26,148

At December 31, 2006 and 2005, no securities had been in a continuous unrealized loss position during the year.

As a result of our periodic reviews for impairment in accordance with EITF 99-20, *Recognition of Interest Income and Impairment on Certain Investments* (EITF 99-20), during the year ended December 31, 2006 the Company recorded $6.1 million in impairment charges on residual securities.

The fair value of residual securities is determined by discounting estimated net future cash flows using discount rates that approximate current market rates and expected prepayment rates. Estimated net future cash flows include assumptions related to expected credit losses on these securities. The Company maintains a model that evaluates the default rate and severity of loss on the residual securities collateral, considering such factors as loss experience, delinquencies, loan-to-value ratio, borrower credit scores and property type.

The fair value of all other non-agency and agency mortgage-backed securities is estimated based on market information.

Note 6 Other Investments

Other investments are summarized as follows (in thousands):

	December 31,			
	2006		2005	
Type	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Mutual Funds	$ 23,320	$ 23,320	$ 21,328	$ 21,328
U.S. Treasury Bonds	715	715	629	629
Total	$ 24,035	$ 24,035	$ 21,957	$ 21,957

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The Company has invested in these securities because of interim investment strategies in trust subsidiaries, collateral requirements required in swap and deposit transactions, and Community Reinvestment Act investment requirements. U.S. Treasury bonds in the amount of $517,000 and $529,000 are pledged as collateral in association with the issuance of certain trust preferred securities at December 31, 2006 and 2005, respectively.

Note 7 Loans Available for Sale

The following table summarizes loans available for sale (in thousands):

	December 31,	
	2006	2005
Mortgage loans	$ 3,146,943	$ 1,658,175
Consumer loans	41,050	114,772
Second mortgage loans	802	447
Total	$ 3,188,795	$ 1,773,394

These loans had a fair value that approximates their recorded amount for each year presented. The majority of these loans were originated or acquired in the fourth quarter of the respective year.

Note 8 Loans Held for Investment

Loans held for investment are summarized as follows (in thousands):

	December 31,	
	2006	2005
Mortgage loans	$ 6,211,765	$ 8,248,897
Second mortgage loans	715,154	700,492
Commercial real estate loans	1,301,819	995,411
Construction loans	64,528	65,646
Warehouse lending	291,656	146,694
Consumer loans	340,157	410,920
Commercial loans	14,606	8,411
Total	8,939,685	10,576,471

Less allowance for loan losses	(45,779)	(39,140)
Total	$ 8,893,906	$ 10,537,331

Activity in the allowance for loan losses is summarized as follows (in thousands):

	For the Years Ended December 31,		
	2006	**2005**	**2004**
Balance, beginning of period	$ 39,140	$ 38,318	$ 37,828
Provision charged to earnings	25,450	18,876	16,077
Charge-offs, net of recoveries	(18,811)	(18,054)	(15,587)
Balance, end of period	$ 45,779	$ 39,140	$ 38,318

Loans on which interest accruals have been discontinued totaled approximately $57.1 million at December 31, 2006 and $64.5 million at December 31, 2005. Interest on these loans is recognized as income when collected. Interest that would have been accrued on such loans totaled approximately $3.8 million,

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$4.1 million, and $3.7 million during 2006, 2005, and 2004, respectively. There are no loans greater than 90 days past due still accruing interest at December 31, 2006 and 2005.

A loan is impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement.

Impaired loans are as follows (in thousands):

	December 31,		
	2006	2005	2004
Impaired loans with no allowance for loan losses allocated	$ 15,228	$ 27,876	$ 5,811
Impaired loans with allowance for loan losses allocated	10,934	6,556	708
Total impaired loans	$ 26,162	$ 34,432	$ 6,519
Amount of the allowance allocated to impaired loans	$ 1,119	$ 1,618	$ 691
Average investment in impaired loans	28,469	27,048	5,903
Cash-basis interest income recognized during impairment	1,792	2,099	

No additional funds are committed to be advanced in connection with impaired loans. Those impaired loans not requiring an allowance represent loans for which the fair value of the collateral exceeded the recorded investments in such loans. At December 31, 2006, substantially all of the total impaired loans were evaluated based on fair value of related collateral.

Note 9 Securitization Activity

The Company recorded $26.1 million in residual interests as of December 31, 2005, as a result of its non-agency securitization of $600 million in home equity line of credit loans (the HELOC Securitization). In addition, each month draws on the home equity lines of credit in the trust established in the HELOC Securitization are purchased from the Company by the trust, resulting in additional residual interests to the Company. These residual interests are recorded as securities available for sale and are therefore recorded at fair value. Any gains or losses realized on the sale of such securities or any unrealized losses that are deemed to be other-than-temporarily impaired (OTTI) are reported in the consolidated statement of earnings. All unrealized gains or losses that are deemed to be temporary are reported in the consolidated statement of stockholders equity and comprehensive income under accumulated other comprehensive income.

On April 28, 2006, the Company completed a guaranteed mortgage securitization transaction of approximately $400 million of fixed second mortgage loans that the Company held at the time in its investment portfolio (the Second Mortgage Securitization). The transaction was treated as a recharacterization of loans held for investment to mortgage-backed securities held to maturity and, therefore, no gain on sale was recorded. The securitization resulted

in the Company recording a residual interest of approximately $9.9 million that is carried as a security available for sale.

On December 31, 2006, the Company recorded $11.2 million in residual interests as a result of its non-agency securitization of $302 million in home revolving equity line of credit loans (the HELOC Revolving Securitization). In addition, each month draws on the revolving home equity lines of credit in the trust established in the HELOC Revolving Securitization are purchased from the Company by the trust, resulting in additional residual interests to the Company. These residual interests are recorded as securities available for sale and are therefore recorded at fair value. Any gains or losses realized on the sale of such securities or any unrealized losses that are deemed to be OTTI are reported in the consolidated statement of earnings. All unrealized gains or losses that are deemed to be temporary are reported in the consolidated statement of stockholders equity and comprehensive income under accumulated other comprehensive income.

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At December 31 2006, key assumptions used in determining the value of residual interests resulting from the securitizations were as follows:

	Prepayment Speed	Projected Credit Losses	Annual Discount Rate
Home Equity:			
Flagstar Home Equity Loan Trust 2005-1	42%	1.25%	15%
Flagstar GMS Trust 2006-1	25%	1.50%	15%
Flagstar Home Equity Loan Trust 2006-2	42%	1.25%	15%

Certain cash flows received from the securitization trusts were as follows (in thousands):

	For the Years Ended December 31,	
	2006	2005
Proceeds from new securitizations	$ 302,182	$ 600,000
Proceeds from collections reinvested in securitizations	73,122	
Servicing fees received	2,259	
Loan repurchases for representations and warranties	(752)	

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The tables below set forth key economic assumptions and the hypothetical sensitivity of the fair value of residual interests to an immediate adverse change in any single key assumption. Changes in fair value based on 10% and 20% variations in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. The effect of a variation in a particular assumption on the fair value of the residual interest is calculated without changing any other assumptions. In practice, changes in one factor may result in changes in other factors, such as increases in market interest rates that may magnify or counteract sensitivities.

	Fair Value	Prepayment Speed	Projected Credit Losses	Discount Rate
		(Dollars in thousands)		
HELOC Securitization				
Residual asset as of December 31, 2006	$ 20,745	42%	1.25%	15%
Impact on fair value of 10% adverse change in assumption		$ 928	$ 574	$ 510
Impact on fair value of 20% adverse change in assumption		1,717	1,148	1,002
Servicing asset as of December 31, 2006	$ 1,705	42%	1.25%	15%
Impact on fair value of 10% adverse change of assumptions		$ 201		$ 20
Impact on fair value of 20% adverse change of assumptions		378		40
Second Mortgage Securitization				
Residual asset as of December 31, 2006	$ 10,522	25%	1.50%	15%
Impact on fair value of 10% adverse change in assumption		$ 78	$ 415	$ 542
Impact on fair value of 20% adverse change in assumption		158	828	1,047
Servicing asset as of December 31, 2006	$ 3,485	25%	1.50%	15%
Impact on fair value of 10% adverse change of assumptions		$ 213		$ 58
Impact on fair value of 20% adverse change of assumptions		420		112
HELOC Revolving				
Residual asset as of December 31, 2006	$ 11,184	42%	1.25%	15%
Impact on fair value of 10% adverse change of assumptions		$ 1,038	$ 184	$ 344
Impact on fair value of 20% adverse change of assumptions		1,932	369	674

Servicing asset as of December 31, 2006	$ 1,656	42%	1.25%	14%
Impact on fair value of 10% adverse change of assumptions		$ 164		$ 26
Impact on fair value of 20% adverse change of assumptions		305		52

Note 10 FHLB Stock

The Company s investment in FHLB stock totaled $277.6 million and $292.1 million at December 31, 2006 and 2005, respectively. As a member of the FHLB, the Company is required to hold shares of FHLB stock in an amount at least equal to 1% of the aggregate unpaid principal balance of its mortgage loans, home purchase contracts and similar obligations at the beginning of each year, or 1/20th of its FHLB advances, whichever is greater. Dividends received on the stock equaled $13.7 million, $10.7 million, and $9.9 million for the years ended December 31, 2006, 2005 and 2004, respectively. These dividends were recorded in the consolidated statement of earnings as other fees and charges.

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Note 11 Repossessed Assets

Repossessed assets include the following (in thousands):

	December 31,	
	2006	2005
One-to-four family properties	$ 74,548	$ 40,687
Commercial properties	6,447	7,037
Repossessed assets	$ 80,995	$ 47,724

Note 12 Premises and Equipment

Premises and equipment balances are as follows (in thousands):

	December 31,	
	2006	2005
Land	$ 70,437	$ 56,646
Office buildings	135,186	120,406
Computer hardware and software	130,574	123,598
Furniture, fixtures and equipment	72,173	61,314
Automobiles	285	294
Total	408,655	362,258
Less accumulated depreciation	(189,412)	(161,469)
	$ 219,243	$ 200,789

Depreciation expense amounted to approximately $26.9 million, $30.7 million, and $30.1 million, for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company conducts a portion of its business from leased facilities. Such leases are considered to be operating leases based on their lease terms. Lease rental expense totaled approximately $8.7 million, $9.8 million, and $9.9 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The following outlines the Company s minimum contractual lease obligations as of December 31, 2006 (in thousands):

2007	$ 5,911
2008	4,242
2009	3,058
2010	2,367
2011	1,097
Thereafter	1,983
Total	$ 18,658

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Note 13 Mortgage Servicing Rights

Mortgage loans serviced for others are not included in the accompanying consolidated financial statements. The unpaid principal balances of these loans are summarized as follows (in thousands):

	December 31,	
	2006	2005
Mortgage loans serviced for:		
FHLMC and FNMA	$ 12,566,869	$ 27,941,451
FHLBI	272,273	303,807
GNMA	1,224,010	821,947
Flagstar Trusts	968,423	579,752
Other investors	928	1,131
Total	$ 15,032,503	$ 29,648,088

Not included in the above totals are $229.4 million and $5.0 billion of mortgage loans at December 31, 2006 and December 31, 2005, respectively, that are being serviced on a temporary basis in connection with the sale of mortgage servicing rights.

Mortgage loans serviced for others were geographically disbursed throughout the United States. As of December 31, 2006, approximately 21.2% of these properties are located in Michigan (measured by principal balance), and another 27.4% were located in the states of Texas (10.1%), Florida (10.0%), California (7.3%) and Washington (4.4%). No other state contains more than 4% of the properties collateralizing these serviced loans.

Custodial accounts maintained in connection with the above mortgage servicing rights (including the above mentioned subservicing) were approximately $237.0 million and $537.7 million at December 31, 2006 and December 31, 2005 respectively. These amounts include payments for principal, interest, taxes, and insurance collected on behalf of the individual investor.

The following is an analysis of the changes in the recorded value of the Company s mortgage servicing rights (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Balance, beginning of period	$ 315,678	$ 187,975	$ 260,128
Capitalization	223,934	328,954	318,028
Sales	(296,163)	(106,703)	(314,124)
Amortization	(69,562)	(94,548)	(76,057)

Valuation allowance	(599)		
Balance, end of period	$ 173,288	$ 315,678	$ 187,975

At December 31, 2006 and 2005, the estimated fair value of the mortgage loan-servicing portfolio was $197.6 million and $421.1 million, respectively. At December 31, 2006, the fair value of each MSR was based upon the following weighted-average assumptions: (1) a discount rate of 10.3%; (2) an anticipated loan prepayment rate of 28.5% (i.e. CPR); and (3) servicing costs per conventional loan of $42 and $45 for each government or adjustable-rate loan.

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Changes in the valuation allowance for impairment of MSRs are as follows (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Balance, beginning of period	$	$	$
Provision for valuation	599		
Permanent impairment			
Balance, end of period	$ 599	$	$

Note 14 Deposit Accounts

The deposit accounts are as follows (in thousands):

	December 31,	
	2006	2005
Demand accounts	$ 380,162	$ 374,816
Savings accounts	144,460	239,215
Money market demand accounts	608,282	781,087
Certificates of deposit	3,763,781	3,450,450
Total retail deposits	4,896,685	4,845,568
Municipal deposits	1,419,964	1,353,633
National accounts	1,062,646	1,779,799
Total deposits	$ 7,379,295	$ 7,979,000

At December 31, 2006, municipal deposits included $1.3 billion of certificates of deposit with maturities typically less than one year and $87.3 million in checking and savings accounts. At December 31, 2005, municipal deposits included $1.3 billion of certificates of deposit and $70.7 million in checking and savings accounts.

Non-interest-bearing deposits included in the demand accounts and money market demand accounts balances at December 31, 2006 and 2005, were approximately $0.9 billion and $1.1 billion, respectively.

The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was approximately $2.6 billion and $2.4 billion at December 31, 2006 and 2005, respectively. The following table indicates the scheduled maturities for certificates of deposit with a minimum denomination of $100,000 (in thousands):

	December 31,	
	2006	**2005**
Three months or less	$ 1,268,286	$ 1,222,304
Over three months to six months	601,625	406,848
Over six months to twelve months	429,199	422,837
One to two years	179,393	190,948
Thereafter	120,305	168,267
Total	$ 2,598,808	$ 2,411,204

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The following table indicates the scheduled maturities of the Company s certificates of deposit by acquisition channel as of December 31, 2006 (in thousands):

	Consumer Direct	Municipal	National Accounts	Total
Twelve months or less	$ 2,963,733	$ 1,294,508	$ 686,175	$ 4,944,416
One to two years	473,756	36,996	250,416	761,168
Two to three years	215,578	1,048	126,055	342,681
Three to four years	64,687	100		64,787
Four to five years	34,119			34,119
Thereafter	11,908			11,908
Total	$ 3,763,781	$ 1,332,652	$ 1,062,646	$ 6,159,079

Note 15 FHLB Advances

The portfolio of FHLB advances includes floating rate daily adjustable advances, fixed rate putable advances and fixed rate term advances. The following is a breakdown of the advances outstanding (dollars in thousands):

	December 31,			
	2006		2005	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Floating rate daily advances	$	%	$ 766,000	4.18%
Fixed rate putable advances	500,000	4.24%	700,000	4.49%
Fixed rate term advances	4,907,000	4.66%	2,759,000	3.69%
Total	$ 5,407,000	4.62%	$ 4,225,000	3.91%

The portfolio of putable FHLB advances held by the Company matures in 2011 and may be called by the FHLB based on FHLB volatility models.

The following indicates certain information related to the FHLB advances (dollars in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Maximum outstanding at any month end	$ 5,407,000	$ 5,373,279	$ 4,097,000
Average balance	4,270,660	4,742,079	3,631,851
Average interest rate	4.40%	3.85%	3.96%

The following outlines the Company s FHLB advance maturity dates as of December 31, 2006 (in millions):

2007	$ 2,757
2008	750
2009	500
2010	400
2011	750
Thereafter	250
Total	$ 5,407

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The Company has the authority and approval from the FHLB to utilize a total of $6.75 billion in collateralized borrowings. Pursuant to collateral agreements with the FHLB, advances are collateralized by non-delinquent single-family residential mortgage loans.

Note 16 Security Repurchase Agreements

The following table presents security repurchase agreements outstanding (dollars in thousands):

	December 31,			
	2006		2005	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Security repurchase agreements	$ 990,806	5.31%	$ 1,060,097	4.32%

These repurchase agreements have maturities of less than six months. At December 31, 2006 and 2005, security repurchase agreements were collateralized by $1.0 billion and $1.2 billion of mortgage-backed securities held to maturity, respectively.

The following table indicates certain information related to the security repurchase agreements (dollars in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Maximum outstanding at any month end	$ 1,259,812	$ 1,101,242	$
Average balance	1,065,458	899,488	
Average interest rate	5.01%	4.17%	

Note 17 Long Term Debt

The following table presents long-term debt (in thousands):

	December 31,	
	2006	2005
Junior subordinated notes related to trust preferred securities		

Floating 3 month LIBOR plus 3.25%(1) (8.62% and 7.40% at December 31, 2006 and 2005, respectively), matures 2032	$ 25,774	$ 25,774
Fixed 6.55%(2), matures 2033	25,774	25,774
Fixed 6.75%(2), matures 2033	25,780	25,780
Floating 3 month LIBOR plus 2.00% (7.37% and 6.15% at December 31, 2006 and 2005, respectively), matures 2035	25,774	25,774
Floating 3 month LIBOR plus 2.00% (7.37% and 6.15% at December 31, 2006 and 2005, respectively), matures 2035	25,774	25,774
Fixed 6.47%(3), matures 2035	51,547	51,547
Floating 3 month LIBOR plus 1.50%(4) (6.87% and 4.15% at December 31, 2006 and 2005, respectively), matures 2035	25,774	25,774
Subtotal	206,197	206,197
Other Debt		
Fixed 7.00% due 2013	1,275	1,300
Total long-term debt	$ 207,472	$ 207,497

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(1) As part of the transaction, the Company entered into an interest rate swap with the placement agent under which the Company is required to pay 6.88% fixed rate on a notional amount of $25 million and will receive a floating rate equal to three month LIBOR plus 3.25%. The swap matures on December 26, 2007. The securities are callable after December 26, 2007.

(2) In 2008, the callable date, the rate converts to a variable rate equal to three month LIBOR plus 3.25%, adjustable quarterly. The securities are callable after February 26, 2008 and March 26, 2008.

(3) In 2010, the callable date, the rate converts to a variable rate equal to three month LIBOR plus 2.00% adjustable quarterly. The securities are callable after March 31, 2010.

(4) As part of the transaction, the Company entered into an interest rate swap with the placement agent, under which the Company is required to pay 4.33% fixed rate on a notional amount of $25 million and will receive a floating rate equal to three month LIBOR. The swap matures on October 7, 2010. The securities are callable after October 7, 2010.

The following presents the aggregate annual maturities of long term-debt obligations (based on final maturity dates) as of December 31, 2006 (in thousands):

2007	$ 25
2008	25
2009	25
2010	25
2011	25
Thereafter	207,347
Total	$ 207,472

Note 18 Federal Income Taxes

Total federal income tax provision (benefit) is allocated as follows (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Income from operations	$ 40,819	$ 44,090	$ 77,592
Stockholders equity, for the tax benefit from stock-based compensation	(999)	(8,379)	(2,049)
Stockholders equity, for the tax effect of other comprehensive income	(1,222)	1,340	1,779
	$ 38,598	$ 37,051	$ 77,322

Components of the provision for federal income taxes from operations consist of the following (in thousands):

	For the Years Ended December 31,		
	2006	**2005**	**2004**
Current provision (benefit)	$ 93,634	$ (12,342)	$ 99,462
Deferred provision (benefit)	(52,815)	56,432	(21,870)
	$ 40,819	$ 44,090	$ 77,592

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The Company s effective tax rate differs from the statutory federal tax rate. The following is a summary of such differences (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Provision at statutory federal income tax rate	$ 40,607	$ 43,384	$ 77,115
Increase resulting from other, net	212	706	477
Provision at effective federal income tax rate	$ 40,819	$ 44,090	$ 77,592

The details of the net tax liability are as follows (in thousands):

	December 31,	
	2006	2005
Deferred tax assets:		
Allowance for loan and other losses	$ 32,891	$ 26,293
Premises and equipment	3,509	
Accrued vacation pay	1,605	1,386
Non-accrual interest revenue	1,068	1,101
HELOC securitization	723	
Deferred gain on termination of hedge		683
State income taxes		3,168
Restatement of accrued interest		5,931
Other	995	1,301
	40,791	39,863
Deferred tax liabilities:		
Mortgage loan servicing rights	(59,491)	(109,523)
Federal Home Loan Bank stock dividends	(8,543)	(7,533)
Deferred loan costs and fees	(4,837)	(5,693)
Mark-to-market adjustments forward commitments	(2,880)	(1,306)
Mark-to-market adjustments loans available for sale	(969)	(3,164)
Mark-to-market adjustments available for sale securities	(362)	

Mark-to-market adjustments-HELOCS	(189)	(268)
Unrealized hedging gains	(2,258)	(4,669)
State income taxes	(2,545)	
Premises and equipment		(5,131)
HELOC securitization		(4,473)
Other	(224)	(19)
	(82,298)	(141,779)
Net deferred tax liability	(41,507)	(101,916)
Current federal income taxes receivable	11,833	26,645
Income taxes payable	$ (29,674)	$ (75,271)

The Company has not provided deferred income taxes for the Bank s pre-1988 tax bad debt reserves of approximately $4 million because it is not anticipated that this temporary difference will reverse in the foreseeable future. Such reserves would only be taken into taxable income if the Bank, or a successor

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institution, liquidates, redeems shares, pays dividends in excess of earnings and profits, or ceases to qualify as a bank for tax purposes.

Note 19 Secondary Market Reserve

The following table shows the activity in the secondary market reserve (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Balance, beginning of period,	$ 17,550	$ 19,002	$ 10,254
Provision			
Charged to gain on sale for current loan sales	5,897	5,328	5,932
Charged to other fees and charges for changes in estimates	14,312	7,156	18,105
Total	20,209	12,484	24,037
Charge-offs, net	(13,559)	(13,936)	(15,289)
Balance, end of period	$ 24,200	$ 17,550	$ 19,002

Reserve levels are a function of expected losses based on actual pending and expected claims and repurchase requests, historical experience and loan volume. While the ultimate amount of repurchases and claims is uncertain, management believes that reserves are adequate. We will continue to evaluate the adequacy of our reserves and may continue to allocate a portion of our gain on sale proceeds to these reserves going forward.

Note 20 Employee Benefit Plans

The Company maintains a 401(k) plan for its employees. Under the plan, eligible employees may contribute up to 60% of their annual compensation, subject to a maximum amount proscribed by law. The maximum annual contribution was $15,000 for 2006, $14,000 for 2005 and $13,000 for 2004. Participants who were 50 years old or older prior to the end of the year could make additional catch-up contributions of up to $5,000, $4,000, and $3,000 for 2006, 2005, and 2004, respectively. The Company currently provides a matching contribution up to 3% of an employee s annual compensation up to a maximum of $6,600. The Company s contributions vest at a rate such that an employee is fully vested after five years of service. The Company s contributions to the plan for the years ended December 31, 2006, 2005, and 2004 were approximately $3.1 million, $3.3 million, and $3.2 million, respectively. The Company may also make discretionary contributions to the plan; however, none have been made.

Prior to March 31, 2005, the Company offered a deferred compensation plan to employees. The deferred compensation plan allowed employees to defer up to 25% of their annual compensation and directors to defer all of

their compensation. Funds deferred remained the property of the Company. The Company discontinued this compensation plan March 31, 2005.

Note 21 Contingencies and Commitments

The Company is involved in certain lawsuits incidental to its operations. Management, after review with its legal counsel, is of the opinion that resolution of such litigation will not have a material effect on the Company s financial condition, results of operations, or liquidity.

A substantial part of the Company s business has involved the origination, purchase, and sale of mortgage loans. During the past several years, numerous individual claims and purported consumer class action claims were commenced against a number of financial institutions, their subsidiaries and other mortgage lending institutions generally seeking civil statutory and actual damages and rescission under the federal Truth in

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Lending Act, as well as remedies for alleged violations of various state unfair trade practices laws restitution or unjust enrichment in connection with certain mortgage loan transactions.

The Company has a substantial mortgage loan-servicing portfolio and maintains escrow accounts in connection with this servicing. During the past several years, numerous individual claims and purported consumer class action claims were commenced against a number of financial institutions, their subsidiaries and other mortgage lending institutions generally seeking declaratory relief that certain of the lenders escrow account servicing practices violate the Real Estate Settlement Practices Act and breach the lenders contracts with borrowers. Such claims also generally seek actual damages and attorney s fees.

In addition to the foregoing, mortgage lending institutions have been subjected to an increasing number of other types of individual claims and purported consumer class action claims that relate to various aspects of the origination, pricing, closing, servicing, and collection of mortgage loans that allege inadequate disclosure, breach of contract, or violation of state laws. Claims have involved, among other things, interest rates and fees charged in connection with loans, interest rate adjustments on adjustable rate loans, timely release of liens upon payoffs, the disclosure and imposition of various fees and charges, and the placing of collateral protection insurance.

While the Company has had various claims similar to those discussed above asserted against it, management does not expect that the ultimate resolution of these claims will have a material adverse effect on the Company s financial condition, results of operations, or liquidity.

A summary of the contractual amount of significant commitments is as follows (in thousands):

	December 31,	
	2006	**2005**
Commitments to extend credit:		
Mortgage Loans	$ 1,779,000	$ 1,644,000
Commercial	134,000	185,000
Other	30,000	60,000

Commitments to extend credit are agreements to lend. Since many of these commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements. Certain lending commitments for commercial and mortgage loans to be sold in the secondary market are considered derivative instruments in accordance with SFAS 133. Changes to the fair value of these commitments as a result of changes in interest rates are recorded on the statement of financial condition as either an other asset or other liability. The commitments related to mortgage loans and commercial real estate loans are included in mortgage loans and commercial loans in the above table.

The credit risk associated with loan commitments is essentially the same as that involved in extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management s credit assessment of the customer.

Note 22 Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

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Quantitative measures that have been established by regulation to ensure capital adequacy require the Bank to maintain minimum capital amounts and ratios (set forth in the table below). The Bank s primary regulatory agency, the OTS, requires that the Bank maintain minimum ratios of tangible capital (as defined in the regulations) of 1.5%, core capital (as defined) of 3.0%, and total risk-based capital (as defined) of 8.0%. The Bank is also subject to prompt corrective action capital requirement regulations set forth by the FDIC. The FDIC requires the Bank to maintain a minimum of Tier 1 total and core capital (as defined) to risk-weighted assets (as defined), and of core capital (as defined) to adjusted tangible assets (as defined). Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2006 and 2005, the most recent guidelines from the OTS categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank s category.

	Actual		For Capital Adequacy Purposes		Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
As of December 31, 2006						
Tangible capital (to tangible assets)	$ 984,981	6.4%	$ 231,901	1.5%	N/A	N/A
Core capital (to adjusted tangible assets)	984,981	6.4%	463,802	3.0%	$ 773,005	5.0%
Tier I capital (to risk weighted assets)	957,388	11.0%	N/A	N/A	520,502	6.0%
Total capital (to risk weighted assets)	1,001,937	11.6%	693,996	8.0%	867,494	0.0%
As of December 31, 2005						
Tangible capital (to tangible assets)	$ 941,457	6.3%	$ 225,670	1.5%	N/A	N/A
Core capital (to adjusted tangible assets)	941,457	6.3%	451,340	3.0%	$ 752,333	5.0%
Tier I capital (to risk weighted assets)	924,461	10.7%	N/A	N/A	520,301	6.0%
Total capital (to risk weighted assets)	961,864	11.1%	693,727	8.0%	867,159	10.0%

Note 23 Accumulated Other Comprehensive Income

The following table sets forth the ending balance in accumulated other comprehensive income for each component (in thousands):

	December 31,		
	2006	2005	2004
Net gain on interest rate swap extinguishment	$ 101	$ 1,268	$ 2,650
Net unrealized gain on derivatives used in cashflow hedges	4,193	6,068	2,693
Net unrealized gain on securities available for sale	888	498	
Ending balance	$ 5,182	$ 7,834	$ 5,343

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The following table sets forth the changes to other comprehensive income and the related tax effect for each component (in thousands):

	For the Years Ended December 31,		
	2006	2005	2004
Gain (reclassified to earnings) on interest rate swap extinguishment	$ (1,795)	$ (2,054)	$ 4,077
Related tax (expense) benefit	628	719	(1,427)
Unrealized gain (loss) on derivatives used in cashflow hedges	(2,628)	5,119	872
Related tax (expense) benefit	754	(1,792)	(352)
Unrealized gain on securities available for sale	805	767	
Related tax expense	(416)	(268)	
Change	$ (2,652)	$ 2,491	$ 3,170

On December 30, 2004, the Company extinguished $250.0 million of interest rate swaps. These swaps were eliminated at an after-tax gain of $2.6 million. This gain was deferred and is being reclassified into earnings from accumulated other comprehensive income over three years, which is the original duration of the extinguished swaps. The Company will reclassify into earnings after-tax $0.1 million in 2007.

Note 24 Concentrations of Credit

Properties collateralizing mortgage loans held for investment were geographically disbursed throughout the United States. As of December 31, 2006, approximately 13.1% of these properties are located in Michigan (measured by principal balance), and another 52.3% were located in the states of California (23.1%), Florida (12.6%), Washington (5.0%), Colorado (4.5%), Texas (4.1%) and Arizona (3.0%). No other state contains more than 3% of the properties collateralizing these loans.

A substantial portion of the Company s commercial real estate loan portfolio (76.9%) is collateralized by properties located in Michigan.

Additionally, the following loan products contractual terms may give rise to a concentration of credit risk and increase the Company s exposure to risk of nonpayment or realization:

a. Hybrid or ARM loans that are subject to future payment increases

b. Option power ARM loans that permit negative amortization

c. Loans under a. or b. above with loan-to-value ratios above 80%

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The following table details the unpaid principal balance of these loans at December 31, 2006:

	Held for Investment Portfolio Loans (In thousands)
Amortizing hybrid ARMs	
3/1 ARM	$ 729,158
5/1 ARM	1,437,021
7/1 ARM	85,117
Interest only hybrid ARMs	
3/1 ARM	908,534
5/1 ARM	1,798,121
7/1 ARM	6,853
Option power ARMs	13,707
All other ARMs	469,666
	$ 5,448,177

Of the loans listed above, the following have original loan-to-value ratios exceeding 80%.

	Principal Outstanding At December 31, 2006 (In thousands)
Loans with original loan-to-value ratios above 80%	
> 80%< = 90%	$ 335,809
> 90%< = 100%	282,749
>100%	17,492
	$ 636,050

As of December 31, 2006, the aggregate amount of the securities from each of the following issuers were greater than 10% of the Company s shareholders equity. These issuers include qualifying special-purpose entities created by the Company in conjunction with a securitization transaction with the objective to recharacterize loans as securities for the purposes of (1) lower our cost of funds, (2) improve our liquidity profile, and (3) improve our risk profile through the use of bond insurance.

Name of Issuer	Amortized Cost	Fair Market Value

	(In thousands)	
Chase Mortgage Financial Corporation	$ 99,330	$ 99,884
JP Morgan Mortgage Trust	100,000	100,000
Flagstar Home Equity Loan Trust 2006-1	332,362	329,979
Total	$ 531,692	$ 529,863

Note 25 Related Party Transactions

The Company has and expects to have in the future, transactions with certain of the Company s directors and principal officers. Such transactions were made in the ordinary course of business and included extensions of credit and professional services. With respect to the extensions of credit, all were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers and did not, in management s opinion, involve more than normal risk of collectibility or present other unfavorable features. At December 31, 2006, the balance of the loans attributable

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to directors and principal officers totaled $6.9 million, with the unused lines of credit totaling $11.5 million. At December 31, 2005, the balance of the loans attributable to directors and principal officers totaled $4.5 million, with the unused lines of credit totaling $10.3 million. During 2006 and 2005, the Company purchased $96.1 million and $35.8 million in mortgage loans from correspondents and brokers affiliated with directors and executive officers, during the ordinary course of business.

Note 26 Derivative Financial Instruments

We follow the provisions of SFAS 133, as amended, for our derivative instruments and hedging activities, which require us to recognize all derivative instruments on the consolidated statements of financial condition at fair value. The following derivative financial instruments were identified and recorded at fair value as of December 31, 2006 and 2005:

FNMA, FHLMC and other forward contracts
Rate lock commitments
Interest rate swap agreements

Generally speaking, if interest rates increase, the value of our rate lock commitments and funded loans decrease and loan sale margins are adversely impacted. We hedge the risk of overall changes in fair value of loans held for sale and rate lock commitments generally by selling forward contracts on securities of Fannie Mae, Freddie Mac and Ginnie Mae. Under SFAS 133, certain of these positions may qualify as a fair value hedge of a portion of the funded loan portfolio and result in adjustments to the carrying value of designated loans through gain on sale based on value changes attributable to the hedged risk. The forward contracts used to economically hedge the loan commitments are accounted for as non-designated hedges and naturally offset rate lock commitment mark-to-market gains and losses recognized as a component of gain on sale. The Bank recognized pre-tax gains of $4.5 million for the year ended December 31, 2006, and pre-tax losses of $2.9 million and $357,000 for the years ended December 31, 2005 and 2004, respectively, on our hedging activity.

We use interest rate swap agreements to reduce our exposure to interest rate risk inherent in a portion of the current and anticipated borrowings and advances. A swap agreement is a contract between two parties to exchange cash flows based on specified underlying notional amounts and indices. Under SFAS 133, the swap agreements used to hedge our anticipated borrowings and advances qualify as cash flow hedges. As of December 31, 2006 and 2005, the net fair market value adjustment on our interest rate swap agreements on an after-tax basis was $3.6 million and $5.4 million, respectively, which was recorded as a component of accumulated other comprehensive income. Future effective changes in fair value on these interest rate swap agreements will be adjusted through OCI as long as the cash flow hedge requirements continue to be met.

On December 30, 2004, the Company extinguished $250.0 million of interest rate swaps. These swaps were eliminated at an after-tax gain of $2.6 million. This gain was deferred and is being reclassified into earnings from accumulated other comprehensive income over three years, which is the original duration of the extinguished swaps. During 2006 and 2005, $1.2 million and $1.3 million was recognized in earnings, respectively.

The Company recognizes ineffective changes in hedge values resulting from designated SFAS 133 hedges discussed above in the same statement of earnings captions as effective changes when such material ineffectiveness occurs. The Company has not recognized gains or losses due to ineffectiveness in earnings due to immateriality.

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We had the following derivative financial instruments (dollars in thousands):

	December 31, 2006		
	Notional Amounts	Fair Value	Expiration Dates
Mortgage Banking Derivatives:			
Rate lock commitments	$ 1,720,879	$ 3,819	2007
Forward agency and loan sales	2,156,566	4,409	2007
Borrowings and advances hedges:			
Interest rate swaps (LIBOR)	300,000	6,452	2007-2010

	December 31, 2005		
	Notional Amounts	Fair Value	Expiration Dates
Mortgage Banking Derivatives:			
Rate lock commitments	$ 1,342,000	$ 8,362	2006
Forward agency and loan sales	1,643,620	(4,145)	2006
Borrowings and advances hedges:			
Interest rate swaps (LIBOR)	300,000	9,599	2006-2010

Counterparty Credit Risk

The Bank is exposed to credit loss in the event of non-performance by the counterparties to its various derivative financial instruments. The Company manages this risk by selecting only well-established, financially strong counterparties, spreading the credit risk among such counterparties, and by placing contractual limits on the amount of unsecured credit risk from any single counterparty.

Note 27 Fair Value of Financial Instruments

The Company is required to disclose the fair value information about financial instruments, whether or not recognized in the consolidated statement of financial condition, where it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Because assumptions used in these valuation techniques are inherently subjective in nature, the estimated fair values cannot always be substantiated by comparison to independent market quotes and, in many cases; the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument.

The fair value estimates presented herein are based on relevant information available to management as of December 31, 2006 and 2005, respectively. Management is not aware of any factors that would significantly affect

these estimated fair value amounts. As these reporting requirements exclude certain financial instruments and all non-financial instruments, the aggregate fair value amounts presented herein do not represent

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management s estimate of the underlying value of the Company. Additionally, such amounts exclude intangible asset values such as the value of core deposit intangibles.

The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments and certain non-financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents. Due to their short term nature, the carrying amount of cash and cash equivalents approximates fair value.

Securities available for sale. The carrying amount of the securities available for sale approximates fair value. Fair value is estimated using quoted market prices or by discounting future cash flows using assumptions for prepayment rates, market yield requirements and credit losses.

Other investments. The carrying amount of other investments approximates fair value.

Loans receivable. Mortgage loans available for sale and held for investment are valued using fair values attributable to similar mortgage loans. The fair value of the other loans and mortgage-backed securities is based on the fair value of obligations with similar credit characteristics.

FHLB stock. No secondary market exists for FHLB stock. The stock is bought and sold at par by the FHLB. The recorded value, therefore, is the fair value.

Deposit Accounts. The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposits with similar remaining maturities.

FHLB Advances. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

Security Repurchase Agreements. Due to their short term nature, the carrying amount of the repurchase agreements approximates fair value.

Long Term Debt. The fair value of the long-term debt is estimated based on a discounted cash flow model that incorporates the Company s current borrowing rates for similar types of borrowing arrangements.

Payables for Securities Purchased. Due to their short term nature, the carrying amount of the payables for securities purchased approximates fair value.

Derivative Financial Instruments. The fair value of forward sales contracts, interest rate swaps and fixed-rate commitments to extend credit are based on observable market prices or cash flow projection models acquired from third parties.

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The following tables set forth the fair value of the Company s financial instruments (in thousands):

	December 31,			
	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial instruments:				
Assets:				
Cash and cash equivalents	$ 277,236	$ 277,236	$ 201,163	$ 201,163
Securities available for sale	617,450	617,450	26,148	26,148
Other investments	24,035	24,035	21,957	21,957
Loans available for sale	3,188,795	3,212,824	1,773,394	1,780,258
Loans held for investment and mortgage-backed securities	10,505,105	10,555,375	11,991,457	11,950,105
FHLB stock	277,570	277,570	292,118	292,118
Liabilities:				
Retail deposits:				
Demand deposits and savings accounts	(1,132,904)	(1,132,904)	(1,395,118)	(1,395,118)
Certificates of deposit	(3,763,781)	(3,752,959)	(3,450,450)	(3,429,063)
Municipal deposits	(1,419,964)	(1,414,362)	(1,353,633)	(1,351,218)
National certificates of deposit	(1,062,646)	(1,046,768)	(1,779,799)	(1,748,185)
FHLB advances	(5,407,000)	(5,365,825)	(4,225,000)	(4,181,458)
Security repurchase agreements	(990,806)	(990,806)	(1,060,097)	(1,060,049)
Long term debt	(207,472)	(205,860)	(207,497)	(207,497)
Payables for securities purchased	(249,694)	(249,694)		
Derivative Financial Instruments:				
Forward delivery contracts	4,409	4,409	(4,145)	(4,145)
Commitments to extend credit	3,819	3,819	8,362	8,362
Interest rate swaps	6,452	6,452	9,599	9,599

Note 28 Segment Information

The Company s operations are broken down into two business segments: banking and home lending. Each business operates under the same banking charter but is reported on a segmented basis for this report. Each of the business lines is complementary to each other. The banking operation includes the gathering of deposits and investing those deposits in duration-matched assets primarily originated by the home lending operation. The banking group holds these loans in the investment portfolio in order to earn income based on the difference or spread between the interest earned on loans and the interest paid for deposits and other borrowed funds. The home lending operation involves the origination, packaging, and sale of loans in order to receive transaction income. The lending operation also services mortgage loans for others and sells MSRs into the secondary market. Funding for the lending operation is provided by

deposits and borrowings garnered by the banking group. All of the non-bank consolidated subsidiaries are included in the banking segment. No such subsidiary is material to the Company s overall operations.

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Following is a presentation of financial information by business segment for the period indicated (in thousands):

	As of or for the Year Ended December 31, 2006			
	Banking Operation	Home Lending Operation	Eliminations	Combined
Net interest income	$ 159,255	$ 55,692	$	$ 214,947
Net gain on sale revenue		135,002		135,002
Other income	31,353	35,806		67,159
Total net interest income and non-interest income	190,608	226,500		417,108
Earnings before federal income taxes	59,728	56,293		116,021
Depreciation and amortization	10,143	86,323		96,466
Capital expenditures	43,652	1,704		45,356
Identifiable assets	14,939,341	3,597,864	(3,040,000)	15,497,205
Inter-segment income (expense)	80,100	(80,100)		

	As of or for the Year Ended December 31, 2005			
	Banking Operation	Home Lending Operation	Eliminations	Combined
Net interest income	$ 185,276	$ 60,994	$	$ 246,270
Net gain on sale revenue		81,737		81,737
Other income	55,813	21,898		77,711
Total net interest income and non-interest income	241,089	164,629		405,718
Earnings before federal income taxes	123,726	229		123,955
Depreciation and amortization	10,139	115,112		125,251
Capital expenditures	32,764	18,633		51,397
Identifiable assets	14,176,340	2,379,090	(1,480,000)	15,075,430
Inter-segment income (expense)	42,375	(42,375)		

	As of or for the Year Ended December 31, 2004			
	Banking Operation	Home Lending Operation	Eliminations	Combined

Net interest income	$ 175,403	$ 47,888	$	$ 223,291
Net gain on sale revenue		169,559		169,559
Other income	63,227	23,335		86,562
Total net interest income and non-interest income	238,630	240,782		479,412
Earnings before federal income taxes	135,080	85,250		220,330
Depreciation and amortization	6,810	99,303		106,113
Capital expenditures	18,431	30,664		49,095
Identifiable assets	12,136,082	2,245,932	(1,239,000)	13,143,014
Inter-segment income (expense)	25,475	(25,475)		

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Revenues are comprised of net interest income (before the provision for loan losses) and non-interest income. Non-interest expenses are fully allocated to each business segment. The intersegment income (expense) consists of interest expense incurred for intersegment borrowing.

Note 29 Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing earnings available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock or resulted in the issuance of common stock that could then share in the earnings of the Company.

The following are reconciliations of the numerator and denominator of the basic and diluted earnings per share calculation (dollars in thousands, except per share data):

	For the Year Ended December 31, 2006		
	Earnings (Numerator)	Average Shares (Denominator)	Per Share Amount
Basic earnings	$ 75,202	63,504	$ 1.18
Effect of options		824	(0.01)
Diluted earnings	$ 75,202	64,328	$ 1.17

In 2006, the Company had 820,582 options that were classified as anti-dilutive and were excluded from the EPS calculations.

	For the Year Ended December 31, 2005		
	Earnings (Numerator)	Average Shares (Denominator)	Per Share Amount
Basic earnings	$ 79,865	62,128	$ 1.29
Effect of options		1,882	(0.04)
Diluted earnings	$ 79,865	64,010	$ 1.25

In 2005, the Company had 837,449 options that were classified as anti-dilutive and were excluded from the EPS calculations.

	For the Year Ended December 31, 2004		
	Earnings (Numerator)	Average Shares (Denominator)	Per Share Amount
Basic earnings	$ 142,738	61,057	$ 2.34
Effect of options		3,115	(0.12)
Diluted earnings	$ 142,738	64,172	$ 2.22

In 2004, the Company had 501,300 options that were classified as anti-dilutive and were excluded from the EPS calculations.

Note 30 Stock-Based Compensation

In 1997, Flagstar s board of directors adopted resolutions to implement various stock option and purchase plans and incentive compensation plans in conjunction with the public offering of common stock.

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On May 26, 2006, the Company s shareholders approved the Flagstar Bancorp, Inc. 2006 Equity Incentive Plan (the 2006 Plan). The 2006 Plan consolidates, amends and restates the Company s 1997 Employees and Directors Stock Option Plan, its 2000 Stock Incentive Plan, and its 1997 Incentive Compensation Plan (each, a Prior Plan). Awards still outstanding under any of the Prior Plans will continue to be governed by their respective terms. Under the 2006 Plan, key employees, officers, directors and others expected to provide significant services to the Company and its affiliates are eligible to receive awards. Awards that may be granted under the 2006 Plan include stock options, incentive stock options, cash-settled stock appreciation rights, restricted stock units, performance shares and performance units and other awards.

Under the 2006 Plan, the exercise price of any award granted must be at least equal to the fair market value of the Company s common stock on the date of grant. Non-qualified stock options granted to directors expire five years from the date of grant. Grants other than non-qualified stock options have term limits set by the board of directors in the applicable agreement. Stock appreciation rights expire seven years from the date of grant unless otherwise provided by the Compensation Committee of the board of directors.

In December 2004, the FASB issued SFAS 123R (revised 2004), *Share-Based Payment*, (SFAS 123R) which requires that compensation costs related to share-based payment transactions be recognized in financial statements. SFAS 123R eliminated the alternative to use the intrinsic method of accounting previously allowed under APB 25, *Accounting for Stock Issued to Employees*, which generally did not require any compensation expense to be recognized in the financial statements for the grant of stock options to employees if certain conditions were met. Only certain pro forma disclosures of share-based payments were required.

On January 1, 2006, the Company adopted SFAS 123R using the modified prospective method. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as expense in the consolidated statement of earnings based on their fair values. The amount of compensation expense is determined based on the fair value of the options when granted and is expensed over the required service period, which is normally the vesting period of the options. SFAS 123R applies to awards granted or modified on or after January 1, 2006, and to any unvested awards that were outstanding at December 31, 2005. Consequently, compensation expense is recorded for prior option grants that vest on or after January 1, 2006, the date of adoption.

Prior to the adoption of SFAS 123R, the Company accounted for its Prior Plans under the recognition and measurement principles of APB 25. The Company reported all tax benefits resulting from the exercise of stock options as financing cash flows in the consolidated statements of cash flows. In accordance with SFAS 123R, for the period beginning January 1, 2006, only the excess tax benefits from the exercise of stock options are presented as financing cash flows. The excess tax benefits totaled $1.0 million for the year ended December 31, 2006.

The fair value concepts were not changed significantly in SFAS 123R; however, in adopting this standard, companies must choose among alternative valuation models and amortization assumptions. The Company has elected to continue to use both the Black-Scholes option pricing model and the straight-line method of amortization of compensation expense over the requisite service period of the grant. The Company will reconsider use of the Black-Scholes model if additional information in the future indicates another model would be more appropriate at that time or if grants issued in future periods have characteristics that could not be reasonably estimated using this model.

During 2006, compensation expense recognized related to the 2006 Plan totaled $2.2 million.

Stock Option Plan

The Company used the following weighted average assumptions in applying the Black-Scholes model to determine the fair value of options it issued during the years ended December 31, 2005 and 2004: dividend yield of 4.80% and 4.89%; expected volatility of 45.28% and 28.33%; and a risk-free rate of 3.80% and

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3.16%; and respectively an expected life of five years for both 2005 and 2004. There were no options granted during the year ended December 31, 2006.

The following tables summarize the activity that occurred in the years ended December 31:

	Number of Shares		
	2006	**2005**	**2004**
Options outstanding, beginning of year	3,417,366	4,961,529	5,425,870
Options granted		372,792	332,920
Options exercised	(359,503)	(1,788,354)	(686,117)
Options canceled, forfeited and expired	(28,126)	(128,601)	(111,144)
Options outstanding, end of year	3,029,737	3,417,366	4,961,529
Options exercisable, end of year	2,885,787	2,861,884	2,914,871

The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 was $3.2 million, $23.9 million and $12.1 million, respectively. Additionally, the aggregate intrinsic value of options outstanding and exercisable at December 31, 2006 was $9.1 million and $8.7 million, respectively.

	Weighted Average Exercise Price		
	2006	**2005**	**2004**
Options outstanding, beginning of year	$ 13.02	$ 9.34	$ 7.87
Options granted		20.50	22.55
Options exercised	6.13	4.17	4.19
Options canceled, forfeited and expired	18.30	15.64	11.59
Options outstanding, end of year	$ 13.79	$ 13.02	$ 9.34
Options exercisable, end of year	$ 13.86	$ 13.20	$ 6.94

The following information pertains to the stock options issued pursuant to the Prior Plans but not exercised at December 31, 2006:

	Options Outstanding			Options Exercisable	
Range of Grant Price	**Number of Options Outstanding at December 31, 2006**	**Weighted Average Remaining Contractual Life (Years)**	**Weighted Average Exercise Price**	**Number Exercisable at December 31, 2006**	**Weighted Average Exercise Price**
$ 1.76 - 1.96	139,099	3.50	$ 1.78	139,099	$ 1.78
4.32 - 4.77	15,000	1.29	4.48	15,000	4.48
5.01 - 6.06	181,676	3.32	5.20	181,676	5.20
11.80 - 12.27	1,873,380	4.27	11.99	1,736,930	11.97
15.23	11,000	7.55	15.23	3,500	15.23
19.35 - 19.42	18,429	6.17	19.38	18,429	19.38
20.02 - 20.73	357,863	6.51	20.69	357,863	20.69
22.68 - 24.72	433,290	6.87	23.38	433,290	23.38
	3,029,737		$ 13.79	2,885,787	$ 13.86

At December 31, 2006, options available for future grants were 2,293,514.

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The following table illustrates the effect on net earnings and earnings per share as of and for the years ended December 31, 2005 and 2004 as if the Company had applied the fair value recognition provision of SFAS No. 123R to stock-based employee compensation (in thousands except per share data):

	For the Years Ended December 31,	
	2005	2004
Net earnings	$ 79,865	$ 142,738
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	4,540	2,885
Pro forma net earnings	$ 75,325	$ 139,853
Basic earnings per share		
As reported	$ 1.29	$ 2.34
Pro forma	$ 1.21	$ 2.29
Diluted earnings per share		
As reported	$ 1.25	$ 2.22
Pro forma	$ 1.18	$ 2.18

The fair value of each option grant is estimated using the Black-Scholes options-pricing model with the following weighted average assumptions used for grants in 2005 and 2004, respectively: dividend yield of 4.80% and 4.89%; expected volatility of 45.28% and 28.33%; a risk-free rate of 3.80% and 3.16%; an expected life of 5 years; and a fair value per option of $5.86 and $9.79.

During the fourth quarter of 2005, the Company accelerated the vesting of its unvested and out-of-the-money stock options awarded to its employees, executive members and board members under its stock option plan. The acceleration applied only to unvested options with an exercise price of $19.35 per share or higher. The options considered to be out-of-the-money had exercise prices greater than the Company s stock closing sales price on November 29, 2005, which was $15.20 per share. Outstanding unvested options that were in-the-money were not subject to acceleration and will continue to vest on their normal schedule. As a result of the acceleration, options to

purchase 829,899 shares of Flagstar common stock, which would otherwise have vested over the next four years, became fully vested. These options represented approximately 24% of the then total options outstanding. The total weighted average exercise price per share was $22.16 for these options.

Cash-settled Stock Appreciation Rights

The Company used the following weighted average assumptions in applying the Black-Scholes model to determine the fair value of the cash-settled stock appreciation rights it issued during the year ended December 31, 2006: dividend yield of 3.68%; expected volatility of 21.98%; a risk-free rate of 4.99%; and an expected life of five years.

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued

The following table presents the status and changes in cash-settled stock appreciation rights issued under the 2006 Plan:

Stock Appreciation Rights Awarded:	Shares	Weighted Average Exercise Price
Non-vested balance at December 31, 2005 and prior		$
Granted	328,873	16.28
Vested		
Forfeited		
Non-vested balance at December 31, 2006	328,873	$ 16.28

Restricted Stock Units

The Company issues restricted stock units to officers, directors and key employees in connection with year-end compensation. Restricted stock units generally vest as outlined in the applicable restricted stock unit agreements and are delivered shortly after the grant date. The Company incurred expenses of approximately $446,000, $2.9 million, and $750,000 with respect to restricted stock units, during 2006, 2005 and 2004, respectively. As of December 31, 2006, restricted stock units had a market value of $1.5 million.

Stock Purchase Plan

Under the Employee Stock Purchase Plan (Purchase Plan), eligible participants, upon providing evidence of a purchase of the Company s common shares from any third party on the open market, receive a payment from the Company equal to 15% of the share price. The Purchase Plan includes limitations on the maximum reimbursement to a participant during a year. The Purchase Plan has not been designed to comply with the requirements of the Internal Revenue Code with respect to employee stock purchase plans. During 2005 and 2004, respectively, the Company incurred expenses of approximately $82,100, and $81,200 under the Purchase Plan. This Purchase Plan was terminated as of December 31, 2005.

Incentive Compensation Plan

The Incentive Compensation Plan (Incentive Plan) is administered by the compensation committee of the board of directors. Each year the committee decides which employees of the Company will be eligible to participate in the Incentive Plan and the size of the bonus pool. During 2006, 2005 and 2004 all members of the executive management team were included in the Incentive Plan. The Company incurred expenses of $2.2 million, $2.2 million, and $3.7 million on the Incentive Plan for the years ended December 31, 2006, 2005 and 2004, respectively.

Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued

Note 31 Quarterly Financial Data (Unaudited)

The following table represents summarized data for each of the quarters in 2006, 2005, and 2004 (in thousands, except earnings per share data) certain per share results have been adjusted to conform to the 2006 presentation:

	2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 191,299	$ 192,648	$ 205,557	$ 211,362
Interest expense	132,624	141,910	151,929	159,456
Net interest income	58,675	50,738	53,628	51,906
Provision for loan losses	4,063	5,859	7,291	8,237
Net interest income after provision for loan losses	54,612	44,879	46,337	43,669
Loan administration	4,355	309	7,766	602
Net gain on loan sales	17,084	9,650	(8,197)	23,844
Net gain on MSR sales	8,586	34,932	45,202	3,901
Other non-interest income	12,596	16,681	9,567	15,283
Non-interest expense	68,070	62,354	68,853	76,360
Earning before federal income tax provision	29,163	44,097	31,822	10,939
Provision for federal income taxes	10,253	15,457	11,070	4,039
Net earnings	$ 18,910	$ 28,640	$ 20,752	$ 6,900
Basic earnings per share	$ 0.30	$ 0.45	$ 0.33	$ 0.11
Diluted earnings per share	$ 0.29	$ 0.44	$ 0.32	$ 0.11

Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued

	2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 163,125	$ 166,111	$ 185,391	$ 194,035
Interest expense	97,916	107,670	124,617	132,191
Net interest income	65,209	58,441	60,774	61,844
Provision for loan losses	6,246	2,903	3,690	6,036
Net interest income after provision for loan losses	58,963	55,538	57,084	55,808
Loan administration	5,945	1,669	(1,913)	3,060
Net gain on loan sales	9,577	32,348	3,426	18,229
Net gain on MSR sales	4,248	2,262	492	11,155
Other non-interest income	15,792	18,590	18,763	15,806
Non-interest expense	63,723	67,074	63,229	68,862
Earnings before federal income tax provision	30,802	43,333	14,623	35,196
Provision for federal income taxes	11,024	15,533	5,163	12,369
Net earnings	$ 19,778	$ 27,800	$ 9,460	$ 22,827
Basic earnings per share	$ 0.32	$ 0.45	$ 0.15	$ 0.36
Diluted earnings per share	$ 0.31	$ 0.43	$ 0.15	$ 0.36

	2004			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 130,841	$ 140,214	$ 140,818	$ 151,564
Interest expense	79,864	80,893	84,914	94,475

Net interest income	50,977	59,321	55,904	57,089
Provision for losses	9,302	3,603	3,172	
Net interest income after provision for losses	41,675	55,718	52,732	57,089
Loan administration	8,232	5,589	9,760	6,516
Net gain on loan sales	38,633	11,705	25,989	1,492
Net gain on MSR sales	21,785	37,248	15,734	16,973
Other non-interest income	9,431	16,497	16,883	13,654
Non-interest expense	62,769	63,728	59,900	56,608
Earnings before federal income tax provision	56,987	63,029	61,198	39,116
Provision for federal income taxes	20,284	22,093	21,461	13,754
Net earnings	$ 36,703	$ 40,936	$ 39,737	$ 25,362
Basic earnings per share	$ 0.60	$ 0.68	$ 0.65	$ 0.42
Diluted earnings per share	$ 0.57	$ 0.65	$ 0.62	$ 0.40

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued

Note 32 Holding Company Only Financial Statements

The following are unconsolidated financial statements for the Company. These condensed financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto:

Flagstar Bancorp, Inc.
Condensed Unconsolidated Statements of Financial Condition
(In thousands)

	December 31,	
	2006	**2005**
Assets		
Cash and cash equivalents	$ 4,393	$ 12,830
Investment in subsidiaries	1,013,390	973,404
Other assets	3,011	3,740
Total assets	$ 1,020,794	$ 989,974
Liabilities and Stockholders Equity		
Liabilities		
Long term debt	206,197	206,197
Total interest paying liabilities	206,197	206,197
Due to subsidiaries		9,481
Other liabilities	2,363	2,413
Total liabilities	208,560	218,091
Stockholders Equity		
Common stock	636	632
Additional paid in capital	63,223	57,304
Accumulated other comprehensive income	5,182	7,834
Retained earnings	743,193	706,113
Total stockholders equity	812,234	771,883

Total liabilities and stockholders equity	$ 1,020,794	$ 989,974

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued
Flagstar Bancorp, Inc.
Condensed Unconsolidated Statements of Earnings
(In thousands)

	For the Years Ended December 31,		
	2006	**2005**	**2004**
Income			
Dividends from subsidiaries	$ 46,250	$ 22,200	$ 136,900
Interest	450	335	1,430
Total	46,700	22,535	138,330
Expenses			
Interest	13,833	10,662	8,835
Other taxes	(179)		
General and administrative	1,981	2,015	3,707
Total	15,635	12,677	12,542
Earnings before undistributed earnings of subsidiaries	31,065	9,858	125,788
Equity in undistributed earnings of subsidiaries	38,822	65,695	13,061
Earnings before federal income tax benefit	69,887	75,553	138,849
Federal income tax benefit	(5,315)	(4,312)	(3,889)
Net earnings	$ 75,202	$ 79,865	$ 142,738

Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements - continued
Flagstar Bancorp, Inc.
Condensed Unconsolidated Statements of Cash Flows
(In thousands)

	For the Years Ended December 31, 2006	2005	2004
Operating Activities			
Net earnings	$ 75,202	$ 79,865	$ 142,738
Adjustments to reconcile net earnings to net cash provided by operating activities			
Equity in undistributed earnings of subsidiaries	(38,822)	(65,695)	(13,061)
Stock-based compensation	2,718	745	
Change in other assets	669	(667)	2,815
Provision for deferred tax benefit	(120)		4
Change in other liabilities	(9,412)	11,043	52
Net cash provided by operating activities	30,235	25,291	132,548
Investing Activities			
Net change in other investments	11	11	11
Net change in investment in subsidiaries	(3,766)	(77,719)	(25,667)
Net cash used in investment activities	(3,755)	(77,708)	(25,656)
Financing Activities			
Proceeds from the issuance of junior subordinated debentures		103,095	25,774
Redemption of junior subordinated debentures			(77,062)
Proceeds from exercise of stock options and grants issued	2,205	7,444	3,318
Tax benefit from stock options exercised	1,000	8,379	2,049
Dividends paid	(38,122)	(55,995)	(61,122)
Net cash provided by (used in) financing activities	(34,917)	62,923	(107,043)
Net increase (decrease) in cash and cash equivalents	(8,437)	10,506	(151)
Cash and cash equivalents, beginning of year	12,830	2,324	2,475
Cash and cash equivalents, end of year	$ 4,393	$ 12,830	$ 2,324

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

The information regarding our change in accountants during 2005 was previously reported on our Current Report on Forms 8-K dated June 15, 2005 and August 8, 2005.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We are responsible for establishing and maintaining disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 as amended (the Exchange Act), that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is: (a) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms; and (b) accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosures. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving the desired control objectives, and that our management s duties require it to make its best judgment regarding the design of our disclosure controls and procedures.

As of December 31, 2006, we conducted an evaluation, under the supervision (and with the participation) of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were operating effectively.

Management s Report on Internal Control Over Financial Reporting

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. 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 U.S. GAAP. Internal control over financial reporting includes policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) 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 existing policies or procedures

may deteriorate.

Under the supervision of our Chief Executive Officer and Chief Financial Officer, our management conducted an assessment of our internal control over financial reporting as of December 31, 2006, based on the framework and criteria established in *Internal Control-Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on this assessment, we assert that, as of December 31, 2006 and based on the specific criteria, the Company maintained effective internal control over financial reporting, involving the preparation and reporting of the Company s consolidated financial statements presented in uniformity with U.S. GAAP.

Management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, has been audited by Virchow, Krause & Company, LLP, our independent registered public accounting firm, as stated in their report, which is included herein.

Changes in Internal Control Over Financial Reporting

Prior Year Material Weakness. As of December 31, 2005, we did not maintain effective controls over financial reporting because of a material weakness relating to the accuracy and completeness of the filing of state tax returns, the accrual for state taxes and the related state tax expense.

Additional Controls and Enhanced Procedures. During 2006, we implemented a number of remediation measures to address the material weakness described above. These measures included the following:

- Designed and implemented procedures to ensure appropriate recording of tax expense;
- Hired an experienced Chief Tax Officer;
- Hired additional personnel in the tax department;
- Continued to utilize an independent accounting firm to assist in the preparation of tax returns and to assist with the determination of the effective tax rate; and
- Filed all delinquent returns.

Management believes that implementation of these measures have remediated the material weakness described above.

Other than as described above, there have not been any changes in our internal control over financial reporting during the fourth quarter of 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm
Board of Directors and Shareholders
Flagstar Bancorp, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Flagstar Bancorp, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Flagstar Bancorp, Inc. 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. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company 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, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and 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. Because management s assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management s assessment and our audit of Flagstar Bancorp, Inc. s internal control over financial reporting included controls over the preparation of financial statements in accordance with the Office of Thrift Supervision Instructions for Thrift Financial Reports. 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, management s assessment that Flagstar Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Flagstar Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Flagstar Bancorp, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of earnings, stockholders equity and comprehensive income, and cash flows for the years then ended and our report dated February 26, 2007 expressed and

unqualified opinion on those consolidated financial statements.

/s/ Virchow, Krause & Company, LLP
Southfield, Michigan

February 26, 2007

ITEM 9B. OTHER INFORMATION

On February 28, 2007, the Company entered into amended and restated employment agreements (the agreements) with Thomas J. Hammond, as Chairman, Mark T. Hammond, as President, Chief Executive Officer and Vice-Chairman, Paul D. Borja, as Executive Vice-President and Chief Financial Officer, Kirstin A. Hammond, as Executive Director, and Robert O. Rondeau, Jr., as Executive Director (each a named executive officer) to be effective as of January 1, 2007. The agreements were primarily amended to reflect recent legal and regulatory developments, such as the enactment of Section 409A of the Internal Revenue Code and, in the case of Thomas J. Hammond, to reflect changes in the scope of his duties to the Company since the prior agreement was executed in 1997.

The initial term of the agreements is three years. On January 1 of each year, the term of the agreements may be extended for an additional one-year period upon approval of our board of directors. The base salary in 2007 for each of the named executive officers is $625,000 for Thomas J. Hammond, $840,000 for Mark T. Hammond, $435,000 for Paul D. Borja, $390,000 for Kirstin A. Hammond, and $360,000 for Robert O. Rondeau. The agreements also provide that the base salary may not be less than the 2007 base salary during the term of the agreements. The base salaries will be reviewed annually, and the named executive officers may participate in any plan the Company maintains for the benefit of its employees, including discretionary bonus plans, profit-sharing plan, retirement and medical plans, customary fringe benefits and paid time off.

The agreements terminate upon the named executive officer s death or disability, and are terminable by the Company for just cause as defined in the agreements. In the event of termination for just cause or disability, no severance benefits are available. If the Company terminates the named executive officer without just cause or constructively terminates the named executive officer, such officer will be entitled to a lump sum payment equal to twelve months salary, the amount of incentive compensation that would have been payable assuming that the Company achieved 100% of its target goals during the year terminated, and the continuation of benefit plans through the expiration date of the agreement. Constructive termination includes the following events that have not been consented to in advance by the named executive officer in writing: (i) the requirement that the named executive officer perform his or her principal executive functions more than 50 miles from his or her primary office; (ii) a reduction in the named executive officer s base compensation as then in effect; (iii) the failure of the Company to continue to provide the named executive officer with contractual compensation and benefits, including material vacation, fringe benefits, stock option and retirement plans; (iv) the assignment to the named executive officer of duties and responsibilities which are other than those normally associated with his or her position with the Company; and (v) a material reduction in the named executive officer s authority and responsibility (including, solely in the context of a change-in-control, performing such responsibilities solely for a subsidiary of the controlling entity). In the event of the named executive officer s death during the term of the agreement, the named executive officer s estate will be entitled to six months base salary, accrued and unpaid discretionary bonuses, and a six month continuation of benefits. The named executive officer is able to terminate voluntarily the agreement by providing 60 days written notice to the board of directors, in which case such officer is entitled to receive only the compensation, vested rights and benefits up to the date of termination.

The agreements also contain provisions stating that in the event of the named executive officer s involuntary termination of employment in connection with, or within one year after, any change in control of the Company, other than for just cause, such officer will be paid cash in an amount equal to the difference between (i) 2.99 times his or her base amount, as defined in Section 280G(b)(3) of the Internal Revenue Code, and (ii) the sum of any other parachute payments, as defined under Section 280G(b)(2) of the Internal Revenue Code, that the named executive officer receives on account of the change in control. The named executive officer will also receive health insurance for six months. Control generally refers to the acquisition, by any person or entity, of the ownership or power to vote more

than 50% of the Company s voting stock, the control of the election of a majority of the Company s directors, or the exercise of a controlling influence over the management or policies of the Company. In addition, under the agreements, a change in control occurs when, during any consecutive two-year period, directors of the Company at the beginning of such period cease to constitute at least a majority of our board of directors. The change in

control payment would also be paid in the event of the named executive officer s constructive termination within one year following a change in control.

The foregoing description of the amended and restated employment agreements is qualified in its entirety by the terms of such agreements, which are filed as Exhibits 10.1 through 10.5 to this Form 10-K and are incorporated herein by reference.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item 10 is hereby incorporated by reference to the Company s Proxy Statement for the Company s 2007 Annual Meeting of Stockholders (the Proxy Statement), to be filed pursuant to Regulation 14A within 120 days after the end of our 2006 fiscal year.

We have adopted a Code of Business Conduct and Ethics that applies to our employees, officers and directors, including our principal executive officer, principal financial officer, and principal accounting officer. Our Code of Business Conduct and Ethics can be found on our web site, which is located at www.flagstar.com. We intend to make all required disclosures concerning any amendments to, or waivers from, our Code of Business Conduct and Ethics on our website.

We have also adopted Corporate Governance Guidelines and charters for the Audit Committee, Compensation Committee, and Nominating Corporate Governance Committee and copies are available at http://www.flagstar.com or upon written request for stockholders to Flagstar Bancorp, Inc., Attn: Paul Borja, CFO, 5151 Corporate Drive, Troy, MI 48098. None of the information currently posted, or posted in the future, on our website is incorporated by reference into this Form 10-K.

In 2006, the Company s Chief Executive Officer provided to the NYSE the Annual CEO Certification regarding the Company s compliance with the NYSE s corporate governance listing standards as required by Section 303A-12(a) of the NYSE Listed Company Manual. In addition, the Company has filed as exhibits to this annual report on Form 10-K for the year ended December 31, 2006, the applicable certifications of its Chief Executive Officer and its Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of the Company s public disclosures.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is hereby incorporated by reference to the Company s Proxy Statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2006 fiscal year.

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

The information required by this Item 12 is hereby incorporated by reference to the Company s Proxy Statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2006 fiscal year. Reference is also made to the information appearing in Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, under Item 5 of this Form 10-K, which is incorporated herein by, reference.

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

The information required by this Item 13 is hereby incorporated by reference to the Company s Proxy Statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2006 fiscal year.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 is hereby incorporated by reference to the Company s Proxy Statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2006 fiscal year.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) and (2) Financial Statements and Schedules

The information required by these sections of Item 15 are set forth in the Index to Consolidated Financial Statements under Item 8 of this annual report on Form 10-K.

(3) Exhibits

The following documents are filed as a part of, or incorporated by reference into, this report:

Exhibit No.	Description
3.1*	Second Restated Articles of Incorporation of the Company (previously filed as Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q, dated August 4, 2006, and incorporated herein by reference).
3.2*	Second Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q, dated August 4, 2006, and incorporated herein by reference).
10.1+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Thomas J. Hammond.
10.2+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Mark T. Hammond.
10.3+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Paul D. Borja.
10.4+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Kirstin A. Hammond.
10.5+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Robert O. Rondeau, Jr.
10.6*+	Employment Agreement, dated July 6, 2004 between Flagstar Bank, FSB and Joel D. Murray (previously filed as Exhibit 10.1 to the Company s Current Report on Form 8-K, dated August 2, 2005, and incorporated herein by reference).
10.7*+	Flagstar Bancorp, Inc. 1997 Employees and Directors Stock Option Plan as amended (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-125513), dated June 3, 2005, and incorporated herein by reference).
10.8*+	Flagstar Bank 401(k) Plan (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-77501), dated April 30, 1999, and incorporated herein by reference).
10.9*+	Flagstar Bancorp, Inc. 2000 Stock Incentive Plan as amended (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-125512), dated June 3, 2005, and incorporated

	herein by reference).
10.10*+	Flagstar Bancorp, Inc. Incentive Compensation Plan (previously filed as Exhibit 10.4 to the Company s Form S-1 Registration Statement (No. 333-21621) and incorporated herein by reference).
10.11*+	Flagstar Bancorp, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.1 to the Company s Current Report on Form 8-K, dated March 26, 2006, and incorporated herein by reference).
11	Statement regarding computation of per share earnings incorporated by reference to Note 29 of the Notes to Consolidated Financial Statements of this report.

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Exhibit No.	Description
14*	Flagstar Bancorp, Inc. Code of Business Conduct and Ethics (previously filed as Exhibit 14 to the Company s Annual Report on Form 10-K, dated March 16, 2006, and incorporated herein by reference)
21	List of Subsidiaries of the Company.
23	Consent of Virchow, Krause & Company, LLP
23.1	Consent of Grant Thornton LLP
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification, as furnished by the Chief Executive Officer pursuant to SEC Release No. 34-47551
32.2	Section 906 Certification, as furnished by the Chief Financial Officer pursuant to SEC Release No. 34-47551

* Incorporated herein by reference

\+ Constitutes a management contract or compensation plan or arrangement

Flagstar Bancorp, Inc., will furnish to any stockholder a copy of any of the exhibits listed above upon written request and upon payment of a specified reasonable fee, which fee shall be equal to the Company s reasonable expenses in furnishing the exhibit to the stockholder. Requests for exhibits and information regarding the applicable fee should be directed to Paul Borja, CFO at the address of the principal executive offices set forth on the cover of this Annual Report on Form 10-K.

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

(c) Financial Statement Schedules. See Item 15(a)(2) above.

[Remainder of page intentionally left blank.]

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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, on February 28, 2007.

FLAGSTAR BANCORP, INC.

By: /s/ MARK T. HAMMOND

Mark T. Hammond
President and Chief Executive 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 indicated on February 28, 2007.

	SIGNATURE	TITLE
By:	/s/ THOMAS J. HAMMOND Thomas J. Hammond	Chairman of the Board
By:	/s/ MARK T. HAMMOND Mark T. Hammond	Vice Chairman of the Board, President, and Chief Executive Officer (Principal Executive Officer)
By:	/s/ PAUL D. BORJA Paul D. Borja	Executive Vice-President and Chief Financial Officer (Principal Financial and Accounting Officer)
By:	/s/ KIRSTIN A. HAMMOND Kirstin A. Hammond	Executive Director and Director
By:	/s/ ROBERT O. RONDEAU, JR. Robert O. Rondeau, JR.	Executive Director and Director
By:	/s/ CHARLES BAZZY Charles Bazzy	Director
By:	/s/ JAMES D. COLEMAN James D. Coleman	Director
By:	/s/ RICHARD S. ELSEA Richard S. Elsea	Director

By:	/s/ MICHAEL LUCCI SR	Director
	Michael Lucci Sr.	

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	SIGNATURE	TITLE
By:	/s/ ROBERT W. DEWITT	Director
	Robert W. Dewitt	
By:	/s/ FRANK D ANGELO	Director
	Frank D Angelo	
By:	/s/ B. BRIAN TAUBER	Director
	B. Brian Tauber	
By:	/s/ JAY J. HANSEN	Director
	Jay J. Hansen	

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EXHIBIT INDEX

Exhibit No.	Description
3.1*	Second Restated Articles of Incorporation of the Company (previously filed as Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q, dated August 4, 2006, and incorporated herein by reference).
3.2*	Second Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q, dated August 4, 2006, and incorporated herein by reference).
10.1+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Thomas J. Hammond.
10.2+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Mark T. Hammond.
10.3+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Paul D. Borja.
10.4+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Kirstin A. Hammond.
10.5+	Employment Agreement, dated as of February 28, 2007, between the Company, Flagstar Bank, FSB, and Robert O. Rondeau, Jr.
10.6*+	Employment Agreement, dated July 6, 2004 between Flagstar Bank, FSB and Joel D. Murray (previously filed as Exhibit 10.1 to the Company s Current Report on Form 8-K, dated August 2, 2005, and incorporated herein by reference).
10.7*+	Flagstar Bancorp, Inc. 1997 Employees and Directors Stock Option Plan as amended (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-125513), dated June 3, 2005, and incorporated herein by reference).
10.8*+	Flagstar Bank 401(k) Plan (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-77501), dated April 30, 1999, and incorporated herein by reference).
10.9*+	Flagstar Bancorp, Inc. 2000 Stock Incentive Plan as amended (previously filed as Exhibit 4.1 to the Company s Form S-8 Registration Statement (No. 333-125512), dated June 3, 2005, and incorporated herein by reference).
10.10*+	Flagstar Bancorp, Inc. Incentive Compensation Plan (previously filed as Exhibit 10.4 to the Company s Form S-1 Registration Statement (No. 333-21621) and incorporated herein by reference).
10.11*+	Flagstar Bancorp, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.1 to the Company s Current Report on Form 8-K, dated March 26, 2006, and incorporated herein by reference).
11	Statement regarding computation of per share earnings incorporated by reference to Note 29 of the Notes to Consolidated Financial Statements of this report.
14*	Flagstar Bancorp, Inc. Code of Business Conduct and Ethics (previously filed as Exhibit 14 to the Company s Annual Report on Form 10-K, dated March 16, 2006, and incorporated herein by reference).
21	List of Subsidiaries of the Company.
23	Consent of Virchow, Krause & Company, LLP
23.1	Consent of Grant Thornton LLP
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer

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Exhibit No.	Description
32.1	Section 906 Certification, as furnished by the Chief Executive Officer pursuant to SEC Release No. 34-47551
32.2	Section 906 Certification, as furnished by the Chief Financial Officer pursuant to SEC Release No. 34-47551
23.1	Consent of Grant Thornton LLP
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification, as furnished by the Chief Executive Officer pursuant to SEC Release No. 34-47551
32.2	Section 906 Certification, as furnished by the Chief Financial Officer pursuant to SEC Release No. 34-47551

* Incorporated herein by reference

\+ Constitutes a management contract or compensation plan or arrangement

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