

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

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

For the quarter ended September 30, 1996

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

Commission file number 1-9819

RESOURCE MORTGAGE CAPITAL, INC.

(Exact name of registrant as specified in its charter)

Virginia 52-1549373

(State or other jurisdiction of I.R.S. Employer  
incorporation or organization) Identification No.)

4880 Cox Road, Glen Allen, Virginia 23060

(Address of principal executive offices) (Zip Code)

(804) 967-5800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
registrant was required to file such reports), and (2) has been subject  
to such filing requirements for the past ninety days. ☒ Yes ☐ No

On October 31, 1996, the registrant had 20,653,593 shares of common stock of  
\$.01 value outstanding, which is the registrant's only class of common stock.

RESOURCE MORTGAGE CAPITAL, INC.  
FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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RESOURCE MORTGAGE CAPITAL, INC.  
CONSOLIDATED BALANCE SHEETS

(amounts in thousands except share data)

<CAPTION>

|                             | September 30,<br>1996 | December 31,<br>1995 |
|-----------------------------|-----------------------|----------------------|
|                             | -----                 | -----                |
| <S>                         | <C>                   | <C>                  |
| ASSETS                      |                       |                      |
| Investments:                |                       |                      |
| Mortgage investments:       |                       |                      |
| Collateral for CMOs         | \$ 2,894,434          | \$ 1,028,935         |
| Mortgage securities         | 1,340,400             | 2,149,416            |
| Loans in warehouse          | 190,253               | 247,633              |
| Note receivable             | 47,500                | -                    |
|                             | -----                 | -----                |
|                             | 4,472,587             | 3,425,984            |
| Cash                        | 13,752                | 22,229               |
| Accrued interest receivable | 10,104                | 14,851               |
| Other assets                | 16,946                | 26,974               |
|                             | -----                 | -----                |
|                             | \$ 4,513,389          | \$ 3,490,038         |
|                             | =====                 | =====                |

LIABILITIES AND SHAREHOLDERS' EQUITY

|                                     |              |            |
|-------------------------------------|--------------|------------|
| LIABILITIES:                        |              |            |
| Collateralized mortgage obligations | \$ 2,710,648 | \$ 949,139 |
| Repurchase agreements               | 1,226,401    | 1,983,358  |
| Notes payable                       | 94,969       | 154,041    |
| Accrued interest payable            | 3,807        | 5,278      |
| Other liabilities                   | 29,721       | 43,399     |
|                                     | -----        | -----      |
|                                     | 4,065,546    | 3,135,215  |
|                                     | -----        | -----      |

SHAREHOLDERS' EQUITY:

Preferred stock, par value \$.01 per share, 50,000,000 shares authorized:

|  |         |         |
|--|---------|---------|
| 9.75% Cumulative Convertible Series A              |         |         |
| 1,552,500 issued and outstanding                   |         |         |
| (\$37,260 aggregate liquidation preference)        | 35,460  | 35,460  |
| 9.55% Cumulative Convertible Series B              |         |         |
| 2,196,824 issued and outstanding                   |         |         |
| (\$53,822 aggregate liquidation preference)        | 51,425  | 51,425  |
| Common stock, par value \$.01 per share,           |         |         |
| 50,000,000 shares authorized,                      |         |         |
| 20,553,943 and 20,198,654 issued and               |         |         |
| outstanding, respectively                          | 206     | 202     |
| Additional paid-in capital                         | 289,085 | 281,508 |
| Net unrealized gain (loss) on mortgage investments | 65,596  | (4,759) |
| Retained earnings (deficit)                        | 6,071   | (9,013) |
|  | -----   | -----   |

|    |           |              |
|----|-----------|--------------|
|    | 447,843   | 354,823      |
|    | -----     | -----        |
| \$ | 4,513,389 | \$ 3,490,038 |
|    | =====     | =====        |

See notes to unaudited consolidated financial statements.

</TABLE>

RESOURCE MORTGAGE CAPITAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(amounts in thousands except share data)

<TABLE>

<CAPTION>

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 1996                                | 1995      | 1996                               | 1995      |
|  | -----                               | -----     | -----                              | -----     |
| <S>  | <C>                                 | <C>       | <C>                                | <C>       |
| Interest income:   |                                     |           |                                    |           |
| Collateral for CMOs  | \$ 40,237                           | \$ 18,234 | \$ 95,880                          | \$ 40,940 |
| Mortgage securities  | 33,388                              | 42,110    | 105,344                            | 122,695   |
| Loans in warehouse   | 4,025                               | 6,406     | 26,505                             | 24,941    |
| Note receivable  | 763                                 | -         | 1,175                              | -         |
|  | -----                               | -----     | -----                              | -----     |
|  | 78,413                              | 66,750    | 228,904                            | 188,576   |
|  | -----                               | -----     | -----                              | -----     |
| Interest and related expense:  |                                     |           |                                    |           |
| Collateralized mortgage obligations                                  | 31,191                              | 14,557    | 75,270                             | 34,747    |
| Repurchase agreements  | 25,190                              | 35,130    | 88,150                             | 111,441   |
| Notes payable  | 1,743                               | 3,192     | 6,588                              | 9,045     |
| Other  | 387                                 | 791       | 2,083                              | 3,182     |
| Provision for losses   | 900                                 | 1,174     | 1,700                              | 1,636     |
|  | -----                               | -----     | -----                              | -----     |
|  | 59,411                              | 54,844    | 173,791                            | 160,051   |
|  | -----                               | -----     | -----                              | -----     |
| Net interest margin  | 19,002                              | 11,906    | 55,113                             | 28,525    |
| Gain (loss) on sale of single-family operations                      | (1,385 )                            | -         | 17,514                             | -         |
| Gain (loss) on sale of mortgage investments, net of associated costs | 3,297                               | 2,307     | (2,899 )                           | 7,157     |
| Other income   | 89                                  | 316       | 1,112                              | 2,235     |
| General and administrative expenses                                  | (4,445 )                            | (4,401 )  | (15,700 )                          | (13,152 ) |
|  | =====                               | =====     | =====                              | =====     |
| Net income   | \$ 16,558                           | \$ 10,128 | \$ 55,140                          | \$ 24,765 |
|  | =====                               | =====     | =====                              | =====     |
| Net income   | 16,558                              | 10,128    | 55,140                             | 24,765    |
| Dividends on preferred stock   | (2,195 )                            | (908 )    | (6,581 )                           | (908 )    |
|  | =====                               | =====     | =====                              | =====     |
| Net income available to common shareholders                          | \$ 14,363                           | \$ 9,220  | \$ 48,559                          | \$ 23,857 |
|  | =====                               | =====     | =====                              | =====     |
| Per common share:  |                                     |           |                                    |           |
| Primary  | \$ 0.70                             | \$ 0.46   | \$ 2.38                            | \$ 1.19   |
|  | =====                               | =====     | =====                              | =====     |
| Fully diluted  | \$ 0.68                             | \$ 0.46   | \$ 2.28                            | \$ 1.19   |
|  | =====                               | =====     | =====                              | =====     |

See notes to unaudited consolidated financial statements.

</TABLE>

RESOURCE MORTGAGE CAPITAL, INC.  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
(amounts in thousands except share data)

<TABLE>

&lt;CAPTION&gt;

|  | Net             |           |              |                            |  |                             |            |
|--|-----------------|-----------|--------------|----------------------------|--|-----------------------------|------------|
|  | Preferred stock |           | Common stock | Additional paid-in capital | unrealized gain (loss) on mortgage investments | Retained earnings (deficit) | Total      |
|  | Series A        | Series B  |              |                            |  |                             |            |
|  | -----           | -----     | -----        | -----                      | -----  | -----                       | -----      |
| <S>  | <C>             | <C>       | <C>          | <C>                        | <C>  | <C>                         | <C>        |
| Balance at December 31, 1995                                 | \$35,460        | \$ 51,425 | \$ 202       | \$ 281,508                 | \$ (4,759 )                                    | \$ (9,013)                  | \$354,823  |
| Net income - nine months ended                               |                 |           |              |                            |  |                             |            |
| September 30, 1996   | -               | -         | -            | -                          | -  | 55,140                      | 55,140     |
| Issuance of common stock                                     | -               | -         | 4            | 7,577                      | -  | -                           | 7,581      |
| Net change in unrealized gain (loss) on mortgage investments | -               | -         | -            | -                          | 70,355   | -                           | 70,355     |
| Common dividends declared - \$1.645 per share                | -               | -         | -            | -                          | -  | (33,475 )                   | (33,475)   |
| Preferred Series A dividends declared - \$1.755 per share    | -               | -         | -            | -                          | -  | (2,725 )                    | (2,725)    |
| Preferred Series B dividends declared - \$1.755 per share    | -               | -         | -            | -                          | -  | (3,856 )                    | (3,856)    |
|  | -----           | -----     | -----        | -----                      | -----  | -----                       | -----      |
| Balance at September 30, 1996                                | \$35,460        | \$ 51,425 | \$ 206       | \$ 289,085                 | \$ 65,596                                      | \$ 6,071                    | \$ 447,843 |
|  | =====           | =====     | =====        | =====                      | =====  | =====                       | =====      |

See notes to unaudited consolidated financial statements.

&lt;/TABLE&gt;

&lt;TABLE&gt;

RESOURCE MORTGAGE CAPITAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
<CAPTION>  
(amounts in thousands)

|   | Nine Months Ended |            |
|---|-------------------|------------|
|   | September 30,     |            |
|   | 1996              | 1995       |
|   | -----             | -----      |
| <S>   | <C>               | <C>        |
| Operating activities:   |                   |            |
| Net income available to common shareholders                                       | \$ 48,559         | \$23,857   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |            |
| Provision for losses  | 1,700             | 1,636      |
| Net loss (gain) from sale of mortgage investments                                 | 2,899             | (2,276 )   |
| Gain on sale of single-family operations  | (17,514 )         | -          |
| Amortization and depreciation   | 16,574            | 9,651      |
| Net decrease in loans in warehouse  | 78,969            | 191,574    |
| Net decrease in accrued interest, other assets and other liabilities              | (61,604 )         | (14,064 )  |
| Other   | -                 | 2,638      |
|   | -----             | -----      |
| Net cash provided by operating activities   | 69,583            | 213,016    |
|   | -----             | -----      |
| Investing activities:   |                   |            |
| Collateral for CMOs:  |                   |            |
| Fundings of loans subsequently securitized  | (1,571,670)       | (464,564 ) |
| Principal payments on collateral  | 296,752           | 149,908    |
| Net change in funds held by trustees  | 3,056             | 797        |
|   | -----             | -----      |
|   | (1,271,862)       | (313,859 ) |
| Purchase of mortgage securities   | (51,157 )         | (431,226 ) |
| Principal payments on mortgage securities   | 287,277           | 171,875    |
| Proceeds from sales of mortgage securities  | 25,112            | 634,364    |
| Proceeds from sale of single-family operations                                    | 20,413            | -          |
| Capital expenditures  | (1,913 )          | (584 )     |
|   | -----             | -----      |
| Net cash (used for) provided by investing activities                              | (992,130 )        | 60,570     |
|   | -----             | -----      |
| Financing activities:   |                   |            |

Financing activities:

|   |            |            |
|---|------------|------------|
| Collateralized mortgage obligations                       |            |            |
| Proceeds from issuance of securities                      | 2,059,754  | 451,155    |
| Principal payments on securities                          | (277,840 ) | (125,692 ) |
|   | -----      | -----      |
|   | 1,781,914  | 325,463    |
| Repayments of borrowings, net                             | (837,921 ) | (623,146 ) |
| Proceeds from issuance of common stock, net               | 7,581      | 36,435     |
| Dividends paid  | (37,504 )  | (15,275 )  |
|   | -----      | -----      |
| Net cash provided by (used for) financing activities      | 914,070    | (276,523 ) |
|   | -----      | -----      |
| Net decrease in cash                                      | (8,477 )   | (2,937 )   |
| Cash at beginning of period                               | 22,229     | 6,340      |
|   | =====      | =====      |
| Cash at end of period                                     | \$ 13,752  | \$ 3,403   |
|   | =====      | =====      |
| Cash paid for interest                                    | \$167,404  | \$ 160,279 |
|   | =====      | =====      |
| See notes to unaudited consolidated financial statements. |            |            |
| </TABLE>  |            |            |

#### RESOURCE MORTGAGE CAPITAL, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS September 30, 1996 (amounts in thousands except share data)

#### NOTE 1--BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. The consolidated financial statements include the accounts of Resource Mortgage Capital, Inc., its wholly-owned subsidiaries, and certain other entities. As used herein, the "Company" refers to Resource Mortgage Capital, Inc. (RMC) and each of the entities that is consolidated with RMC for financial reporting purposes. A portion of the Company's operations are operated by taxable corporations that are consolidated with RMC for financial reporting purposes, but are not consolidated for income tax purposes. All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the consolidated financial statements have been included. The Consolidated Balance Sheet at September 30, 1996, the Consolidated Statements of Operations for the three and nine months ended September 30, 1996 and 1995, the Consolidated Statement of Shareholders' Equity for the nine months ended September 30, 1996, the Consolidated Statements of Cash Flows for the nine months ended September 30, 1996 and 1995 and related notes to consolidated financial statements are unaudited. Operating results for the nine months ended September 30, 1996 are not necessarily indicative of the results that may be expected for the year ending December 31, 1996. For further information, refer to the audited consolidated financial statements and footnotes included in the Company's Form 10-K for the year ended December 31, 1995.

Certain amounts for 1995 have been reclassified to conform with the presentation for 1996.

#### NOTE 2--NET INCOME PER COMMON SHARE

Net income per common share as shown on the consolidated statements of operations for the three and nine months ended September 30, 1996 and 1995 is presented on both a primary net income per common share and fully diluted net income per common share basis. Fully diluted net income per common share is computed by dividing net income applicable to common stock by the average number of shares of common stock and common stock equivalents outstanding for items that are dilutive. The average number of shares is increased by the assumed conversion of convertible items, but only if dilutive. For the three and nine months ended September 30, 1996, the Company's Series A and B Cumulative Convertible Preferred Stocks were dilutive. Series A and Series B Preferred Stock are convertible to shares of common stock on a one-for-one basis. The following table summarizes the average number of shares of common stock and equivalents used to compute primary and fully diluted net income per common share for the three and nine months ended September 30, 1996 and 1995:

<TABLE>

<CAPTION>

|               | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|---------------|-------------------------------------|------------|------------------------------------|------------|
|               | 1996                                | 1995       | 1996                               | 1995       |
| <S>           | <C>                                 | <C>        | <C>                                | <C>        |
| Primary       | 20,510,777                          | 20,129,011 | 20,385,592                         | 20,104,265 |
| Fully diluted | 24,260,101                          | 20,129,011 | 24,134,916                         | 20,104,265 |

</TABLE>

NOTE 3--AVAILABLE FOR SALE MORTGAGE INVESTMENTS

The following table summarizes the Company's amortized cost basis of collateral for CMOs and mortgage securities held at September 30, 1996 and December 31, 1995, and the related average effective interest rates (calculated excluding unrealized gains and losses) for the month ended September 30, 1996 and December 31, 1995:

<TABLE>

|                                     | September 30, 1996   |                               | December 31, 1995    |                            |
|-------------------------------------|----------------------|-------------------------------|----------------------|----------------------------|
|                                     | Amortized<br>Cost    | Effective<br>Interest<br>Rate | Amortized<br>Cost    | Effective<br>Interest Rate |
| <S>                                 | <C>                  | <C>                           | <C>                  | <C>                        |
| Collateral for CMOs                 | \$ 2,850,371         | 8.3%                          | \$ 1,012,399         | 8.4%                       |
| Allowance for losses                | (31,764)             |                               | (1,800)              |                            |
| Amortized cost, net                 | \$ 2,818,607         |                               | \$ 1,010,599         |                            |
| Mortgage securities:                |                      |                               |                      |                            |
| Adjustable-rate mortgage securities | \$ 1,296,188         | 6.6%                          | \$ 2,087,435         | 7.0%                       |
| Fixed-rate mortgage securities      | 22,680               | 10.3%                         | 35,074               | 10.6%                      |
| Other mortgage securities           | 38,006               | 18.0%                         | 56,190               | 8.8%                       |
| Allowance for losses                | 1,356,874<br>(6,244) |                               | 2,178,699<br>(6,188) |                            |
| Amortized cost, net                 | \$ 1,350,630         |                               | \$ 2,172,511         |                            |

</TABLE>

The Company has classified collateral for CMOs and all mortgage securities as available-for-sale. Other mortgage securities with an aggregate principal balance of \$27,087 were sold during the three and nine months ended September 30, 1996 for an aggregate net loss of \$1,975. The specific identification method is used to calculate the basis of mortgage investments sold. In addition, the Company reduced the basis in certain other mortgage securities as expectations of future prepayment rates would result in the Company receiving less cash than its current basis in those investments. The adjustment recorded was \$1,143 and is included in loss on sale of mortgage investments in the accompanying financial statements.

The following table presents the fair value of the Company's collateral for CMOs and mortgage securities held at September 30, 1996 and December 31, 1995:

<TABLE>

<CAPTION>

|     | September 30, 1996     |                        | December 31, 1995      |                        |
|-----|------------------------|------------------------|------------------------|------------------------|
|     | Collateral<br>for CMOs | Mortgage<br>securities | Collateral<br>for CMOs | Mortgage<br>securities |
| <S> | <C>                    | <C>                    | <C>                    | <C>                    |

|                         |              |              |              |              |
|-------------------------|--------------|--------------|--------------|--------------|
| Amortized cost, net     | \$ 2,818,607 | \$ 1,350,630 | \$ 1,010,599 | \$ 2,172,511 |
| Gross unrealized gains  | 76,288       | 21,647       | 20,208       | 22,488       |
| Gross unrealized losses | (461 )       | (31,877 )    | (1,872 )     | (45,583 )    |
| <hr/>                   |              |              |              |              |
| Fair value              | \$ 2,894,434 | \$ 1,340,400 | \$ 1,028,935 | \$ 2,149,416 |
| <hr/>                   |              |              |              |              |

</TABLE>

#### NOTE 4--SALE OF SINGLE-FAMILY OPERATIONS

On May 13, 1996, the Company sold its single-family correspondent, wholesale, and servicing operations (collectively, the single-family mortgage operations) to Dominion Mortgage Services, Inc. (Dominion), a wholly-owned subsidiary of Dominion Resources, Inc. (NYSE: D). The purchase price was \$68 million for the stock and assets of the single-family mortgage operations. The terms of the purchase included an initial cash payment of \$20.4 million, with the remainder of the purchase price paid in five annual installments of \$9.5 million beginning January 2, 1997, pursuant to a note agreement. The note bears interest at a rate of 6.50%. The terms of the sale generally prohibit the Company from acquiring single-family, residential mortgages through either correspondents or a wholesale network for a period of five years. As a result of the sale, the Company recorded a net gain of \$17.5 million. Such amount is net of various reserves for contingent liabilities related to the sale of the operations and includes a provision of \$31.0 million for possible losses on single-family loans where the Company, which performed the servicing of such loans prior to the sale, has retained a portion of the credit risk on these loans.

#### NOTE 5--ADOPTION OF FINANCIAL ACCOUNTING STANDARDS

In January 1996, the Company adopted Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation" (FAS No. 123). FAS No. 123 establishes a fair value based method of accounting for stock-based compensation plans. FAS No. 123 permits entities to expense an estimated fair value of employee stock options or to continue to measure compensation cost for these plans using the intrinsic value accounting method contained in APB Opinion No. 25. As the Company issues only stock appreciation rights pursuant to various stock incentive plans which are currently paid in cash, the impact of adopting FAS No. 123 did not result in a material change to the Company's financial position or results of operations.

In June 1996, the Financial Accounting Standards Board (FASB) issued FAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". FAS No. 125 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities based on consistent application of a financial components approach that focuses on control of the respective assets and liabilities. It distinguishes transfers of financial assets that are sales from transfers that are secured borrowings. FAS No. 125 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996. The impact of this statement on the Company's financial position and results of operations has not been determined, but is not expected to be material.

#### NOTE 6--ACQUISITION OF MULTI-FAMILY CAPITAL MARKETS, INC.

On August 30, 1996, the Company acquired Multi-Family Capital Markets, Inc. (MCM), which specializes in the sourcing, underwriting and closing of multi-family loans secured by first liens on apartment properties that have qualified for low income housing tax credits. The Company acquired all of the outstanding stock and assets of MCM for \$4 million. Of this amount, \$2.8 million was paid in cash with the remaining \$1.2 million paid through the issuance of notes to the sellers, due in installments through September 1, 1999 and September 1, 2001. The acquisition was accounted for as a purchase, and accordingly, the purchase price was allocated to the assets and liabilities acquired based on their estimated fair values as of the date of acquisition. MCM's results of operations are not material to the Company's consolidated financial statements and proforma financial information has therefore not been presented.

#### NOTE 7--SUBSEQUENT EVENT

On October 9, 1996, the Company issued 1,840,000 shares of Series C 9.73% Cumulative Convertible Preferred Stock at a price of \$30 per share. Net proceeds from this issuance totaled \$52.9 million.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

Summary

Resource Mortgage Capital, Inc. (the Company) is a mortgage and consumer finance company which uses its production operations to create investments for its portfolio. Currently, the Company's primary production operations include the origination of loans secured by manufactured housing and the origination of mortgage loans secured by multi-family properties. The Company will generally securitize loans funded as collateral for collateralized mortgage obligations (CMOs) or pass-through securities to limit its credit risk and provide long-term financing for its portfolio. The majority of the Company's current investment portfolio is comprised of loans or securities ("ARM loans" or "ARM securities") that have coupon rates which adjust over time (subject to certain limitations) in conjunction with changes in short-term interest rates. The Company intends to expand its production sources in the future to include other financial products, such as commercial real estate loans. The Company has elected to be treated as a real estate investment trust (REIT) for federal income tax purposes and as such must distribute substantially all of its taxable income to shareholders and will generally not be subject to federal income tax.

On May 13, 1996, the Company completed the sale of its single-family mortgage operations to Dominion Mortgage Services, Inc. (Dominion), a wholly-owned subsidiary of Dominion Resources, Inc., for approximately \$68 million. Included in the single-family mortgage operations were the Company's single-family correspondent, wholesale, and servicing operations. The sale resulted in a gain of \$17.5 million, which was net of various reserves for contingent liabilities related to the single-family mortgage operations including a provision of \$31.0 million for possible losses on single-family loans where the Company has retained a portion of the credit risk and where, prior to the sale, the Company had serviced such single-family loans.

The Company's principle sources of earnings are net interest income on its investment portfolio and loans in warehouse. The Company's investment portfolio consists principally of collateral for CMOs and adjustable-rate mortgage (ARM) securities. The Company funds its production and its portfolio investments with both borrowings and cash raised from the issuance of equity capital. For the portion of loans in warehouse and portfolio investments funded with borrowings, the Company generates net interest income to the extent that there is a positive spread between the yield on the earning assets and the cost of borrowed funds. For that portion of the balance sheet that is funded with equity capital, net interest income is primarily a function of the yield generated from the interest earning asset. The cost of the Company's borrowings may be increased or decreased by interest rate swap, cap or floor agreements.

Approximately \$3.7 billion of the Company's investment portfolio as of September 30, 1996, is comprised of ARM loans or ARM securities. Generally, during a period of rising interest rates, the Company's net interest spread earned on its investment portfolio will decrease. The decrease of the net interest spread results from (i) the lag in resets of the ARM loans underlying the ARM securities and collateral for CMOs and (ii) rate resets on the ARM loans which are generally limited to 1% every six months, while the associated borrowings have no such limitation. As interest rates stabilize and the ARM loans reset, the net interest margin may be restored to its former level as the yields on the ARM loans adjust to market conditions. Conversely, net interest margin may increase following a fall in short-term interest rates; this increase may be temporary as the yields on the ARM loans adjust to the new market conditions after a lag period. In each case, however, the Company expects that the increase or decrease in the net interest spread due to changes in the short-term interest rates is temporary. The net interest spread may also be increased or decreased by the cost or proceeds of the interest rate swap, cap or floor agreements.

The Company strives to create a diversified portfolio of investments that in the aggregate generates stable income for the Company in a variety of interest rate environments and preserves the capital base of the Company. The Company seeks to generate growth in earnings and dividends per share in a variety of ways, including (i) adding investments to its portfolio when opportunities in the market are favorable; (ii) developing production capabilities to originate and acquire financial assets in order to create attractively priced investments for its portfolio, as well as control the underwriting and servicing of such financial assets; and (iii) increasing the efficiency with which the Company utilizes its equity capital over time. To increase potential returns to shareholders, the Company also employs leverage through the use of secured borrowings and repurchase agreements to fund a portion of its production and portfolio investments. Currently, the Company's production operations are comprised of multi-family and manufactured housing lending. The Company's strategy is to expand these existing production sources as well as to diversify into other financial products such as commercial real estate loans. The Company also intends to selectively purchase single-family loans in bulk with the intent to securitize such loans as collateral for CMOs. By pursuing these strategies, the Company believes it can create investments for the portfolio at a lower effective cost than if such assets were purchased in the market, although there can be no assurance that the Company will be successful in accomplishing this strategy.



In order to grow its equity base, the Company may issue additional preferred or common stock. Management strives to issue such additional shares when it believes existing shareholders are likely to benefit from such offerings through higher earnings and dividends per share than as compared to the level of earnings and dividends the Company would likely generate without such offerings.

On August 30, 1996, the Company acquired Multi-Family Capital Markets, Inc. (MCM), which specializes in the sourcing, underwriting and closing of multi-family loans secured by first liens on apartment properties that have qualified for low income housing tax credits. The Company acquired all of the outstanding stock and assets of MCM for \$4.0 million. The Company believes this acquisition will complement its current strategy of expanding its multi-family lending business and will improve its competitive position in the marketplace for such loans.

<TABLE>

# RESULTS OF OPERATIONS

<CAPTION>

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| (amounts in thousands except per share information)             | 1996                                | 1995      | 1996                               | 1995      |
| <S>   | <C>                                 | <C>       | <C>                                | <C>       |
| Net interest margin   | \$ 19,002                           | \$ 11,906 | \$ 55,113                          | \$ 28,525 |
| Gain (loss) on sale of single-family operations                 | (1,385 )                            | -         | 17,514                             | -         |
| Gain (loss) on sale of mortgage investments, net                | 3,297                               | 2,307     | (2,899 )                           | 7,157     |
| General and administrative expenses                             | 4,445                               | 4,401     | 15,700                             | 13,152    |
| Net income  | 16,558                              | 10,128    | 55,140                             | 24,765    |
| Primary net income per common share                             | 0.70                                | 0.46      | 2.38                               | 1.19      |
| Fully diluted net income per common share                       | 0.68                                | 0.46      | 2.28                               | 1.19      |
| Principal balance of loans funded through production operations | 70,757                              | 242,213   | 656,460                            | 679,008   |
| Dividends declared per share:                                   |                                     |           |                                    |           |
| Common  | \$ 0.585                            | \$ 0.440  | \$ 1.645                           | \$ 1.200  |
| Series A Preferred  | 0.585                               | 0.585     | 1.755                              | 0.585     |
| Series B Preferred  | 0.585                               | -         | 1.755                              | -         |

</TABLE>

Three Months and Nine Months Ended September 30, 1996 Compared to Three Months and Nine Months Ended September 30, 1995. The increase in the Company's earnings during the nine months ended September 30, 1996 as compared to the same period in 1995 is primarily the result of the increase in net interest margin and the gain on the sale of the single-family operations offset partially by a decline in the gain on sale of mortgage investments and an increase in general and administrative expenses. The increase in the Company's earnings during the three months ended September 30, 1996 as compared with the same period in 1995 can be attributed primarily to an increase in net interest margin.

Net interest margin for the nine months ended September 30, 1996 increased to \$55.1 million, or 93%, over the \$28.5 million for the same period for 1995. This increase was a result of an overall increase in the net interest spread on all interest-earning assets, as well as the increased contribution from CMOs issued. The net interest spread on all investments increased to 160 basis points for the nine months ended September 30, 1996 versus 92 basis points for the nine months ended September 30, 1995. The increase in the net interest spreads is generally attributable to the ARM securities continued upward rate resets, such that these securities were generally fully-indexed for the first nine months of 1996, and the more favorable interest rate environment on borrowings related to the ARM securities and CMOs.

Gain on sale of the Company's single-family operations and mortgage investments increased to a net \$14.6 million for the nine months ended September 30, 1996, from \$7.2 million for the nine months ended September 30, 1995. The increase of the net gain is due to a one-time gain related to the sale of the Company's single-family correspondent, wholesale and servicing business. The sale of the Company's single-family operations was completed in May 1996, at a recorded gain of \$18.9 million. Additional adjustments related to the sale were made in the third quarter, reducing the gain recorded by \$1.4 million to \$17.5 million. The gain generated from the sale of single-family operations is offset by a \$7.5

million loss during the second quarter from the sale of certain underperforming securities in the Company's investment portfolio. Additional adjustments related to the sale of these underperforming investments were made in the third quarter, reducing the loss by \$2.2 million to \$5.3 million. The net gain on sale for the nine months ended September 30, 1996, was further reduced by a reduction in the carrying value of certain other mortgage securities as expectations of future prepayment rates will result in the Company receiving less cash than its current basis in those investments. For the nine months ended September 30, 1995, the gain on sale of mortgage investments includes gains of \$3.6 million related to securitizations and whole loan sales of single-family loans, \$1.2 million from the sale of servicing and \$2.3 million related to the sale of investments.

General and administrative expenses increased \$2.5 million, or 19.4%, to \$15.7 million for the nine months ended September 30, 1996, as the Company continues to build its infrastructure for its manufactured housing operations. General and administrative expenses also increased from 1995 as a result of the Company's continued expansion of its wholesale origination capabilities for its single-family operations prior to the sale.

The following table summarizes the average balances of the Company's interest-earning assets and their average effective yields, along with the Company's average interest-bearing liabilities and the related average effective interest rates, for each of the periods presented.

Average Balances and Effective Interest Rates

<TABLE>

<CAPTION>

|                        |  | Three Months Ended September 30, |                   |                    |                   | Nine Months Ended September 30, |                   |                    |                   |
|------------------------|--|----------------------------------|-------------------|--------------------|-------------------|---------------------------------|-------------------|--------------------|-------------------|
| (amounts in thousands) |  | 1996                             |                   | 1995               |                   | 1996                            |                   | 1995               |                   |
|                        |  | Average<br>Balance               | Effective<br>Rate | Average<br>Balance | Effective<br>Rate | Average<br>Balance              | Effective<br>Rate | Average<br>Balance | Effective<br>Rate |
| <S>                    |  | <C>                              | <C>               | <C>                |                   | <C>                             | <C>               | <C>                | <C>               |
|                        | Interest-earning assets : (1)                |                                  |                   |                    |                   |                                 |                   |                    |                   |
|                        | Collateral for CMOs (2)                      | \$1,949,747                      | 8.25%             | \$ 833,871         | 8.38 %            | \$1,541,407                     | 8.29%             | \$635,493          | 8.50%             |
|                        | Adjustable-rate mortgage securities          | 1,821,973                        | 6.61              | 2,209,192          | 6.96              | 1,910,486                       | 6.72              | 2,151,567          | 6.74              |
|                        | Fixed-rate mortgage securities               | 41,631                           | 10.22             | 66,674             | 9.09              | 41,157                          | 10.77             | 104,699            | 8.10              |
|                        | Other mortgage securities                    | 50,934                           | 17.32             | 54,132             | 15.81             | 56,368                          | 13.45             | 56,744             | 17.76             |
|                        | Note receivable                              | 47,500                           | 6.43              | -                  | -                 | 24,278                          | 6.45              | -                  | -                 |
|                        | Loans in warehouse                           | 194,753                          | 8.27              | 286,566            | 9.01              | 424,599                         | 8.32              | 385,207            | 8.30              |
|                        | Total interest-earning assets                | \$4,106,538                      | 7.64%             | \$ 3,450,435       | 7.66 %            | \$ 3,998,295                    | 7.63%             | \$3,333,710        | 7.49%             |
|                        |  | =====                            | =====             | =====              | =====             | =====                           | =====             | =====              | =====             |
|                        | Interest-bearing liabilities:                |                                  |                   |                    |                   |                                 |                   |                    |                   |
|                        | CMOs (3)                                     | \$1,843,194                      | 6.50%             | \$787,372          | 7.14 %            | \$1,461,615                     | 6.59%             | \$ 614,651         | 7.23%             |
|                        | Repurchase agreements:                       |                                  |                   |                    |                   |                                 |                   |                    |                   |
|                        | Adjustable-rate mortgage securities          | 1,720,430                        | 5.50              | 2,075,714          | 6.17              | 1,819,937                       | 5.57              | 1,981,963          | 6.31              |
|                        | Fixed-rate mortgage securities               | 37,691                           | 5.68              | 59,786             | 5.63              | 33,175                          | 5.75              | 95,533             | 5.48              |
|                        | Other mortgage securities                    | 8,911                            | 5.62              | 6,212              | 6.31              | 8,421                           | 5.73              | 5,870              | 6.36              |
|                        | Warehouse                                    | 55,927                           | 5.89              | 118,545            | 6.92              | 240,757                         | 6.28              | 248,067            | 7.08              |
|                        | Warehouse notes payable                      | 1,791                            | 7.15              | 112,048            | 7.13              | 45,951                          | 5.80              | 85,751             | 7.68              |
|                        | Total interest-bearing liabilities           | \$3,667,944                      | 6.07%             | \$ 3,159,677       | 6.46 %            | \$3,609,856                     | 6.03%             | \$3,031,835        | 6.57%             |
|                        |  | =====                            | =====             | =====              | =====             | =====                           | =====             | =====              | =====             |
|                        | Net interest spread on all investments       |                                  | 1.57%             |                    | 1.20 %            |                                 | 1.60%             |                    | 0.92%             |
|                        |  |                                  | -----             |                    | -----             |                                 | -----             |                    |                   |
|                        | Net yield on average interest earning assets |                                  | 2.21%             |                    | 1.74 %            |                                 | 2.19%             |                    | 1.51%             |

<FN>

(1) Average balances exclude adjustments made in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" to record available-for-sale securities at

(2) Average balances exclude funds held by trustees of \$2,555 and \$2,953 for the three months ended September 30, 1996 and September 30, 1995, respectively and \$2,995 and \$3,999 for the nine months ended September 30, 1996 and September 30, 1995, respectively.

(3) Effective rates are calculated excluding non-interest related CMO expenses and provision for credit losses.

</FN>

</TABLE>

## PORTFOLIO RESULTS

Interest Income and Interest Earning Assets

&lt;TABLE&gt;

|     | Average<br>Interest<br>Earning<br>Assets | Interest<br>Income | Average<br>Asset<br>Yield | Daily<br>Average Six<br>Month LIBOR | Yield<br>versus<br>Six Month<br>LIBOR |
|-----|--|--------------------|---------------------------|-------------------------------------|---------------------------------------|
| <C> | <C>                                      | <C>                | <C>                       | <C>                                 | <C>                                   |

|                 |            |         |       |       |       |
|-----------------|------------|---------|-------|-------|-------|
| 1995, Quarter 1 | \$ 3,406.9 | \$ 60.8 | 7.14% | 6.60% | 0.54% |
| 1995, Quarter 2 | 3,181.4    | 61.3    | 7.71% | 6.14% | 1.57% |
| 1995, Quarter 3 | 3,450.4    | 66.1    | 7.66% | 5.89% | 1.77% |
| 1995, Quarter 4 | 3,360.8    | 64.5    | 7.67% | 5.75% | 1.92% |
| 1996, Quarter 1 | 3,746.3    | 72.1    | 7.70% | 5.34% | 2.36% |
| 1996, Quarter 2 | 4,164.8    | 78.3    | 7.52% | 5.64% | 1.88% |
| 1996, Quarter 3 | 4,106.5    | 78.4    | 7.64% | 5.80% | 1.84% |

</TABLE>

The net yield on average interest earning assets increased to 2.21% for the three months ended September 30, 1996, compared to 2.11% for the three months ended June 30, 1996 and 1.74% for the three months ended September 30, 1995. The increase from the three months ended June 30, 1996 and September 30, 1995 is principally due to the increase in the spread earned on the interest-earning assets, despite an increase in average interest-earning assets to \$4.1 billion for the three months ended September 30, 1996. Average interest earning assets will continue to increase as the Company retains loans funded through its production operations as collateral for CMOs. Net yield on average interest-earning assets is expected to decrease as a result. Net yield as a percentage of net average assets (defined as interest earning assets less non-recourse CMOs issued), was 6.84% for the three months ended September 30, 1996, versus 5.62% for the three months ended June 30, 1996 and 3.01% for the three months ended September 30, 1995. Net yield as a percentage of net average assets is expected to increase due to the continued use of non-recourse CMOs. The net yield percentages presented below exclude non-interest CMO expenses such as provision for credit losses, and interest on senior notes payable. For the three months ended September 30, 1996, if these expenses were included, the net yield on average interest-earning assets would be 1.85%, and the net yield on net average assets would be 6.30%, respectively.

<TABLE>

Net Yield on Average Interest Earning Assets  
(\$ in millions)

| <CAPTION>       |     |  |  |                              |  |
|-----------------|-----|--|--|------------------------------|--|
|                 |     | Average<br>Interest<br>Earning<br>Assets | Net Yield<br>on Average<br>Interest<br>Earning<br>Assets | Net<br>Average<br>Assets (1) | Net Yield<br>on Net<br>Average<br>Assets |
| <S>             | <C> | <C>                                      | <C>  | <C>                          | <C>                                      |
| 1995, Quarter 1 | \$  | 3,406.9                                  | 1.23%  | \$ 3,259.8                   | 1.46%                                    |
| 1995, Quarter 2 |     | 3,181.4                                  | 1.60%  | 3,036.6                      | 2.28%                                    |
| 1995, Quarter 3 |     | 3,450.4                                  | 1.74%  | 3,031.5                      | 3.01%                                    |
| 1995, Quarter 4 |     | 3,360.8                                  | 2.00%  | 2,800.4                      | 3.78%                                    |
| 1996, Quarter 1 |     | 3,746.3                                  | 2.23%  | 2,757.5                      | 4.72%                                    |
| 1996, Quarter 2 |     | 4,164.8                                  | 2.11%  | 2,937.9                      | 5.62%                                    |
| 1996, Quarter 3 |     | 4,106.5                                  | 2.21%  | 2,734.3                      | 6.84%                                    |

<FN>

(1) Average interest earning assets less non-recourse CMOs.

</FN>

</TABLE>

The average asset yield is reduced for the amortization of premium on the Company's investment portfolio. By creating its investments through its production operations, the Company believes that premium amounts are less than if the investments were acquired in the market. As indicated in the table below, premiums on the Company's ARM securities, fixed-rate securities and collateral for CMOs at September 30, 1996 was \$60.8 million, or approximate by 1.60% of the aggregate investment portfolio balance. The mortgage principal repayment rate for the Company (indicated in the table below as "CPR Annualized Rate") was 19% for the three months ended September 30, 1996. The Company expects that the long-term prepayment speeds will range between 18% and 21%. The CPR for the third quarter of 1996 is currently within this range and the Company expects it will remain within this range for the fourth quarter of 1996. CPR stands for "constant prepayment rate" and is a measure of the annual prepayment rate on a pool of loans.

<TABLE>

Premium Basis and Amortization  
(\$ in millions)

|  |  |             |              |                | Amortization                |
|--|--|-------------|--------------|----------------|-----------------------------|
|  |  |             |              |                | Expense as                  |
|  |  |             |              |                | a % of                      |
|  |  |             |              |                | Average                     |
|  |  | Net Premium | Amortization | CPR Annualized | Ending Investment Principal |

|                 | (Discount) | Expense | Rate | Balance    | Assets |
|-----------------|------------|---------|------|------------|--------|
| <S>             | <C>        | <C>     | <C>  | <C>        | <C>    |
| 1995, Quarter 1 | 26.6       | \$ 1.0  | (1)  | \$ 2,454.2 | 0.12%  |
| 1995, Quarter 2 | 23.7       | 1.6     | (1)  | 2,432.5    | 0.21%  |
| 1995, Quarter 3 | 35.3       | 2.5     | (1)  | 2,705.0    | 0.30%  |
| 1995, Quarter 4 | 39.3       | 2.8     | (1)  | 2,772.9    | 0.33%  |
| 1996, Quarter 1 | 49.3       | 3.2     | 30%  | 3,214.4    | 0.34%  |
| 1996, Quarter 2 | 56.0       | 4.0     | 28%  | 3,557.7    | 0.38%  |
| 1996, Quarter 3 | 60.8       | 2.8     | 19%  | 3,808.3    | 0.28%  |

<FN>  
(1) CPR rates were not available for those periods.

</FN>  
</TABLE>

#### Interest Expense and Cost of Funds

The Company's largest expense is the interest cost on borrowed funds. Funds to finance the investment portfolio are borrowed in the form of CMOs or repurchase agreements, both of which are primarily indexed to LIBOR, principally one-month LIBOR. For the nine month period ended September 30, 1996 as compared to the same period in 1995, interest expense increased to \$163.4 million from \$149.8 million while the average cost of funds decreased to 6.07% for the nine month period ended September 30, 1996 compared to 6.57% for the nine month period ended September 30, 1995. The Company's cost of funds rose in conjunction with the increase in the one-month LIBOR rate through the second quarter of 1995, and then began to decline correspondingly with the decline in interest rates since that time. The Company may use interest rate swaps, caps and financial futures to manage its interest rate risk. The net costs during the related period of these instruments are included in the cost of funds table below.

<TABLE>  
Cost of Funds  
(\$ in millions)

<CAPTION>

|                 | Average<br>Borrowed Funds | GAAP<br>Interest<br>Expense (a) | Cost<br>of<br>Funds | Average<br>One-month<br>LIBOR |
|-----------------|---------------------------|---------------------------------|---------------------|-------------------------------|
| <S>             | <C>                       | <C>                             | <C>                 | <C>                           |
| 1995, Quarter 1 | \$ 3,058.1                | \$ 50.3                         | 6.58%               | 6.06%                         |
| 1995, Quarter 2 | 2,906.1                   | 48.5                            | 6.68%               | 6.08%                         |
| 1995, Quarter 3 | 3,159.7                   | 51.0                            | 6.46%               | 5.88%                         |
| 1995, Quarter 4 | 3,025.3                   | 47.6                            | 6.30%               | 5.86%                         |
| 1996, Quarter 1 | 3,425.8                   | 51.3                            | 5.99%               | 5.43%                         |
| 1996, Quarter 2 | 3,735.8                   | 56.4                            | 6.04%               | 5.45%                         |
| 1996, Quarter 3 | 3,667.9                   | 55.7                            | 6.07%               | 5.46%                         |

<FN>  
(a) Excludes non-interest CMO-related expenses and interest on non-portfolio related notes payable

</FN>  
</TABLE>

#### Interest Rate Agreements

As part of its asset/liability management process, the Company enters into interest rate agreements such as interest rate caps and swaps and financial futures contracts ("hedges"). These agreements are used to reduce interest rate risk which arise from the lifetime yield caps on the ARM securities, the mismatched repricing of portfolio investments versus borrowed funds, and finally, assets repricing on indices such as the prime rate which are different than the related borrowing indices. The agreements are designed to protect the portfolio's cash flow, and to provide income and capital appreciation to the Company in the event that short-term interest rates rise quickly.

The following table includes all interest rate agreements in effect as of the various quarter ends. This table excludes hedge amounts for the Company's production operations. Generally, interest rate swaps and caps are used to manage the interest rate risk associated with assets that have periodic and annual reset limitations financed with borrowings that have no such limitations. Financial futures contracts and options on futures are used to lengthen the terms of repurchase agreement financing, generally from one month to three and six months. Amounts presented are aggregate notional amounts. To the extent any of these agreements are terminated, gains and losses are generally amortized over the remaining period of the original hedge.

<TABLE>

Instruments Used for Interest Rate Risk Management Purposes  
(\$ in millions)

<CAPTION>

| Notional Amounts | Interest<br>Rate Caps | Interest<br>Rate Swaps | Financial<br>Futures | Options<br>on Futures |
|------------------|-----------------------|------------------------|----------------------|-----------------------|
| <S>              | <C>                   | <C>                    | <C>                  | <C>                   |
| 1995, Quarter 1  | \$ 1,475              | \$ 200                 | \$ -                 | \$ -                  |
| 1995, Quarter 2  | 1,475                 | 200                    | 1,000                | 500                   |
| 1995, Quarter 3  | 1,475                 | 220                    | 1,000                | 500                   |
| 1995, Quarter 4  | 1,575                 | 1,227                  | 1,000                | 2,130                 |
| 1996, Quarter 1  | 1,575                 | 1,631                  | 1,000                | 1,250                 |
| 1996, Quarter 2  | 1,575                 | 1,559                  | 400                  | 880                   |
| 1996, Quarter 3  | 929                   | 2,191                  | 1,550                | -                     |

</TABLE>

#### Net Interest Rate Agreement Expense

The net interest rate agreement expense, or hedging expense, equals the expenses, net of any benefits received, from these agreements. For the quarter ended September 30, 1996, net hedging expense amounted to \$1.20 million versus \$1.02 million and \$0.86 million for the quarters ended June 30, 1996 and September 30, 1995, respectively. For the nine months ended September 30, 1996, net hedging expense was \$3.94 million versus \$3.54 million for the nine months ended September 30, 1995. Such amounts exclude the hedging costs and benefits associated with the Company's production activities as these amounts are deferred as additional premium or discount on the loan funded and amortized over the life of the loan as an adjustment to its yield.

<TABLE>

Net Interest Rate Agreement Expense  
(\$ in millions)

<CAPTION>

|                 | Net Interest<br>Rate Agreement<br>Expense | Net Expense<br>as Percentage<br>of Average<br>Assets<br>(annualized) | Net Expense as<br>Percentage of<br>Average Borrowings<br>(annualized) |
|-----------------|---|--|---|
| <S>             | <C>                                       | <C>  | <C>   |
| 1995, Quarter 1 | \$ 1.38                                   | 0.160%   | 0.180%  |
| 1995, Quarter 2 | 1.30                                      | 0.163%   | 0.165%  |
| 1995, Quarter 3 | 0.86                                      | 0.108%   | 0.119%  |
| 1995, Quarter 4 | 0.16                                      | 0.018%   | 0.020%  |
| 1996, Quarter 1 | 1.63                                      | 0.174%   | 0.191%  |
| 1996, Quarter 2 | 1.02                                      | 0.100%   | 0.110%  |
| 1996, Quarter 3 | 1.29                                      | 0.126%   | 0.141%  |

</TABLE>

#### Fair value

The fair value of the Company's investment portfolio as of September 30, 1996, as measured by the net unrealized gain on mortgage investments, has improved relative to September 30, 1995. The net unrealized gain on mortgage investments improved by \$74.4 million from September 30, 1995 to September 30, 1996. This increase in the portfolio's value is primarily attributable to the increase in the value of the collateral for CMOs relative to the CMOs issued during the last twelve months, as well as an increase in value of the Company's ARM securities due principally to the ARM securities being fully-indexed, and the stabilization of interest rates.

#### Credit Exposures

The Company has historically securitized its loan production in pass-through or CMO securitization structures. With either structure, the Company may use overcollateralization, subordination, reserve funds, bond insurance, mortgage pool insurance or any combination of the foregoing for credit enhancement. Regardless of the form of credit enhancement, the Company may retain a limited portion of the direct credit risk after securitization. This risk can include risk of loss related to hazards not covered under standard hazard insurance policies and credit risks on loans not covered by standard borrower mortgage insurance, or pool insurance.

Beginning in 1994, the Company issued pass-through securities which used subordination structures as their form of credit enhancement. The credit risk of

subordinated pass-through securities is concentrated in the subordinated classes (which may themselves partially be credit enhanced with reserve funds or pool insurance) of the securities, thus allowing the senior classes of the securities to receive the higher credit rating. To the extent credit losses are greater than expected (or exceed the protection provided by any reserve funds or pool insurance), the holders of the subordinated securities will experience a lower yield (which may be negative) than expected on their investments. At September 30, 1996, the Company retained \$21.2 million in aggregate principal amount of subordinated securities, which are carried at a book value of \$3.8 million, reflecting such potential credit loss exposure.

With CMO structures, the Company also retains credit risk relative to the amount of overcollateralization required in conjunction with the bond insurance. Losses are generally first applied to the overcollateralization amount, and any losses in excess of that amount would be borne by the bond insurer or the holders of the CMOs. The Company only incurs credit losses to the extent that losses are incurred in the repossession, foreclosure and sale of the underlying collateral. Such losses generally equal the excess of the principal amount outstanding, less any proceeds from mortgage or hazard insurance, over the liquidation value of the collateral. To compensate the Company for retaining this loss exposure, the Company generally receives an excess yield on the mortgage loans relative to the yield on the CMOs. At September 30, 1996, the Company retained \$88.3 million in aggregate principal amount of overcollateralization, and had reserves or otherwise had provided coverage on \$62.1 million of the potential credit loss exposure.

The Company principally used pool insurance as its means of credit enhancement for years prior to 1994. Pool insurance has generally been unavailable as a means of credit enhancement since the beginning of 1994. Pool insurance covered substantially all credit risk for the security with the exception of fraud in the origination or certain special hazard risks. Loss exposure due to special hazards is generally limited to an amount equal to a fixed percentage of the principal balance of the pool of mortgage loans at the time of securitization. Fraud in the origination exposure is generally limited to those loans which default within one year of origination. The reserve for potential losses on these risks was \$7.9 million at September 30, 1996, which the Company believes represents its maximum exposure from these risks.

The following table summarizes the aggregate principal amount of collateral for CMOs and pass-through securities outstanding which are subject to credit exposure, the maximum credit exposure held by the Company represented by the amount of overcollateralization and first loss securities owned by the Company, the credit reserves established by the Company for such exposure and the actual credit losses incurred. The table excludes reserves and losses due to fraud and special hazard exposure.

<TABLE>

Credit Reserves and Actual Credit Losses  
(\$ in millions)

|                 | Outstanding<br>Loan Balance | Maximum<br>Credit<br>Exposure | Credit<br>Reserves | Actual<br>Credit<br>Losses | Credit<br>Reserves to<br>Average<br>Assets | Credit<br>Reserves to<br>Average<br>Common Equity |
|-----------------|-----------------------------|-------------------------------|--------------------|----------------------------|--|---|
| <S>             | <C>                         | <C>                           | <C>                | <C>                        | <C>  | <C>   |
| 1995, Quarter 2 | \$ 2,435                    | \$ 49.6                       | \$ 14.6            | \$ -                       | 0.46%                                      | 5.36%   |
| 1995, Quarter 3 | 2,462                       | 51.3                          | 16.4               | -                          | 0.48%                                      | 6.01%   |
| 1995, Quarter 4 | 2,504                       | 65.9                          | 18.5               | -                          | 0.55%                                      | 6.71%   |
| 1996, Quarter 1 | 2,888                       | 79.2                          | 19.3               | -                          | 0.52%                                      | 6.95%   |
| 1996, Quarter 2 | 3,131                       | 106.7                         | 79.0               | 1.1                        | 1.90%                                      | 27.04%  |
| 1996, Quarter 3 | 3,919                       | 109.5                         | 80.0               | 2.0                        | 1.95%                                      | 26.69%  |

</TABLE>

The following table summarizes the single-family mortgage loan delinquencies as a percentage of the outstanding loan balance for the total collateral for CMOs and pass-through securities outstanding where the Company has retained a portion of the credit risk either through holding a subordinated security or through overcollateralization. There were no delinquencies on any multi-family loans where the Company has retained a portion of the credit risk either through holding a subordinated security or through overcollateralization.

<TABLE>

Delinquency Statistics

|     | 60 to 90 days<br>delinquent | 90 days and over delinquent<br>(includes REO and foreclosures) | Total |
|-----|-----------------------------|--|-------|
| <S> | <C>                         | <C>  | <C>   |

|                 |       |       |       |
|-----------------|-------|-------|-------|
| 1995, Quarter 2 | 0.54% | 1.24% | 1.78% |
| 1995, Quarter 3 | 0.78% | 1.77% | 2.55% |
| 1995, Quarter 4 | 2.50% | 3.23% | 5.73% |
| 1996, Quarter 1 | 0.90% | 2.95% | 3.85% |
| 1996, Quarter 2 | 1.91% | 3.47% | 5.38% |
| 1996, Quarter 3 | 0.73% | 3.01% | 3.75% |

</TABLE>

The following table summarizes the credit rating for investment held in the Company's portfolio. This table excludes the Company's other mortgage securities. (The risk on such securities is prepayment related, not credit related) In preparing the table, the carrying balances of the investments rated below A are net of credit reserves and discounts. The average credit rating of the Company's mortgage investments at the end of the third quarter of 1996 was AAA. Securitized loans with a credit rating of A or better were \$4,142.9 million, or 99.88% of the Company's total mortgage investments. Securitized loans with a credit rating below A represented 0.12% of the total as of September 30, 1996. At the end of the third quarter 1996, \$339.1 million of all mortgage investments were split rated between rating agencies. Where investments were split-rated, for purposes of this table, the Company classified such investments based on the higher credit rating.

<TABLE>

Mortgage Investments by Credit Rating  
(\$ in millions)

<CAPTION>

|                 | AAA<br>Carrying<br>Value | AA<br>Carrying<br>Value | A<br>Carrying<br>Value | Below A<br>Carrying<br>Value | AAA<br>Percent<br>of Total | AA<br>Percent<br>of Total | A<br>Percent<br>of Total | Below A<br>Percent<br>of Total |     |
|-----------------|--------------------------|-------------------------|------------------------|------------------------------|----------------------------|---------------------------|--------------------------|--------------------------------|-----|
| <S>             | <C>                      | <C>                     | <C>                    | <C>                          | <C>                        | <C>                       | <C>                      | <C>                            | <C> |
| 1996, Quarter 1 | 2,540.6                  | \$ 943.1                | \$ 64.2                | \$ 7.3                       | 71.5%                      | 26.5%                     | 1.8%                     | 0.2%                           | \$  |
| 1996, Quarter 2 | 2,958.6                  | 914.0                   | 63.6                   | 5.3                          | 75.1%                      | 23.2%                     | 1.6%                     | 0.1%                           |     |
| 1996, Quarter 3 | 3,359.4                  | 766.4                   | 17.1                   | 4.9                          | 81.0%                      | 18.5%                     | 0.4%                     | 0.1%                           |     |

</TABLE>

#### PRODUCTION ACTIVITIES

Until May 1996, the Company's production operations were comprised mainly of its single-family mortgage operations that concentrated on the "non-conforming" segment of the residential loan market. The Company funded its single-family loans directly through mortgage brokers (wholesale) and purchased loans through a network of mortgage companies (correspondents). Loans originated through the Company's former single-family mortgage operations constitute the majority of loans underlying the securities that comprise the Company's current investment portfolio. On May 13, 1996, the Company sold its single-family mortgage operations to Dominion Mortgage Services, Inc. (Dominion) for approximately \$68 million. Included in the sale of the single-family mortgage operations were the Company's single-family correspondent, wholesale, and servicing operations. Since the sale, the Company's primary production operations have been focused on multi-family lending and manufactured housing lending. The Company is in the process of broadening its multi-family lending capabilities to include other types of commercial real estate loans and to expand its manufactured housing lending to include inventory financing to manufactured housing dealers. The Company may also purchase single-family loans on a "bulk" basis from time to time, and may originate such loans on a retail basis.

The purpose of the Company's production operations is to enhance the return on shareholders' equity (ROE) by earning a favorable net interest spread while loans are in warehouse being accumulated for securitization or sale and creating investments for its portfolio at a lower cost than if such investments were purchased from third parties. The creation of such investments generally involves the issuance of pass-through securities or CMOs collateralized by the loans generated from the Company's production activities, and the retention of one or more classes of the securities or CMOs relating to such issuance. The issuance of pass-through securities and CMOs generally limits the Company's credit and interest rate risk relating to loans generated by the Company's production operations.

When a sufficient volume of loans is accumulated, the Company generally securitizes the loans through the issuance of CMOs or pass-through securities. The Company believes that securitization is an efficient and cost effective way for the Company to (i) reduce capital otherwise required to own the loans in whole loan form; (ii) limit the Company's exposure to credit risk on the loans; (iii) lower the overall cost of financing the loans; and (iv) depending on the securitization structure, limit the Company's exposure to interest rate and/or valuation risk. As a result of the reduction in the availability of mortgage pool insurance, and the Company's desire to both reduce its recourse borrowings as a percentage of its overall borrowings and the variability of its earnings, the Company has utilized the CMO structure for securitizing substantially all of



its loan production since the beginning of 1995.

The following table summarizes the production activity for the three and nine month periods ended September 30, 1996 and 1995.

<TABLE>

Production Activity  
(\$ in thousands)

<CAPTION>

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 1996                                | 1995       | 1996                               | 1995       |
| <S>  | <C>                                 | <C>        | <C>                                | <C>        |
| Multi-family   | \$ 57,394                           | \$ -       | \$ 141,068                         | \$ 10,741  |
| Manufactured Housing   | 13,363                              | -          | 16,104                             | -          |
| Single-family  | -                                   | 242,213    | 499,288                            | 668,267    |
|  | =====                               | =====      | =====                              | =====      |
| Total principal amount of loans<br>funded through mortgage<br>operations | \$ 70,757                           | \$ 242,213 | \$ 656,460                         | \$ 679,008 |
|  | =====                               | =====      | =====                              | =====      |
| Single-family loans bulk purchased                                       | \$ 201,992                          | \$ -       | \$ 719,259                         | 22,433     |
|  | =====                               | =====      | =====                              | =====      |
| Principal amount securitized or sold                                     | \$ 204,924                          | \$ 138,149 | \$ 1,357,564                       | \$ 865,995 |
|  | =====                               | =====      | =====                              | =====      |

</TABLE>

Manufactured housing lending commenced during the second quarter of 1996. Since commencement, the Company has opened region offices in North Carolina, Georgia, Texas and Michigan. The Company is planning to establish a fifth regional office on the West coast during the first quarter of 1997. Principally all funding volume has been obtained through relationships with manufactured housing dealers. As of September 30, 1996, the Company had \$16 million in principal balance of manufactured housing loans in inventory, and had commitments outstanding of approximately \$9 million. The Company's current sources of originations are its dealer network and direct marketing to consumers. In the future, the Company plans to expand its sources of origination to nearly all sources for manufactured housing loans by establishing relationships with park owners, developers of manufactured housing communities, manufacturers of manufactured homes, brokers and correspondents. In addition, the Company also expects to offer dealer inventory financing beginning in the fourth quarter 1996. Once certain volume levels are achieved at a particular region, district offices may be opened in an effort to further market penetration. The first district office is expected to be opened in the first quarter of 1997.

As of September 30, 1996, the Company had \$148.1 million in principal balance of multi-family loans in warehouse. The Company funded \$57.4 million in multi-family loans during the three months ended September 30, 1996 compared to \$72.6 million for the three months ended June 30, 1996 and none for the three months ended September 30, 1995. Principally all fundings are under the Company's lending programs for properties that have been allocated low income housing tax credits. As of September 30, 1996 commitments to fund multi-family loans over the next 20 months were approximately \$532.6 million. The Company expects that it will have funded volume sufficient enough to securitize a portion of its multifamily mortgage loans held in warehouse in the first half of 1997 through the issuance of CMOs. The Company will retain a portion of the credit risk after securitization and intends to service the loans.

On August 30, 1996, the Company acquired Multi-Family Capital Markets, Inc. (MCM). MCM sources, underwrites and closes multi-family loans secured by first liens on apartment properties that have qualified for low income housing tax credits. With the acquisition of MCM, the multi-family mortgage loans originated by the Company are now sourced through the Company's direct relationships with developers and syndicators. There are no correspondent or broker relationships. Through MCM, the Company has funded over \$301 million of multi-family mortgage loans since 1992.

The Company anticipates that it will continue to expand its production operations into new product types, such as commercial mortgages, in the future. Such commercial mortgages would be securitized with the Company's multi-family productions.

OTHER ITEMS

General and Administrative Expenses

General and administrative expenses (G&A expense) consist of expense incurred in conducting the Company's production activities, managing the investment portfolio, and various corporate expenses. G&A expense increased for the nine month period ended September 30, 1996 as compared to the same period in 1995 primarily due to the expansion of the single-family wholesale operations and the start up costs related to the manufactured housing lending operations. As a result of the sale, G&A expense related to the production operations decreased for the three months ended September 30, 1996. This decrease, however, was offset by an increase in the accrual for outstanding stock appreciation rights granted pursuant to the Company's Stock Incentive Plan as a result of the increase in the Company's stock price since June 30, 1996. G&A related to the production operations will increase over time as the Company expands its production activities with current and new product types.

The following table summarizes the Company's efficiency, the ratio of G&A expense to average interest earning assets, and the ratio of G&A expense to average total equity.

<TABLE>

#### Operating Expense Ratios

<CAPTION>

|                 | G&A<br>Efficiency<br>Ratio (a) | G&A Expense/Average<br>Interest-earning<br>Assets<br>(Annualized) | G&A<br>Expense/Average<br>Total Equity (b)<br>(Annualized) |
|-----------------|--------------------------------|---|--|
| <S>             | <C>                            | <C>   | <C>  |
| 1995, Quarter 1 | 7.26%                          | 0.52%   | 6.48%  |
| 1995, Quarter 2 | 7.07%                          | 0.54%   | 6.13%  |
| 1995, Quarter 3 | 6.68%                          | 0.51%   | 5.71%  |
| 1995, Quarter 4 | 7.51%                          | 0.59%   | 5.50%  |
| 1996, Quarter 1 | 8.25%                          | 0.64%   | 6.53%  |
| 1996, Quarter 2 | 6.77%                          | 0.51%   | 5.60%  |
| 1996, Quarter 3 | 5.67%                          | 0.43%   | 4.60%  |

<FN>

(a) G&A expense as a percentage of interest income.

(b) Average total equity excludes unrealized gain (loss) on available for sale mortgage investments.

</FN>

</TABLE>

#### Net Income and Return on Equity

Net income increased from \$24.8 million for the nine months ended September 30, 1995 to \$55.1 million for the nine months ended September 30, 1996. Return on common equity (excluding the impact of the unrealized gain on mortgage investments) also increased from 11.67% for the nine months ended September 30, 1995 to 22.34% for the nine months ended September 30, 1996. The majority of the increase in both the net income and the return on common equity is due to (i) the gain recognized on the sale of the single-family operations in the second quarter of 1996, (ii) the increased net margin related to increased levels of interest-earning assets, and (iii) the increase in the net interest spread on interest-earning assets.

<TABLE>

#### Components of Return on Equity

<CAPTION>

|                 | Net<br>Interest<br>Margin/<br>Average<br>Common<br>Equity<br>(annualized) | Provision<br>for Losses<br>/Average<br>Common<br>Equity<br>(annualized) | Gains and<br>Other<br>Income<br>/Average<br>Common<br>Equity<br>(annualized) | G&A<br>Expense/<br>Average<br>Common<br>Equity<br>(annualized) | Preferred<br>Dividend/<br>Average<br>Common<br>Equity<br>(annualized) | Return on<br>Average<br>Common<br>Equity<br>(annualized) | Net Income<br>Available<br>to Common<br>Shareholders |
|-----------------|---|---|--|--|---|--|--|
| <C>             | <C>   | <C>   | <C>  | <C>  | <C>   | <C>  | <C>  |
| 1995, Quarter 1 | 11.17%  | 0.31%   | 5.30%  | 6.48%  | N/A   | 9.68%  | \$ 6,596   |
| 1995, Quarter 2 | 13.91%  | 0.37%   | 4.64%  | 6.36%  | N/A   | 11.81%   | 8,041  |
| 1995, Quarter 3 | 19.19%  | 1.72%   | 3.85%  | 6.45%  | 1.33%   | 13.53%   | 10,128   |
| 1995, Quarter 4 | 21.99%  | 1.82%   | 4.68%  | 7.22%  | 2.67%   | 14.96%   | 12,145   |
| 1996, Quarter 1 | 26.26%  | 0.58%   | 1.18%  | 8.58%  | 3.16%   | 15.12%   | 10,492   |
| 1996, Quarter 2 | 25.59%  | 0.55%   | 17.67%   | 7.26%  | 3.00%   | 32.45%   | 23,704   |
| 1996, Quarter 3 | 26.56%  | 1.20%   | 2.67%  | 5.93%  | 2.93%   | 19.17%   | 14,363   |

</TABLE>

#### Dividends and Taxable Income

The Company and its qualified REIT subsidiaries (collectively "Resource REIT") have elected to be treated as a real estate investment trust for federal income tax purposes. The REIT provisions of the Internal Revenue Code require Resource REIT to distribute to shareholders substantially all of its taxable income, thereby restricting its ability to retain earnings. The Company may issue additional common stock, preferred stock or other securities in the future in order to fund growth in its operations, growth in its portfolio of mortgage investments, or for other purposes.

The Company intends to declare and pay out as dividends 100% of its taxable income over time. The Company's current practice is to declare quarterly dividends per share. Generally, the Company strives to declare a quarterly dividend per share which will result in the distribution of most or all of the taxable income earned during the quarter. At the time of the dividend announcement, however, the total level of taxable income for the quarter is unknown. Additionally, the Company has considerations other than the desire to pay out most of the taxable earnings for the quarter, which may take precedence when determining the level of dividends.

<TABLE>

Dividend Summary  
(\$ in thousands, except per share amounts)

<CAPTION>

|                 | Taxable Net<br>Income<br>Available<br>to Common<br>Shareholders | Taxable<br>Net<br>Income<br>Per<br>Common<br>Share | Dividend<br>Declared<br>Per<br>Common<br>Share | Dividend<br>Pay-out<br>Ratio | Cumulative<br>Undistributed<br>Taxable<br>Income (Loss) |
|-----------------|---|--|--|------------------------------|---|
| <S>             | <C>   | <C>  | <C>  | <C>                          | <C>   |
| 1995, Quarter 1 | 5,070   | \$ 0.25  | \$ 0.36  | 144%                         | \$ 1,507  |
| 1995, Quarter 2 | 5,577   | 0.28   | 0.40   | 143%                         | (956)   |
| 1995, Quarter 3 | 11,223  | 0.56   | 0.44   | 79%                          | 1,410   |
| 1995, Quarter 4 | 13,176  | 0.65   | 0.48   | 74%                          | 4,882   |
| 1996, Quarter 1 | 12,719  | 0.63   | 0.51   | 81%                          | 7,249   |
| 1996, Quarter 2 | 13,359  | 0.65   | 0.55   | 84%                          | 9,376   |
| 1996, Quarter 3 | 13,973  | 0.68   | 0.585  | 86%                          | 11,194  |

</TABLE>

Taxable income differs from the financial statement net income which is determined in accordance with generally accepted accounting principles (GAAP). For the nine months ended September 30, 1996, the Company's taxable earnings per share of \$1.96 were higher than the Company's declared dividend per share of \$1.645. The majority of the difference was caused by GAAP and tax differences related to the sale of the single-family operations. For tax purposes, the sale will be accounted for on an installment sale basis with annual taxable income of approximately \$10 million. Additionally, the Company has a capital loss carryforward available from prior years of \$9 million which will offset a portion of the tax gain from the sale of the single-family operations that would be recognized in 1996. Cumulative undistributed taxable income represents timing differences in the amounts earned for tax purposes versus the amounts distributed. Such amounts can be distributed for tax purposes in the subsequent year as a portion of the normal quarterly dividend.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company has various sources of cash flow upon which it relies for its working capital needs. Sources of cash flow from operations include primarily the return of principal on its portfolio of mortgage investments and the issuance of CMOs. Other borrowings provide the Company with additional cash flow in the event that it is necessary. Historically, these sources have provided sufficient liquidity for the conduct of the Company's operations. However, if a significant decline in the market value of the Company's mortgage investments should occur, the Company's available liquidity from these other borrowings may be reduced. As a result of such a reduction in liquidity, the Company may be forced to sell certain mortgage assets in order to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of such assets, which could result in losses.

The Company borrows funds on a short-term basis to support the accumulation of loans prior to the sale of such loans or the issuance of mortgage- or asset-backed securities. These borrowings may bear fixed or variable interest rates, may require additional collateral in the event that the value of the existing collateral declines, and may be due on demand or upon the occurrence of certain events. If borrowing costs are higher than the yields on the assets financed with such funds, the Company's ability to acquire or fund additional assets may be substantially reduced and it may experience losses. These short-term borrowings consist of the Company's warehouse lines of credit and repurchase agreements and are paid down as the Company securitizes or sells loans.

A substantial portion of the assets of the Company are pledged to secure indebtedness incurred by the Company. Accordingly, those assets would not be available for distribution to any general creditors or the stockholders of the Company in the event of the Company's liquidation, except to the extent that the value of such assets exceeds the amount of the indebtedness they secure.

#### Warehouse Lines of Credit

The Company has various credit facilities aggregating \$350 million to finance loan fundings and for working capital purposes which expire in November 1996, December 1996 and April 1998. One of these facilities includes several sublines aggregating \$250 million to serve various purposes, such as multi-family loan fundings, working capital, and manufactured housing loan fundings, which may not, in the aggregate, exceed the overall facility commitment of \$150 million at any time. Working capital borrowings are limited to \$30 million. The Company expects that these credit facilities will be renewed, if necessary, at their respective expiration dates, although there can be no assurance of such renewal. The lines of credit contain certain financial covenants which the Company met as of September 30, 1996. However, changes in asset levels or results of operations could result in the violation of one or more covenants in the future.

#### Repurchase Agreements

The Company also may finance a portion of its loans in warehouse with repurchase agreements on an uncommitted basis. As of September 30, 1996, the Company had no outstanding obligations under such repurchase agreements.

The Company finances its mortgage securities through repurchase agreements. Repurchase agreements allow the Company to sell the mortgage securities for cash together with a simultaneous agreement to repurchase the same mortgage securities on a specified date for a price which is equal to the original sales price plus an interest component. At September 30, 1996, the Company had outstanding obligations of \$1.23 billion under such repurchase agreements, of which \$1.2 billion, \$19.9 million and \$8.7 million were secured by ARM securities, fixed-rate mortgage securities and other mortgage securities, respectively. Increases in either short-term interest rates or long-term interest rates could negatively impact the valuation of these mortgage securities and may limit the Company's borrowing ability or cause various lenders to initiate margin calls. Additionally, certain of the Company's ARM securities are AAA or AA rated classes that are subordinate to related AAA rated classes from the same series of securities. Such AAA or AA rated classes have less liquidity than securities that are not subordinated, and the value of such classes is more dependent on the credit rating of the related insurer or the credit performance of the underlying mortgage loans. In instances of a downgrade of an insurer, or the deterioration of the credit quality of the underlying mortgage collateral, the Company may be required to sell certain mortgage assets in order to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of the assets, which could result in losses.

The Company may lengthen the duration of its repurchase agreements secured by mortgage securities by entering into certain futures and/or option contracts. As of September 30, 1996, the Company had lengthened the duration of \$1.0 billion of its repurchase agreements to three months by entering into certain futures and option contracts. The Company also has entered into approximately \$0.5 billion of futures for repurchase agreements which have a duration of one month. Additionally, the Company owns approximately \$370 million of its CMOs and has financed such CMOs with \$370 million of short-term debt. For financial statement presentation purposes, the Company has classified the \$370 million of short-term debt as CMOs outstanding.

Potential immediate sources of liquidity for the Company include cash balances and unused availability on the credit facilities described above.

<TABLE>

Potential Immediate Sources of Liquidity  
(\$ in millions)

<CAPTION>

|                 | Cash Balance | Estimated Unused<br>Borrowing Capacity | Potential<br>Immediate Sources<br>of Liquidity | Potential Immediate<br>Sources of Liquidity<br>as a % of Recourse<br>Borrowings (a) |
|-----------------|--------------|--|--|---|
| <S>             | <C>          | <C>                                    | <C>  | <C>   |
| 1996, Quarter 1 | \$ 8.5       | \$ 32.6                                | \$ 41.1  | 1.79%   |
| 1996, Quarter 2 | 20.9         | 102.8                                  | 123.7  | 6.56%   |
| 1996, Quarter 3 | 13.8         | 118.7                                  | 132.5  | 10.13%  |

<FN>

(a) Excludes borrowings, such as CMOs, that are non-recourse to the Company.

</FN>

</TABLE>

The increase in sources of liquidity as a percentage of borrowings from the second quarter 1996 to the third quarter 1996 is primarily the result of the issuance of a CMOs during the third quarter. The collateral for the CMOs was comprised mainly of mortgage securities owned by the Company which were financed with repurchase agreements. These repurchase agreements were paid off as a result of the issuance of the CMO.

#### Unsecured Borrowings

The Company issued two series of unsecured notes totaling \$50 million in 1994. The proceeds from this issuance were used for general corporate purposes. The notes have an outstanding balance at September 30, 1996 of \$47 million. The first principal repayment of one of the notes was due October 1995 and annually thereafter, with quarterly interest payments due. Principal repayment on the second note is contracted to begin in October 1998. The notes mature between 1999 and 2001 and bear interest at 9.56% and 10.03%. The note agreements contain certain financial covenants which the Company met as of September 30, 1996. However, changes in asset levels or results of operations could result in the violation of one or more covenants in the future.

#### Forward-Looking Statements

Certain written statements in this Form 10-Q made by the Company, that are not historical fact constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements may involve factors that could cause the actual results of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions the public not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize. The Company does not undertake, and the Securities Litigation Reform Act specifically relieves the Company from, any obligation to update any forward-looking statements.

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

**Economic Conditions.** The Company is affected by consumer demand for manufactured housing, multi-family housing and other products which it finances. A material decline in demand for these goods and services would result in a reduction in the volume of loans originated by the Company. The risk of defaults and credit losses could increase during an economic slowdown or recession. This could have an adverse effect on the Company's financial performance and the performance on the Company's securitized loan pools.

**Capital Resources.** The Company relies on various credit facilities and repurchase agreements with certain investment banking firms to help meet the Company's short-term funding needs. The Company believes that as these agreements expire, they will continue to be available or will be able to be replaced; however no assurance can be given as to such availability or the prospective terms and conditions of such agreements or replacements.

**Interest Rate Fluctuations.** The Company's income depends on its ability to earn greater interest on its investments than the interest cost to finance these investments. Interest rates in the markets served by the Company generally rise or fall with interest rates as a whole. A majority of the loans currently originated by the Company are fixed-rate. The profitability of a particular securitization may be reduced if interest rates increase substantially before these loans are securitized. In addition, the majority of the investments held by the Company are variable rate CMOs and adjustable-rate investments. These investments are financed through short-term repurchase agreements. The net interest spread for these investments could decrease during a period of rapidly rising interest rates, since the investments have interest rate caps and the related borrowing have no such interest rate caps.

**Defaults.** Defaults may have an adverse impact on the Company's financial performance, if actual credit losses differ materially from estimates made by the Company at the time of securitization. The allowance for losses is calculated on the basis of historical experience and management's best estimates. Actual defaults may differ from the Company's estimate as a result of economic conditions. Actual defaults on ARM loans may increase during a rising interest rate environment. The Company believes that its reserves are adequate for such risks.

**Prepayments.** Prepayments may have an adverse impact on the Company's financial performance, if prepayments differ materially from estimates made by the Company. The prepayment rate is calculated on the basis of historical experience and management's best estimates. Actual rates of prepayment may vary as a result of the prevailing interest rate. Prepayments are expected to increase during a declining interest rate environment. The Company's exposure to more rapid prepayments is (i) the faster amortization of premium on the investments and (ii) the replacement of investments in its portfolio with lower yield securities.

Competition. The financial services industry is a highly competitive market. Increased competition in the market could adversely affect the Company's market share within the industry.

Regulatory Changes. The Company's business is subject to federal and state regulation which, among other things require the Company to maintain various licenses and qualifications and require specific disclosures to borrowers. Changes in existing laws and regulations or in the interpretation thereof, or the introduction of new laws and regulations, could adversely affect the Company's operation and the performance of the Company's securitized loan pools.

New Production Sources. The Company has recently begun originating manufactured housing loans, and anticipates entering other lending businesses that are complementary to its current multi-family mortgage lending strategy. The Company is incurring or will incur expenditures related to the start-up of these businesses, with no guarantee that production targets set by the Company will be met or that these businesses will be profitable. Various factors such as economic conditions, interest rates, competition and the lack of the Company's prior experience in originating manufactured housing or other loans could all impact these new production sources.

## PART II. OTHER INFORMATION

Item 1. Legal Proceedings  
None

Item 2. Changes in Securities  
Not applicable

Item 3. Defaults Upon Senior Securities  
Not applicable

Item 4. Submission of Matters to a Vote of Security Holders  
None

Item 5. Other Information  
None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

3.1 Form of Amendment to Articles of Incorporation regarding par value of the Preferred Stock (Incorporated herein by reference to the Exhibit to the Registrant's Current Report on Form 8-K, filed October 15, 1996).

(b) Reports on Form 8-K

Current Report on Form 8-K filed with the Commission on October 15, 1996, regarding the issuance of Series C 9.73% Cumulative Convertible preferred Stock)

## SIGNATURES

Pursuant to the requirements 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.

ESOURCE MORTGAGE CAPITAL, INC.

By: /s/ Thomas H. Potts  
Thomas H. Potts, President  
authorized officer of registrant)

/s/ Lynn K. Geurin  
Lynn K. Geurin, Executive Vice  
President and Chief Financial Officer  
(principal accounting officer)

Dated: November 14, 1996

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