ANTHRACITE CAPITAL INC
Form 10-Q
May 15, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2003

OR

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

For the transition period from: ________ to ________

Commission File Number 001-13937

ANTHRACITE CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Maryland	13-3978906
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
40 East 52nd Street, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

(Registrant's telephone number including area code): (212) 409-3333

NOT APPLICABLE
(Former name, former address, and for new fiscal year; if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

(1) Yes _X_ No ___
(2) Yes _X_ No ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

(1) Yes _X_ No ___

As of May 13, 2003, 47,813,550 shares of common stock ($.001 par value per share) were outstanding.

1

ANTHRACITE CAPITAL, INC.,
FORM 10-Q
INDEX

PART I - FINANCIAL INFORMATION Page

Item 1. Interim Financial Statements....................

Consolidated Statements of Financial Condition
At March 31, 2003 (Unaudited) and December 31, 2002....................

Consolidated Statements of Operations (Unaudited)
For the Three Months Ended March 31, 2003 and 2002....................

Consolidated Statement of Changes in Stockholders' Equity (Unaudited)
For the Three Months Ended March 31, 2003....................

Consolidated Statements of Cash Flows (Unaudited)
For the Three Months Ended March 31, 2003 and 2002....................

Notes to Consolidated Financial Statements (Unaudited)....................

Item 2. Management's Discussion and Analysis of Financial Condition and
Results of Operations....................

Item 3. Quantitative and Qualitative Disclosures about Market Risk....................

Item 4. Controls and Procedures....................

Part II - OTHER INFORMATION

Item 1. Legal Proceedings....................

Item 2. Changes in Securities and Use of Proceeds....................

Item 3. Defaults Upon Senior Securities....................

Item 4. Submission of Matters to a Vote of Security Holders....................

Item 5. Other Information....................

Item 6. Exhibits and Reports on Form 8-K....................

SIGNATURES ....

CAUTIONARY STATEMENT REGARDING FORWARD-WORKING STATEMENTS

Certain statements contained herein are not, and certain statements contained in future filings by Anthracite Capital, Inc. (the "Company") with the Securities and Exchange Commission (the "SEC") in the Company's press releases or in the Company's other public or stockholder communications may not be, based on historical facts and are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "believe," "expect," "anticipate," "intend," "estimate," "position," "target," "mission," "assume," "achievable," "potential," "strategy," "goal," "objective," "plan," "aspiration," "outlook," "outcome," "continue," "remain," "maintain," "strive," "trend," and variations

of such words and similar expressions, or future or conditional verbs such as "will," "would," "should," "could," "may," or similar terms or variations on those terms, or the negative of those terms.

Actual results could differ materially from those set forth in forward-looking statements and future results could differ materially from historical performance due to a variety of factors, including, but not limited to: (1) the introduction, withdrawal, success and timing of business initiatives and strategies; (2) changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in deterioration in credit performance; (3) the performance and operations of the Manager; (4) the impact of increased competition; (5) the impact of capital improvement projects; (6) the impact of future acquisitions; (7) the unfavorable resolution of legal proceedings; (8) the extent and timing of any share repurchases; (9) the impact, extent and timing of technological changes and the adequacy of intellectual property protection; (10) the impact of legislative and regulatory actions and reforms; (11) terrorist activities, which may adversely affect the general economy, financial and capital markets, the real estate industry and the Company; and (12) the ability of the Manager to attract and retain highly talented professionals. Forward-looking statements speak only as of the date they are made. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

3

Part I - FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements

Anthracite Capital, Inc. and Subsidiaries
Consolidated Statements of Financial Condition
(in thousands, except per share data)

	March 31, 2003 (Unaudited)	
ASSETS		
Cash and cash equivalents		$ 21,2
Restricted cash equivalents		62,6
Securities available for sale, at fair value		
Subordinated commercial mortgage-backed securities (CMBS)	$ 661,515	
Investment grade securities	1,400,377	
Total securities available for sale		2,061,8
Securities held for trading, at fair value		461,3
Commercial mortgage loans, net		57,7
Investments in real estate joint ventures		7,7
Equity investment in Carbon Capital, Inc.		17,7
Receivable for investments sold		252,2
Other assets		39,3
Total Assets		$2,981,9

LIABILITIES AND STOCKHOLDERS' EQUITY
Liabilities:
Borrowings:

Collateralized debt obligations	$684,684	
Secured by pledge of subordinated CMBS	54,565	
Secured by pledge of other securities available for sale and restricted cash equivalents	1,050,020	
Secured by pledge of securities held for trading	348,319	
Secured by pledge of investments in real estate joint ventures	937	
Secured by pledge of commercial mortgage loans	14,667	
Total borrowings		$2,153,1
Payable for investments purchased		356,8
Distributions payable		16,7
Other liabilities		57,1
Total Liabilities		$2,583,9
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value $0.001 per share; 400,000 shares authorized; 47,731 shares issued and outstanding in March 31, 2003; and 47,398 shares issued and outstanding in December 31, 2002		
10% Series B preferred stock, liquidation preference $47,817		36,3
Additional paid-in capital		518,5
Distributions in excess of earnings		(32,36
Accumulated other comprehensive loss		(124,61
Total Stockholders' Equity		398,0
Total Liabilities and Stockholders' Equity		$2,981,9

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

Anthracite Capital, Inc.
Consolidated Statements of Operations (Unaudited)
(in thousands, except per share data)

	For the Three Months Ended March 31, 2003	For th Months March 3
Income:		
Interest from securities	$24,652	
Interest from commercial mortgage loans	1,185	
Interest from trading securities	15,831	
Earnings from real estate joint ventures	236	
Earnings from equity investment	743	
Interest from cash and cash equivalents	176	
Total income	42,823	
Expenses:		
Interest	15,504	

Interest-trading securities	4,201
Management and incentive fee	2,577
Other expenses - net	582
Total expenses	22,864
Other gain (losses):	
Gain (loss) on sale of securities available for sale	142
Gain (loss) on securities held for trading	(10,404)
Foreign currency gain (loss)	-
Total other gain (loss)	(10,262)
Income before cumulative transition adjustment	9,697
Cumulative transition adjustment - SFAS 142	-
Net Income	9,697
Dividends on preferred stock	1,195
Net Income available to common stockholders	$8,502
Net income per common share, basic:	
Income before cumulative transition adjustment	$0.18
Cumulative transition adjustment - SFAS 142	-
Net income	$0.18
Net income per common share, diluted:	
Income before cumulative transition adjustment	$0.18
Cumulative transition adjustment - SFAS 142	-
Net income	$0.18
Weighted average number of shares outstanding:	
Basic	47,592
Diluted	47,622

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

Anthracite Capital, Inc. and Subsidiaries
Consolidated Statement of Changes in Stockholders' Equity (Unaudited)
For the Three Months Ended March 31, 2003
(in thousands)

	Common Stock, Par Value	Series B Preferred Stock	Additional Paid-In Capital	Distributions In Excess Of Earnings	Accumulate Other Comprehensi Loss
Balance at January 1, 2003	$47	$36,379	$515,180	$(24,161)	$(121,22
Net income				9,697	
Unrealized loss on cash flow hedges					(2,30
Reclassification adjustments from cash flow hedges included in net income					1,86
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment					(2,95
Other Comprehensive loss					
Comprehensive Income					
Dividends declared-common stock				(16,707)	
Dividends on preferred stock				(1,195)	
Issuance of common stock	1		3,417		
Balance at March 31, 2003	$48	$36,379	$518,597	$(32,366)	$(124,618

Disclosure of reclassification adjustment:

Unrealized holding loss

Reclassification for realized gains

previously recorded as unrealized

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

Anthracite Capital, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	For the Three Months Ended March 31, 200
Cash flows from operating activities:	
Net income	$9,697
Adjustments to reconcile net income to net cash provided by operating activities:	
Net sale (purchase) of trading securities	387,278
Net loss on sale of securities	10,262
Cumulative transition adjustment	-
(Discount accretion), premium amortization, net	(8,758)
Non-cash portion of net foreign currency loss	-
Distributions from joint ventures in excess of earnings	487
Decrease (Increase) in other assets	1,578
Increase (Decrease) in other liabilities	2,830
Net cash provided by operating activities	403,374
Cash flows from investing activities:	
Purchase of securities available for sale	(447,774)
Repayments received from commercial mortgage loans	7,923
Decrease in restricted cash equivalents	21,824
Principal payments received on securities available for sale	37,212
Investment in Carbon Capital, Inc.	(2,950)

Proceeds from sales of securities available for sale	-
Net payments from hedging securities	(262)
Net cash (used in) provided by investing activities	(384,027)
Cash flows from financing activities:	
Net decrease in borrowings	(8,469)
Proceeds from issuance of common stock, net of offering costs	3,418
Dividends paid on common stock	(16,589)
Interest paid on preferred stock	(1,195)
Net cash used in financing activities	(22,835)
Net decrease in cash and cash equivalents	(3,488)
Cash and cash equivalents, beginning of period	24,698
Cash and cash equivalents, end of period	$21,210
Supplemental disclosure of cash flow information:	
Interest paid	$15,231
Investments purchased not settled	$252,241
Investments sold not settled	$356,859

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

Anthracite Capital, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)
(In thousands, except per shares and share data)

Note 1 ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anthracite Capital, Inc. (the "Company"), a Maryland corporation, is a real estate finance company that generates income based on the spread between the interest income on its mortgage loans and securities investments and the interest expense from borrowings used to finance its investments. The Company seeks to earn high returns on a risk-adjusted basis to support a consistent quarterly dividend. The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") under the Internal Revenue Code of 1986 and, therefore, its income is largely exempt from corporate taxation. The Company commenced operations on March 24, 1998.

The Company's business focuses on (i) originating high yield commercial real estate loans, (ii) investing in below investment grade commercial mortgage

backed securities ("CMBS") where the Company has the right to control the foreclosure/workout process on the underlying loans, and (iii) acquiring investment grade real estate related securities as a liquidity diversification.

The accompanying unaudited financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. These financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's annual report on Form 10-K for 2002 filed with the Securities and Exchange Commission.

In the opinion of the Company's management, the accompanying financial statements contain all adjustments, consisting of normal and recurring accruals (except for the cumulative transition adjustment for SFAS 142 in the first quarter of 2002 - see Note 2 to the consolidated financial statements), necessary for a fair presentation of the results for the interim periods. Operating results for interim periods are not necessarily indicative of the results that may be expected for the entire year.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the statements of financial condition and revenues and expenses for the periods covered. Actual results could differ from those estimates and assumptions. Significant estimates in the financial statements include the valuation of certain of the Company's mortgage-backed securities and certain other investments.

Note 2 ACCOUNTING CHANGE - BUSINESS COMBINATIONS

In July 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, ''Business Combinations,'' and No. 142, ''Goodwill and Other Intangible Assets'' (''SFAS 142''). These standards changed the accounting for business combinations by, among other things, prohibiting

8

the prospective use of pooling-of-interests accounting and requiring companies to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Instead, goodwill and intangible assets deemed to have an indefinite useful life will be subject to an annual review for impairment. The new standards generally were effective for the Company in the first quarter of 2002. Upon adoption of SFAS 142 in the first quarter of 2002, the Company recorded a one-time, noncash adjustment of approximately $6,327 to write off the unamortized balance of its negative goodwill. Such charge is non-operational in nature and is reflected as a cumulative effect of an accounting change in the accompanying consolidated statement of operations.

Note 3 NET INCOME PER SHARE

Net income per share is computed in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share". Basic income per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated using the weighted average number of common shares outstanding during the period plus the additional dilutive effect of common stock equivalents. The dilutive effect of outstanding stock options is calculated using the treasury stock method, and the dilutive effect of preferred stock is calculated using the "if converted" method.

	For the T Months En March 31,
Numerator:	
Net Income available to common stockholders before cumulative transition adjustment	
Cumulative transition adjustment	
Numerator for basic earnings per share	
Effect of 10.5% series A senior cumulative redeemable preferred stock	
Numerator for diluted earnings per share	
Denominator:	
Denominator for basic earnings per share--weighted average common shares outstanding	
Effect of 10.5% series A senior cumulative redeemable preferred stock	
Dilutive effect of stock options	
Denominator for diluted earnings per share--weighted average common shares outstanding and common share equivalents outstanding	
Basic net income per weighted average common share:	
Income before cumulative transition adjustment	
Cumulative transition adjustment - SFAS 142	
Net income	
Diluted net income per weighted average common share and common share equivalents:	
Income before cumulative transition adjustment	
Cumulative transition adjustment - SFAS 142	
Net income	

9

Note 4 SECURITIES AVAILABLE FOR SALE

The Company's securities available for sale are carried at estimated fair value. The amortized cost and estimated fair value of securities available for sale as of March 31, 2003 are summarized as follows:

Security Description	Amortized Cost	Gross Unrealized Gain	U

Commercial mortgage-backed securities ("CMBS"):			
CMBS IOs	$ 40,858	$ 1,377	$
Investment grade CMBS	49,895	5,364	
Non-investment grade rated subordinated securities	688,685	18,576	
Non-rated subordinated securities	39,783	2,584	
Credit tenant lease	9,025	-	
Investment grade REIT debt	174,431	13,696	
Total CMBS	1,002,677	41,597	
Single-family residential mortgage-backed securities ("RMBS"):			
Agency adjustable rate securities	38,021	450	
Agency fixed rate securities	1,034,436	10,468	
Residential CMOs	10,404	254	
Hybrid Arms	12,485	130	
Total RMBS	1,095,346	11,302	
Total securities available for sale	$ 2,098,023	$ 52,899	

On March 31, 2003, $1,037,519 of RMBS securities classified as trading securities were reclassified as available for sale securities. The reclassification was based on the Company's intent with respect to these securities with the principle objective of generating returns from other than short-term pricing differences.

As of March 31, 2003, an aggregate of $1,906,391 in estimated fair value of the Company's securities available for sale was pledged to secure its collateralized borrowings.

As of March 31, 2003, the anticipated weighted average yield to maturity based upon the amortized cost of the subordinated CMBS ("reported yield") was 9.8% per annum. The anticipated reported yield of the Company's investment grade securities available for sale was 5.1%. The Company's reported yields on its subordinated CMBS and investment grade securities available for sale are based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples of these include, among other things, the rate and timing of principal payments (including prepayments, repurchases, defaults, and liquidations), the pass-through or coupon rate, and interest rate fluctuations. Additional factors that may affect the Company's anticipated yields to maturity on its subordinated CMBS include interest payment shortfalls due to

delinquencies on the underlying mortgage loans, and the timing and magnitude of credit losses on the mortgage loans underlying the subordinated CMBS that are a result of the general condition of the real estate market (including competition for tenants and their related credit quality) and changes in market rental rates. As these uncertainties and contingencies are difficult to predict and are subject to future events which may alter these assumptions, no assurance can be given that the anticipated yields to maturity, discussed above and elsewhere, will be achieved.

The following table sets forth certain information relating to the aggregate principal balance and payment status of delinquent mortgage loans underlying the subordinated CMBS held by the Company as of March 31, 2003:

	March 31, 2003	
	Principal	Number of Loans
Past due 30 days to 60 days	$ 31,540	5
Past due 60 days to 90 days	31,994	4
Past due 90 days or more	124,811	21
Real estate owned ("REO")	23,530	6
Total delinquent	211,875	36
Total principal balance	$10,529,266	2,043

To the extent that the Company's expectation of realized losses on individual loans supporting the CMBS, if any, or such resolutions differ significantly from the Company's original loss estimates, it may be necessary to reduce the projected reported yield on the applicable CMBS investment to better reflect such investment's expected earnings net of expected losses, and write the investment down to its fair value. While realized losses on individual loans may be higher or lower than original estimates, the Company currently believes its aggregate loss estimates and reported yields are appropriate on all investments.

Note 5 SECURITIES HELD FOR TRADING

Securities held for trading reflect short-term trading strategies, which the Company employs from time to time, designed to generate economic and taxable gains based on short-term difference in pricing. As part of its trading strategies, the Company may acquire long or short positions in U.S. Treasury or agency securities, forward commitments to purchase such securities, financial futures contracts and other fixed income or fixed income derivative securities.

The Company's securities held for trading are carried at estimated fair value. At March 31, 2003, the Company's securities held for trading consisted of FNMA Mortgage Pools with an estimated fair value of $358,976, and a forward commitment with an estimated fair value of $102,410. The FNMA Mortgage Pools, and the underlying mortgages, bear interest at fixed rates for specified periods, generally three to seven years, after which the rates are periodically reset to market.

For the three months ended March 31, 2003, losses on securities held for trading in the consolidated statements of operations of $10,404 are largely attributable to hedging the Company's sensitivity to long-

term interest rates. The Company's longstanding policy has been to maintain limits on the exposure of the Company's equity to changes in long-term rates as well as the exposure of earnings to changes in short-term funding rates. The sale of five-year futures on U.S. Treasury notes to reduce the Company's

exposure to intermediate rates resulted in realized losses since market value changes in those hedging investments must be marked-to-market though the income statement. The value of these investments was negatively affected as the five-year US Treasury went up in price (therefore reducing the value of the hedged position) during the quarter.

The Company's trading strategies are subject to the risk of unanticipated changes in the relative prices of long and short positions in trading securities, but are designed to be relatively unaffected by changes in the overall level of interest rates.

Note 6 COMMON STOCK

On March 6, 2003, the Company declared dividends to its common stockholders of $0.35 per share, which were paid on April 30, 2003 to stockholders of record on March 31, 2003. For U.S. Federal income tax purposes, the dividends are expected to be ordinary income to the Company's stockholders.

For the three months ended March 31, 2003, the Company issued 333,328 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $3,517. For the three months ended March 31, 2002, the Company issued 519,303 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $5,661.

In March 2002, the remaining 10,000 shares of Series A Preferred Stock were converted to 34,427 shares of Common Stock at a price of $7.26 per share in accordance with the terms of the Series A Preferred Stock.

Note 7 TRANSACTIONS WITH AFFILIATES

The Company has a Management Agreement with BlackRock Financial Management, Inc. (the "Manager"), a majority owned indirect subsidiary of The PNC Financial Services Group, Inc. ("PNC Bank") and the employer of certain directors and officers of the Company, under which the Manager manages the Company's day-to-day operations, subject to the direction and oversight of the Company's Board of Directors. On March 25, 2002, the Management Agreement was extended for one year through March 27, 2003, with the approval of the unaffiliated directors, on terms similar to the prior agreement with the following changes: (i) the incentive fee calculation would be based on GAAP earnings instead of funds from operations, (ii) the removal of the four-year period to value the Management Agreement in the event of termination and (iii) subsequent renewal periods of the Management Agreement would be for one year instead of two years. The Board was advised by Houlihan Lokey Howard & Zukin Financial Advisors, Inc., a national investment banking and financial advisory firm, in the renewal process.

12

On March 6, 2003, the unaffiliated directors approved an extension of the Management Agreement from its expiration of March 27, 2003 for one year through March 31, 2004. The terms of the renewed agreement are similar to the prior agreement except for the incentive fee calculation which would provide for a rolling four-quarter high watermark rather than a quarterly calculation. In determining the rolling four-quarter high watermark, the Company would calculate the incentive fee based upon the current and prior three quarters' net income. The Manager would be paid an incentive fee in the current quarter if the Yearly Incentive Fee, as defined, is greater than what was paid to the Manager in the prior three quarters cumulatively. The Company will phase in the rolling four-quarter high watermark commencing with the second quarter of 2003.

Calculation of the incentive fee will be based on GAAP and adjusted to exclude special one-time events pursuant to changes in GAAP accounting pronouncements after discussion between the Manager and the unaffiliated directors. The incentive fee threshold did not change. The high watermark will be based on the existing incentive fee hurdle, which provides for the Manager to be paid 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's common stock per share ($11.39 as of March 31, 2003) and the greater of 9.5% or 350 basis points over the ten-year Treasury note.

The Company pays the Manager an annual base management fee equal to a percentage of the average invested assets of the Company as defined in the Management Agreement. The base management fee is equal to 1% per annum of the average invested assets rated less than BB- or not rated, 0.75% of average invested assets rated BB- to BB+, and 0.20% of average invested assets rated above BB+. In order to coincide with the increased size of the Company, effective July 1, 2001, the Manager reduced the base management fee from 0.35% of average invested assets rated above BB+.

The Company incurred $2,577 and $2,219 in base management fees in accordance with the terms of the Management Agreement for the three months ended March 31, 2003 and 2002, respectively. In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of $6 and $5 for certain expenses incurred on behalf of the Company during the three months ended March 31, 2003 and 2002, respectively.

Pursuant to the March 25, 2002 one-year Management Agreement extension, the incentive fee paid to the Manager was based on 25% of earnings (calculated in accordance with GAAP) of the Company. For purposes of calculating the incentive fee during 2002, the cumulative transition adjustment of $6,327 resulting from the Company's adoption of SFAS 142 was excluded from earnings in its entirety and included using an amortization period of three years. This revision saved the Company $1,448 of incentive fee for the three months ended March 31, 2002. The Company incurred $3,188 in incentive fees for the three months ended March 31, 2002. There was no incentive fee due to the Manager for the three months ended March 31, 2003.

On March 17, 1999, the Company's Board of Directors approved an administration agreement with the Manager and the termination of a previous agreement with an unaffiliated third party. Under the terms of the administration agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. The Company pays the Manager a monthly administrative fee at an annual rate of 0.06% of the first $125 million of average net assets, 0.04% of the next $125 million of average net assets and 0.03% of average net assets in excess of $250 million

subject to a minimum annual fee of $120. For the three months ended March 31, 2003 and 2002, the Company paid administration fees of $43 and $43, respectively.

On July 20, 2001, the Company entered into a $50 million commitment to acquire shares in Carbon Capital, Inc. ("Carbon"), a private commercial real estate income opportunity fund managed by the Manager. The period during which the Company may be required to purchase shares under the commitment expires in July 2004. On March 31, 2003, the Company owned 18.8% of the outstanding shares in Carbon. The Company's remaining commitment at March 31, 2003 and December 31, 2002 was $32,436 and $35,116, respectively. On February 6, 2003, the Company funded a capital call notice in the amount of $2,680, which was used by Carbon to acquire a mezzanine loan secured by ownership interests in an entity that

owns a mixed-use development.

On May 15, 2000, the Company completed the acquisition of CORE Cap, Inc. The merger was a stock for stock acquisition where the Company issued 4,180,552 shares of its common stock and 2,261,000 shares of its series B preferred stock. At the time of the CORE Cap acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) $12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow for the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. As of March 31, 2003, the Installment Payment would be $9,500 payable over eight years. The Company does not accrue for this contingent liability.

Note 8 BORROWINGS

Certain information with respect to the Company's collateralized borrowings at March 31, 2003 is summarized as follows:

	Lines of Credit and Term Loans	Reverse Repurchase Agreements	Collateralized Debt Obligations
Outstanding borrowings	$18,789	$1,449,719	$684,684
Weighted average borrowing rate	2.99%	1.31%	6.60%
Weighted average remaining maturity	441 days	21 days	3,308 days
Estimated fair value of assets pledged	$50,438	$1,587,499	$754,514

As of March 31, 2003, the Company's collateralized borrowings had the following remaining maturities:

	Lines of Credit and Term Loans	Reverse Repurchase Agreements	Collateralized Debt Obligations
Within 30 days	$ -	$1,449,719	$ -
31 to 59 days	-	-	-

Over 60 days	18,789	-	684,684
	$18,789	$1,449,719	$684,684

Under the lines of credit and the reverse repurchase agreements, the respective lender retains the right to mark the underlying collateral to estimated market value. A reduction in the value of its pledged assets will require the Company to provide additional collateral or fund margin calls. From time to time, the Company expects that it will be required to provide such additional collateral or fund margin calls.

Note 9 DERIVATIVE INSTRUMENTS

Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of change in the fair value of the derivative are recorded in other comprehensive income ("OCI") and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

The Company uses interest rate swaps to manage exposure to variable cash flows on portions of its borrowings under reverse repurchase agreements and as trading derivatives intended to offset changes in fair value related to securities held as trading assets. On the date in which the derivative contract is entered, the Company designates the derivative as either a cash flow hedge or a trading derivative.

As of March 31, 2003, the Company had interest rate swaps with notional amounts aggregating $1,177,826 that were designated as cash flow hedges of borrowings under reverse repurchase agreements. Their aggregate fair value was a $45,235 asset included in other assets on the consolidated statements of financial condition. For the three months ended March 31, 2003, the net change in the fair value of the interest rate swaps was a decrease of $2,568, of which $262 was deemed ineffective and is included as an increase of interest expense and $2,306 was recorded as a reduction of OCI. As of March 31, 2003, the $1,177,826 notional of swaps which were designated as cash flow hedges had a weighted average remaining term of 5.31 years.

As of March 31, 2003, the Company had interest rate swaps with notional amounts aggregating $651,545 designated as trading derivatives. Their aggregate fair value at March 31, 2003 of $4,408 is included in

15

trading securities on the consolidated statements of financial condition. For the three months ended March 31, 2003, the change in fair value for these trading derivatives was a decrease of $1,473 and is included as an addition to loss on securities held for trading in the consolidated statements of operations. As of March 31, 2003, the $651,545 notional of swaps which were designated as trading derivatives had a weighted average remaining term of 3.68

years.

Occasionally, counterparties will require the Company or the Company will require counterparties to provide collateral for the interest rate swap agreements in the form of margin deposits. Net deposits are recorded as a component of either accounts receivable or other liabilities. Should the counterparty fail to return deposits paid, the Company would be at risk for the fair market value of that asset. At March 31, 2003 and 2002, the balance of such net margin deposits owed to counterparties as collateral under these agreements totaled $15,610 and $680, respectively.

The contracts identified in the remaining portion of this note have been entered into to limit the Company's mark to market exposure to long-term interest rates.

At March 31, 2003, the Company had outstanding short positions of 137 ten-year U.S. Treasury Note future contracts and 3,059 five-year U.S. Treasury Note future contracts expiring in June 2003, which represented $13,700 and $305,900 in face amount of U.S. Treasury Notes, respectively. The estimated fair value of these contracts was approximately $(362,834) at March 31, 2003, and the change in fair value related to these contracts is included as a component of loss on securities held for trading in the consolidated statements of operations.

16

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

All dollar figures expressed herein are expressed in thousands, except share or per share amounts.

I. General

The Company's primary long-term objective is to distribute consistent dividends supported by GAAP earnings. Over the long term, earnings are primarily maintained by consistent credit performance on the Company's investments, stability of the Company's liability structure and reinvestment rates. In 2002, the Company established a strong long-term secured debt issuance platform through two collateralized debt obligation ("CDO") offerings. These transactions effectively match funded a significant part of the Company's long-term credit sensitive CMBS and REIT portfolios at attractive terms. In 2003, the Company expects to redeploy capital raised from these transactions combined with additional equity capital raised from the Company's common stock issuance program. The current low interest rate environment adds a significant challenge to accreting per share earnings, since portfolio cash flows must be reinvested at lower than historical rates. However, issuing stock at a premium and locking in attractive spreads with additional CDO offerings can lead to the accretion of both earnings and book value per share as well as to increase diversification of credit exposure.

Economic activity in the United States continues to point towards slow recovery at best. During the first quarter, low interest rates and rallying stock markets triggered a massive demand for high yield corporate credits causing the high yield market to return 7.6% for the three months ended March 31, 2003. This phenomenon was not replicated in the high yield commercial real estate markets. Management attributes this to high barriers to entry in these markets and believes this represents an opportunity for the Company to continue deploying capital in this sector.

The Company continues to maintain a positive, though controlled exposure to both long and short-term rates through its active hedging strategies. The Company also will continue to seek out the best long-term matched financing solutions to

lock in attractive spreads on the Company's commercial real estate securities portfolio.

The Company establishes its dividend by analyzing the long-term sustainability of net income given existing market conditions and the current composition of its portfolio. This includes an analysis of the Company's credit loss assumptions, general level of interest rates, realized gains and losses and projected hedging costs. These factors are generally beyond the Company's control so there is no certainty that dividends will remain at current levels. During the first quarter of 2003, the Board of Directors declared a dividend of $0.35 per share to stockholders of record on March 31,2003, which was paid on April 30, 2003. This represents the sixth consecutive quarterly $0.35 dividend distribution. Since inception in March 1998, the Company has paid $200,229 in dividends.

For the quarter ended March 31, 2003, the Company recorded $0.18 of GAAP earnings per share. For the quarter ended March 31, 2002, the Company recorded $0.58 of GAAP earnings per share, which included $0.14 per share as a cumulative transition adjustment under the implementation of SFAS 142.

The Company's investment activities encompass three distinct lines of business:

1) Commercial Real Estate Securities

2) Commercial Real Estate Loans
3) Residential Mortgage Backed Securities

The Company believes that these three investment activities represent an integrated strategy where each line of business supports the others and creates value over and above operating each line in isolation. The commercial real estate securities portfolio represents broad exposure to commercial real estate lending and provides diversification and high yields that are adjusted for anticipated losses over a long period of time (typically, a ten year weighted average life). These securities can be financed through the issuance of secured debt that matches the life of the investment. Commercial real estate loans provide attractive risk adjusted returns over shorter periods of time (typically, a three to five year weighted average life) through investments in loans secured by specific property types in specific regions. The RMBS portfolio is a highly liquid portfolio that supports the liquidity needs of the Company while typically earning attractive returns after hedging costs relative to other liquid investments. The Company believes the risks of these portfolios are not always highly correlated and thus can serve to provide stable earnings over long periods of time.

The following table illustrates the change in the mix of the Company's three investment activities:

	Carrying Value as of			
	March 31, 2003		December 31, 2002	
	Amount	%	Amount	%
Commercial real estate securities	$ 955,588	37.0%	$ 894,345	36.1%
Commercial real estate loans(1)	65,520	2.5	73,929	3.0
Residential mortgage backed securities	1,567,690	60.5	1,506,450	60.9
Total	$2,588,798	100.0%	$2,474,724	100.0%

(1) Includes real estate joint ventures

Commercial Real Estate Securities Portfolio Activity

The Company continues to increase its investments in commercial real estate securities. Commercial real estate securities include CMBS and investment grade REIT debt. During the quarter ended March 31, 2003, the Company increased total assets in this sector by 7% from $894,345 to $955,588.

Included in the Company's December 10, 2002 collateralized debt obligation ("CDO II") was a ramp facility that will be utilized to fund the purchase of $50,000 of par of below investment grade CMBS by September 30, 2003. The increase in commercial real estate securities for the quarter includes $30,000 of par of CMBS that was contributed to the ramp facility. At March 31, 2003, the balance of the ramp facility permits another $20,000 of par to be contributed to CDO II.

The CMBS added includes $47,804 par of 2003 vintage CMBS rated BB- thru a nonrated tranche where the Company has the right to direct foreclosure on $1,006,389 of underlying loans. The loss adjusted yield of the controlling class (CMBS rated BB- and lower) CMBS acquired during the first quarter is estimated to be 11.23%. In computing the loss adjusted yields the Company assumed 2.30% of the principal of the underlying loans would result in losses over a weighted average of 8.6 years. The yield

18

of these CMBS assuming there would not be any losses is 16.44%. This is the eighth controlling class trust the Company acquired since its inception.

The following table details the par, fair market value, adjusted purchase price and loss adjusted yield of the Company's commercial real estate securities included in the two CDOs as of March 31, 2003:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar
Investment grade CMBS	$47,730	$51,914	108.77	$46,674	
Investment grade REIT debt	171,545	188,107	109.65	174,431	1
CMBS rated BB+ to B	610,264	483,739	79.27	495,625	
Whole Loans	9,032	8,956	99.16	9,025	
Total	$838,571	$732,716	87.38	$725,755	

The following table details the par, fair market value, adjusted purchase price and loss adjusted yield of the Company's commercial real estate securities outside of the two CDOs as of March 31, 2003:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dolla
CMBS rated BB+ to B	$ 126,567	$89,994	71.10	$104,653	82.6

CMBS rated B- or lower	298,456	87,783	29.41	128,190	42.9
CMBS IOs	915,068	41,750	4.56	40,858	4.4
Whole Loans	4,000	3,345	83.62	3,221	80.5
Total	$1,344,091	$222,872	16.58	$276,922	20.6

Below Investment Grade CMBS and Underlying Loan Performance

The Company divides its below investment grade CMBS investment activity into two portfolios: the eight trusts ("Controlling Class CMBS"), in which the Company is in the first loss position, and other below investment grade CMBS. The distinction between the two is in the controlling class rights. Controlling class rights allow the Company to control the workout and/or disposition of defaults that occur in the underlying loans. These securities absorb the first losses realized in the underlying loan pools. Other below investment grade CMBS have no rights to control the workout and/or disposition of underlying loan defaults, however they are not the first to absorb losses in the underlying pools.

At March 31, 2003, the total par of the Company's other below investment grade CMBS was $261,157; the total credit protection, or subordination level, of this portfolio is 6.33%. The total par of the Company's Controlling Class CMBS at March 31, 2003 was $774,130 and the total par of the loans underlying these securities was $10,529,266. The non-rated security is the first to absorb underlying loan losses until its par is completely written off. The coupon payment on the non-rated security can also be reduced for special servicer fees charged to the trust. The next highest rated security in the structure will then generally be downgraded to non-rated and becomes the first to absorb losses and expenses from that point on.

19

The Company's investment in its Controlling Class CMBS by credit rating category at March 31, 2003 is as follows:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar Price	Subordination Level
BB+	$80,286	$69,341	86.37	$68,518	85.34	7.90%
BB	88,266	74,133	83.99	74,730	84.66	6.22%
BB-	92,520	65,863	71.19	73,947	79.92	5.35%
B+	39,877	26,216	65.74	27,818	69.76	3.59%
B	174,725	104,194	59.63	129,331	74.02	3.31%
B-	92,263	42,024	45.55	56,671	61.42	2.25%
CCC	79,212	19,163	24.19	31,736	40.06	1.41%
NR	126,981	26,560	20.92	39,783	31.33	n/a
Total	$774,130	$427,494	55.22	$502,534	64.92	

The Company's investment in its Controlling Class CMBS by credit rating category at December 31, 2002 is as follows:

Fair Market	Dollar	Adjusted	Dollar	Subordination

	Par	Value	Price	Purchase Price	Price	Level
BB+	$65,159	$56,543	86.78	$56,181	86.22	8.26%
BB	58,170	48,674	83.68	48,560	83.48	6.73%
BB-	84,972	59,415	69.92	68,623	80.76	5.48%
B+	32,329	21,533	66.61	23,173	71.68	3.72%
B	168,435	99,815	59.26	125,197	74.33	3.35%
B-	87,231	40,335	46.24	53,415	61.23	2.32%
CCC	70,407	17,715	25.16	28,942	41.11	1.46%
NR	123,349	25,335	20.54	34,171	27.70	n/a
Total	$690,052	$369,365	53.53	$438,262	63.51	

During the first quarter of 2003, total par writedowns in the CMBS Controlling Class portfolio were $10,469. This reduces the total par of the non-rated securities by 2% and permanently reduces future cashflows. When the principal of loans is written off, the trust must also pay the expense of loan workouts and foreclosures, including special servicer fees. The effect of these cashflow reductions is reflected in the market value of these securities which declined by $4,302 during the quarter causing a reduction in Company book value. Further delinquencies and losses in the underlying loan portfolios may cause shortfalls to continue and cause the Company to conclude that a change in loss adjusted yield is required along with a significant write down of the adjusted purchase price through the income statement in accordance with accounting standard EITF 99-20.

During the first quarter of 2003, the underlying loans were paid down by $39,363. Pay down proceeds are distributed to the highest rated CMBS class first and reduce the percent of total underlying collateral represented by each rating category.

For all of the Company's Controlling Class securities, the Company assumes that 1.95% of the remaining current aggregate loan balance will not be recoverable. This represents an increase from 1.88% as of December 31, 2002 to include the new Controlling Class CMBS transaction acquired on

20

March 14, 2003. This estimate was developed based on an analysis of individual loan characteristics and prevailing market conditions at the time of origination. This loss estimate equates to cumulative expected defaults of approximately 5% over the life of the portfolio and an average assumed loss severity of 39.0% of the defaulted loan balance. All estimated workout expenses including special servicer fees are included in these assumptions. Actual results could differ materially from these estimated results. The following table shows the total amount of collateral outstanding on March 31, 2003 for each vintage year of Controlling Class securities owned by the Company along with losses assumed.

	Total Collateral	Losses Assumed	Weighted Avg. Remaining Life of Losses	Loss Recogniz of To
1998	$ 7,870,911	$ 137,891	6.93	17

1999	733,347	18,950	5.04	-0
2001	918,619	23,797	6.54	0
2003	1,006,389	24,348	7.89	0
Total	$ 10,529,266	$ 204,986	6.85	11

As additional Controlling Class CMBS are added, the Company has been increasing the loss assumptions to take into account slower economic activity. Additionally, the Company plans to perform a detailed re-underwriting for a significant amount of the collateral from its 1998 vintage CMBS over the next 18 months. Upon completion, the Company may determine that its reported yields and book values need to be adjusted. The result of assuming greater losses, if that were the conclusion, would be an other than temporary writedown of CMBS to their market value which would include the realization of the amounts currently carried as unrealized losses on the Company's consolidated statements of financial condition. The Company feels this approach provides the appropriate discipline to maintain steady earnings over the long-term from this portfolio.

See Item 3 -"Quantitative and Qualitative Disclosures About Market Risk" for a discussion of how differences between estimated and actual losses could affect Company earnings.

The Company monitors credit performance on a monthly basis and debt service coverage ratios on a quarterly basis. Using these and other statistics, the Company maintains watch lists for loans that are delinquent thirty days or more and for loans that are not delinquent but have issues that the Company feels require close monitoring.

The Company considers delinquency information from the Lehman Brothers Conduit Guide to be the most relevant measure of credit performance and market conditions applicable to its Controlling Class CMBS holdings. The year of issuance, or vintage year, is important, as older loan pools will tend to have more delinquencies than newly underwritten loans. The Company owns Controlling Class CMBS issued in 1998, 1999, 2001 and 2003. Comparable delinquency statistics referenced by vintage year as a percentage of par outstanding as of March 31, 2003 are shown in the table below:

Vintage Year	Underlying Collateral	Delinquencies Outstanding	Lehman Conduit Guide
1998	$7,870,911	2.55%	2.21%
1999	733,347	1.51%	1.67%
2001	918,619	0.00%	0.76%
2003	1,006,389	0.00%	0.00%
Total	$10,529,266	2.01% *	1.44% *

* Weighted average based on respective collateral

Morgan Stanley also tracks CMBS loan delinquencies for specific CMBS transactions with more than $200,000 of collateral and that have been seasoned

for at least one year. This seasoning criterion will generally adjust for the lower delinquencies that occur in newly originated collateral. As of March 31, 2003, the Morgan Stanley index indicated that delinquencies on 210 securitizations was 2.12%, and as of December 31, 2002, this same index indicated that delinquencies on 204 securitizations was 2.01%. See Item 3 - "Quantitative and Qualitative Disclosures About Market Risks" for a detailed discussion of how delinquencies and loan losses affect the Company.

Delinquencies on the Company's CMBS collateral as a percent of principal increased in line with expectations. The Company's aggregate delinquency experience is consistent with comparable data provided in the Lehman Brothers Conduit Guide.

Of the 36 delinquent loans shown on the chart in Note 4 of the consolidated financial statements, one was delinquent due to technical reasons, six were REO and being marketed for sale, four were in foreclosure, and the remaining 25 loans were in some form of workout negotiations. Aggregate realized losses of $14,277 were realized in the first quarter of 2003. This brings cumulative net losses realized to $23,426, which is 11.4% of total estimated losses. These losses include special servicer and other workout expenses. This experience to date is in line with the Company's loss expectations. Realized losses are expected to increase on the underlying loans as the portfolio ages. Special servicer expenses are also expected to increase as portfolios mature and US economic activity remains weak.

The five transactions acquired in 1998 contributed 35 of the 36 delinquent loans. Of those five, the CMAC 1998 C2 transaction represents eleven delinquent loans with total par of $103,440. At March 31, 2003, this transaction incurred principal reductions of $6,700 which reduces the par and the future cash flows of the non rated class M security. The reduction represents 15% of the original class M principal balance. Furthermore, prior cash flow interruptions due to losses and delinquencies resulted in schedule payment shortfalls to the classes senior to the class M security in the amount of $2,437. This prevents the class M from receiving further cash flows until this shortfall has been paid in full. The Company has determined that cash flows may not resume for a significant period of time depending on future performance on the underlying loans. The fair market value of this security is currently carried at a dollar price of 33.1 to reflect the uncertainty of the cash flows. If underlying loan performance deteriorates, the Company may have to write this security down to its market value through the income statement in accordance with accounting standard EITF 99-20. The current unrealized loss on this security is $8,476.

The Company manages its credit risk through disciplined underwriting, diversification, active monitoring of loan performance and exercise of its right to control the workout process as early as possible. The Company maintains diversification of credit exposures through its underwriting process and can shift its focus in future investments by adjusting the mix of loans in subsequent acquisitions. The comparative profiles of the loans underlying the Company's CMBS by property type as of March 31, 2003 and December 31, 2002 is as follows:

	3/31/03 Exposure		12/31/02 Exposure	
Property Type	Loan Balance	% of Total	Loan Balance	% of Total
Multifamily	$3,577,849	34.0%	$3,302,387	34.4%
Retail	3,021,956	28.7	2,704,952	28.1
Office	2,145,019	20.4	1,809,519	18.8

Lodging	819,927	7.8	834,854	8.7
Industrial	594,293	5.6	589,044	6.1
Healthcare	344,305	3.3	346,298	3.6
Parking	25,917	0.2	29,743	0.3
Total	$10,529,266	100%	$9,616,797	100%

As of March 31, 2003, the fair market value of the Company's holdings of CMBS is $66,953 lower than the adjusted cost for these securities. This decline in the value of the investment portfolio represents market valuation changes and is not due to actual credit experience or credit expectations. The adjusted purchase price of the Company's Controlling Class CMBS portfolio as of March 31, 2003 represents approximately 65% of its par amount. The market value of the Company's Controlling Class CMBS portfolio as of March 31, 2003 represents approximately 55% of its par amount. As the portfolio matures, the Company expects to recoup the unrealized loss, provided that the credit losses experienced for each class of security in a transaction are not greater than the credit losses assumed in the purchase analysis of those individual securities. As of March 31, 2003, the Company believes there has been no material deterioration in the credit quality of its portfolio below original expectations.

As the portfolio matures and expected losses occur, subordination levels of the lower rated classes of a CMBS investment will be reduced. This may cause the lower rated classes to be downgraded, which would negatively affect their market value and therefore the Company's net asset value. Reduced market value will negatively affect the Company's ability to finance any such securities that are not financed through a CDO or similar matched funding vehicle. In some cases, securities held by the Company may be upgraded to reflect seasoning of the underlying collateral and thus would increase the market value of the securities.

The Company's GAAP income for its CMBS securities is computed based upon a yield which assumes credit losses. The yield to compute the Company's taxable income does not assume the occurrence of credit losses, as a loss can only be deducted for tax purposes when it has occurred. As a result, for the years ended December 31, 1998 through the three months ended March 31, 2003, the Company's GAAP income accrued on its CMBS assets was approximately $21,634 lower than the taxable income accrued on the CMBS assets.

Commercial Real Estate Loan Activity

The Company's commercial real estate loan portfolio generally emphasizes larger transactions located in metropolitan markets, as compared to the typical loan in the CMBS portfolio. There are no delinquencies in the Company's commercial real estate loan portfolio which is relatively small and heterogeneous. The Company has determined it is not necessary to establish a loan loss reserve for this portfolio.

23

The following table summarizes the Company's commercial real estate loan portfolio by property type as of March 31, 2003 and December 31, 2002:

	March 31, 2003		December 31, 2002	
		Weighted Average		Weig Aver

Property Type	Loan Outstanding		Coupon	Loan Outstanding		Cou
	Amount	%		Amount	%	
Office	$64,425	95.6%	9.3%	$69,431	91.4%	9.5%
Multifamily	2,965	4.4	3.7	3,013	4.0	3.6
Retail	-	-	-	3,500	4.6	4.6
Total	$67,390	100.0%	9.0%	$75,944	100.0%	9.2%

Residential Mortgage Backed Securities

The RMBS market was extremely volatile in the first quarter as prepayments spiked to record levels and the ten-year Treasury rate increased as high as 4.15% and as low as 3.58%. However, the steep yield curve continues to provide a significant amount of income which offsets some of the volatility. The mark to market of this portfolio with its hedges is reflected in realized and unrealized gain/loss on the Company's consolidated statement of operations, and the net income is reported in the interest income and expense section of the same statements. The Company continues its policy of hedging this portfolio to maintain long-term stability of the portfolio, though short-term volatility can and does occur. The realized losses were substantially from rolling Treasury futures hedges; the Company did not liquidate any RMBS assets at a loss. The Company has significant liquidity to maintain its position over the longer term.

At the end of the third quarter in 2002, the Company reevaluated its RMBS strategy. The Company relies on hedging to protect the value of the RMBS portfolio and maintain stable levels of leverage. The Company determined it would be more favorable to rely less on futures as a hedge, which is required to be marked to market through the consolidated statement of operations, and rely more on swaps which are marked to market on the consolidated statement of financial condition. Reducing the effect of income statement volatility caused by the RMBS portfolio that is not actively traded is important to the Company. At March 31, 2003, the Company reclassified $1,037,519 market value of RMBS from held for trading to available for sale, leaving $461,386 market value of RMBS in held for trading. The securities left in held for trading are 6.0% coupon agency passthroughs hedged to a zero duration with five year futures. These securities will be sold in the short-term with the capital redeployed into commercial real estate assets. The securities reclassified as available for sale are 4% - 5.5% Agency RMBS hedged with interest rate swaps of up to ten year maturities.

A breakdown of the RMBS portfolio income performance for the quarter is as follows:

Interest Income	$20,285
Interest Expense	7,940
Net Interest Income	12,345
Realized loss	(8,672)
Unrealized loss in value	(1,731)
Net Income from RMBS	$1,942

II. Results of Operations

Net income for the three months ended March 31, 2003 was $9,697 or $0.18 per share ($0.18 diluted). Net income for the three months ended March 31, 2002 was $27,743 or $0.58 per share ($0.58 diluted). The decrease in income from 2002 to 2003 is primarily due to the cumulative transition adjustment for SFAS 142 in 2002 and losses on securities classified as held for trading in 2003.

Interest Income: The following tables sets forth information regarding the total amount of income from certain of the Company's interest-earning assets.

	For the Three Months Ended March 31, 2003	2002
	Interest Interest	Income Income
CMBS	$13,154	$13,279
Other securities	11,498	15,400
Commercial mortgage loans	1,185	3,619
Cash and cash equivalents	176	319
Total	$26,013	$32,617

In addition, the Company earned $15,831 and $6,288 in interest income from securities held for trading during the three months ended March 31, 2003 and 2002, respectively, $236 and $261 in earnings from real estate joint ventures during the three months ended March 31, 2003 and 2002, respectively, and $743 and $185 in earnings from an equity investment during the three months ended March 31, 2003, and 2002, respectively.

25

Interest Expense: The following table sets forth information regarding the total amount of interest expense from certain of the Company's collateralized borrowings. Information is based on daily average balances during the period.

	For the Three Months Ended March 31, 2003	2002
	Interest Expense	Interest Expense
Reverse repurchase agreements	$ 5,852	$ 8,147
Lines of credit and term loan	136	695
CDO liabilities	6,405	-
Total	$12,393	$ 8,842

The foregoing interest expense amounts for the three months ended March 31, 2003 do not include a $262 addition to interest expense related to hedge ineffectiveness, as well as a $7,050 addition to interest expense related to swaps. The foregoing interest expense amounts for the three months ended March 31, 2002 do not include a $1,175 reduction of interest expense related to hedge ineffectiveness, as well as a $3,973 addition to interest expense related to swaps. See Note 9 in the consolidated financial statements, Derivative Instruments, for a further description of the Company's hedge ineffectiveness.

Net Interest Margin and Net Interest Spread from the Portfolio: The Company considers its portfolio to consist of its securities available for sale, mortgage loan pools, commercial mortgage loans and cash and cash equivalents because these assets relate to its core strategy of acquiring and originating high yield loans and securities backed by commercial real estate, while at the same time maintaining a portfolio of investment grade securities to enhance the Company's liquidity.

Net interest margin from the portfolio is annualized net interest income from the portfolio divided by the average market value of interest-earning assets in the portfolio. Net interest income from the portfolio is total interest income from the portfolio less interest expense relating to collateralized borrowings. Net interest spread from the portfolio equals the yield on average assets for the period less the average cost of funds for the period. The yield on average assets is interest income from the portfolio divided by average amortized cost of interest earning assets in the portfolio. The average cost of funds is interest expense from the portfolio divided by average outstanding collateralized borrowings.

The following chart describes the interest income, interest expense, net interest margin and net interest spread for the Company's portfolio. The following interest income and interest expense amounts exclude income and expense related to real estate joint ventures, equity investment and hedge ineffectiveness.

	For the Three Months Ended March 31,	
	2003	2002
Interest income	$41,844	$39,090
Interest expense	$19,433	$12,803
Net interest margin	3.62%	5.01%
Net interest spread	3.30%	4.56%

26

Other Expenses: Expenses other than interest expense consist primarily of management fees and general and administrative expenses. Management fees paid to the Manager of $2,577 for the three months ended March 31, 2003 and were solely base management fees. Management fees paid to the Manager of $5,407 for the three months ended March 31, 2002 were comprised of base management fees of $2,219 and incentive fees of $3,188. Other expenses/income-net of $582 and $576 for the three months ended March 31, 2003, and 2002, respectively, were comprised of accounting agent fees, custodial agent fees, directors' fees, fees for professional services, insurance premiums and due diligence costs.

Other Gains (Losses): During the three months ended March 31, 2003 and 2002, the Company sold a portion of its securities available for sale for total proceeds

of $0 and $354,187, respectively, resulting in a realized gain/(loss) of $142 and $(4,079), respectively. The (losses)/gains on securities held for trading were $(10,389) and $4,014 for the three months ended March 31, 2003 and 2002, respectively. The foreign currency loss of $(247) for the three months ended March 31, 2002 relates to the Company's net investment in a commercial mortgage loan denominated in pounds sterling and associated hedging, which was subsequently paid off in December 2002.

Dividends Declared: On March 6, 2003, the Company declared distributions to its stockholders of $.35 per share, which was paid on April 30, 2003 to stockholders of record on March 31, 2003.

27

Changes in Financial Condition

Securities Available for Sale: The Company's securities available for sale, which are carried at estimated fair value, included the following at March 31, 2003 and December 31, 2002:

Security Description	March 31, 2003 Estimated Fair Value	Percentage	December 2002 Estim Fair Value
Commercial mortgage-backed securities:			
CMBS IOs	$ 41,751	2.0%	$ 4
Investment grade CMBS	55,259	2.7	5
Non-investment grade rated subordinated securities	634,919	30.8	57
Non-rated subordinated securities	26,596	1.3	2
Credit tenant lease	8,956	0.4	
Investment grade REIT debt	188,107	9.1	18
Total CMBS	955,588	46.3	89
Single-family residential mortgage-backed securities:			
Agency adjustable rate securities	38,311	1.9	4
Agency fixed rate securities	1,044,720	50.7	
Residential CMOs	10,658	0.5	1
Hybrid arms	12,615	0.6	1
Total RMBS	1,106,304	53.7	7
Total securities available for sale	$2,061,892	100.0%	$97

The increase in the CMBS and investment grade REIT debt is attributable to the attractive opportunities available to the Company to match fund these assets in its two CDOs.

Borrowings: As of March 31, 2003, the Company's debt consisted of collateralized

debt obligations, line-of-credit borrowings, and reverse repurchase agreements, collateralized by a pledge of most of the Company's securities available for sale, securities held for trading, and its commercial mortgage loans. The Company's financial flexibility is affected by its ability to renew or replace on a continuous basis its maturing short-term borrowings. As of March 31, 2003, the Company has obtained financing in amounts and at interest rates consistent with the Company's short-term financing objectives.

Under the collateralized debt obligations, lines of credit, and the reverse repurchase agreements, the lender retains the right to mark the underlying collateral to market value. A reduction in the value of its pledged assets would require the Company to provide additional collateral or fund margin calls. From time to time, the Company expects that it will be required to provide such additional collateral or fund margin calls.

The following table sets forth information regarding the Company's collateralized borrowings:

	For the Three Months En March 31, 2003	
	March 31, 2003 Balance	Maximum Balance
Collateralized debt obligations	$684,684	$684,684
Reverse repurchase agreements	1,449,719	1,858,434
Line of credit and term loan borrowings	18,789	22,057

Hedging Instruments: From time to time, the Company may reduce its exposure to market interest rates by entering into various financial instruments that adjust portfolio duration. These financial instruments are intended to mitigate the effect of changes in interest rates on the value of certain assets in the Company's portfolio. At March 31, 2003, the Company had outstanding short positions of 3,059 five-year and 137 ten-year U.S. Treasury Note future contracts. At December 31, 2002, the Company had outstanding short positions of 3,166 five-year and 1,126 ten-year U.S. Treasury Note future contracts.

Interest rate swap agreements as of March 31, 2003 and December 31, 2002 consisted of the following:

	March 31, 2003			
	Notional Value	Estimated Fair Value	Unamortized Cost	Weight Avera Remaining
Interest rate swaps	$1,179,000	$(15,580)	$0	2.18 ye
Interest rate swaps - CDO	650,371	(34,063)	0	9.36 ye
Total	$1,829,371	$(49,643)	$0	4.73 ye

	December 31, 2002			
	Notional Value	Estimated Fair Value	Unamortized Cost	Weight Avera Remaining
Interest rate swaps	$489,000	$(11,948)	$0	1.79 years
Interest rate swaps - CDO	673,832	(33,654)	0	9.60 years
Total	$1,162,832	$(45,602)	$0	6.31 years

As of March 31, 2003, the Company had designated $1,177,826 notional of the interest rate swap agreements as cash flow hedges. As of December 31, 2002, the Company had designated $791,287 notional of the interest rate swap agreements as cash flow hedges.

Capital Resources and Liquidity

Liquidity is a measurement of the Company's ability to meet potential cash requirements, including

ongoing commitments to repay borrowings, fund investments, loan acquisition and lending activities and for other general business purposes. The primary sources of funds for liquidity consist of collateralized borrowings, principal and interest payments on and maturities of securities available for sale, securities held for trading and commercial mortgage loans, and proceeds from the maturity or sales thereof.

To the extent that the Company may become unable to maintain its borrowings at their current level due to changes in the financing markets for the Company's assets, the Company may be required to sell assets in order to achieve lower borrowing levels. In this event, the Company's level of net income would decline. The Company's principal strategies for mitigating this risk are to maintain portfolio leverage at levels it believes are sustainable and to diversify the sources and types of available borrowing and capital. The Company has utilized committed bank facilities and preferred stock offerings, and will consider resecuritization or other achievable term funding of existing assets.

In March 2002, the Series A Preferred stockholder converted its remaining 10,000 shares of the Series A Preferred Stock into 34,427 shares of Common Stock at a price of $7.26 per share pursuant to the terms of such preferred stock, which is $0.09 lower than the original conversion price due to the effects of anti-dilution provisions in the Series A Preferred Stock.

For the quarter ended March 31, 2003, the Company issued 333,328 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $3,517.

As of March 31, 2003, $166,211 of the Company's $185,000 committed credit facility with Deutsche Bank, AG was available for future borrowings.

The Company's operating activities provided cash flows of $403,374 and $214 during the three months ended March 31, 2003 and 2002, respectively, primarily through sales of trading securities and net income and purchases of trading securities, respectively.

The Company's investing activities (used) provided cash flows of $(384,027) and $193,591 during the three months ended March 31, 2003 and 2002, respectively, primarily to purchase securities available for sale and to fund commercial mortgage loans, offset by significant sales of securities.

The Company's financing activities used $(22,835) and $(217,293) during the three months ended March 31, 2003 and 2002, respectively, primarily from distributions on Common Stock in 2003 and reductions of the level of short-term borrowings in 2002.

Although the Company's portfolio of securities available for sale was acquired at a net discount to the face amount of such securities, the Company has received to date, and expects to continue to have, sufficient cash flows from its portfolio to fund distributions to stockholders.

The Company is subject to various covenants in its lines of credit, including maintaining a minimum GAAP net worth of $305,000, a debt-to-equity ratio not to exceed 5.5 to 1, a minimum cash requirement based upon certain debt to equity ratios, a minimum debt service coverage ratio of 1.5, and a minimum liquidity reserve of $10,000. As of March 31, 2003, the Company was in compliance with all such covenants.

30

The Company's ability to execute its business strategy depends to a significant degree on its ability to obtain additional capital. Factors which could affect the Company's access to the capital markets, or the costs of such capital, include changes in interest rates, general economic conditions and perception in the capital markets of the Company's business, covenants under the Company's current and future credit facilities, results of operations, leverage, financial conditions and business prospects. Current conditions in the capital markets for REITs such as the Company have made permanent financing transactions difficult and more expensive than at the time of the Company's initial public offering. Consequently, there can be no assurance that the Company will be able to effectively fund future growth. Except as discussed herein, management is not aware of any other trends, events, commitments or uncertainties that may have a significant effect on liquidity.

Contingent Liability

On May 15, 2000, the Company completed the acquisition of CORE Cap, Inc. The merger was a stock for stock acquisition where the Company issued 4,180,552 shares of its common stock and 2,261,000 shares of its series B preferred stock. At the time of the CORE Cap acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) $12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow for the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. As of March 31, 2003, the Installment Payment would be $9,500 payable over eight years. The Company does not accrue for this contingent liability.

Transactions with Affiliates

The Company has a Management Agreement with the Manager, a majority owned indirect subsidiary of The PNC Financial Services Group, Inc. ("PNC Bank") and the employer of certain directors and officers of the Company, under which the Manager manages the Company's day-to-day operations, subject to the direction and oversight of the Company's Board of Directors. On March 25, 2002, the Management Agreement was extended for one year through March 27, 2003, with the approval of the unaffiliated directors, on terms similar to the prior agreement with the following changes: (i) the incentive fee calculation would be based on GAAP earnings instead of funds from operations, (ii) the removal of the four-year period to value the Management Agreement in the event of termination and (iii) subsequent renewal periods of the Management Agreement would be for one year instead of two years. The Board was advised by Houlihan Lokey Howard & Zukin Financial Advisors, Inc., a national investment banking and financial advisory firm, in the renewal process.

On March 6, 2003, the unaffiliated directors approved an extension of the Management Agreement from its expiration of March 27, 2003 for one year through March 31, 2004. The terms of the renewed

31

agreement are similar to the prior agreement except for the incentive fee calculation which would provide for a rolling four-quarter high watermark rather than a quarterly calculation. In determining the rolling four-quarter high watermark, the Company would calculate the incentive fee based upon the current and prior three quarters' net income. The Manager would be paid an incentive fee in the current quarter if the Yearly Incentive Fee is greater than what was paid to the Manager in the prior three quarters cumulatively. The Company will phase in the rolling four-quarter high watermark commencing with the second quarter of 2003. Calculation of the incentive fee will be based on GAAP and adjusted to exclude special one-time events pursuant to changes in GAAP accounting pronouncements after discussion between the Manager and the unaffiliated directors. The incentive fee threshold did not change. The high watermark will be based on the existing incentive fee hurdle, which provides for the Manager to be paid 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's common stock per share ($11.39 as of March 31, 2003) and the greater of 9.5% or 350 basis points over the ten-year Treasury note.

The Company pays the Manager an annual base management fee equal to a percentage of the average invested assets of the Company as defined in the Management Agreement. The base management fee is equal to 1% per annum of the average invested assets rated less than BB- or not rated, 0.75% of average invested assets rated BB- to BB+, and 0.20% of average invested assets rated above BB+.

The Company incurred $2,577 and $2,219 in base management fees in accordance with the terms of the Management Agreement for the three months ended March 31, 2003 and 2002, respectively. In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of $6 and $5 for certain expenses incurred on behalf of the Company for the three months ended March 31, 2003 and 2002, respectively.

Pursuant to the March 25, 2002 one-year Management Agreement extension, the incentive fee was based on 25% of earnings (calculated in accordance with GAAP) of the Company. For purposes of calculating the incentive fee during 2002, the cumulative transition adjustment of $6,327 resulting from the Company's adoption of SFAS 142 was excluded from earnings in its entirety and included using an amortization period of three years. This revision saved the Company $1,448 of

incentive fee for the three months ended March 31, 2002. The Company incurred $3,188 in incentive compensation for the three months ended March 31, 2002. The Company did not incur incentive compensation fees for the three months ended March 31, 2003.

On March 17, 1999, the Company's Board of Directors approved an administration agreement with the Manager and the termination of a previous agreement with an unaffiliated third party. Under the terms of the administration agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. The Company pays the Manager a monthly administrative fee at an annual rate of 0.06% of the first $125 million of average net assets, 0.04% of the next $125 million of average net assets and 0.03% of average net assets in excess of $250 million subject to a minimum annual fee of $120. For the three months ended March 31, 2003 and 2002, the Company paid administration fees of $43 and $43, respectively.

On July 20, 2001, the Company entered into a $50 million commitment to acquire shares in Carbon. The period during which the Company may be required to purchase shares under the commitment, expires in July 2004. On March 31, 2003, the Company owned 18.8% of the outstanding shares in

32

Carbon. The Company's remaining commitment at March 31, 2003 and December 31, 2002 was $32,436 and $35,116, respectively. On February 6, 2003, the Company funded a capital call notice in the amount of $2,680, which was used by Carbon to acquire a mezzanine loan secured by ownership interests in an entity that owns a mixed-use development.

REIT Status: The Company has elected to be taxed as a REIT and therefore must comply with the provisions of the Internal Revenue Code with respect thereto. Accordingly, the Company generally will not be subject to Federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company may, however, be subject to tax at corporate rates or at excise tax rates on net income or capital gains not distributed.

33

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk: Market risk is the exposure to loss resulting from changes in interest rates, credit curve spreads, foreign currency exchange rates, commodity prices and equity prices. The primary market risks to which the Company is exposed are interest rate risk and credit curve risk. Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond the control of the Company. Credit risk is highly sensitive to dynamics of the markets for commercial mortgage securities and other loans and securities held by the Company. Excessive supply of these assets combined with reduced demand will cause the market to require a higher yield. This demand for higher yield will cause the market to use a higher spread over the U.S. Treasury securities yield curve, or other benchmark interest rates, to value these assets. Changes in the general level of the U.S. Treasury yield curve can have significant effects on the market value of the Company's portfolio.

The majority of the Company's assets are fixed rate securities valued based on a

market credit spread to U.S. Treasuries. As U.S. Treasury securities are priced to a higher yield and/or the spread to U.S. Treasuries used to price the Company's assets is increased, the market value of the Company's portfolio may decline. Conversely, as U.S. Treasury securities are priced to a lower yield and/or the spread to U.S. Treasuries used to price the Company's assets is decreased, the market value of the Company's portfolio may increase. Changes in the market value of the Company's portfolio may affect the Company's net income or cash flow directly through their impact on unrealized gains or losses on securities held for trading or indirectly through their impact on the Company's ability to borrow. Changes in the level of the U.S. Treasury yield curve can also affect, among other things, the prepayment assumptions used to value certain of the Company's securities and the Company's ability to realize gains from the sale of such assets. In addition, changes in the general level of the LIBOR money market rates can affect the Company's net interest income. The majority of the Company's liabilities are floating rate based on a market spread to U.S. LIBOR. As the level of LIBOR increases or decreases, the Company's interest expense will move in the same direction.

The Company may utilize a variety of financial instruments, including interest rate swaps, caps, floors and other interest rate exchange contracts, in order to limit the effects of fluctuations in interest rates on its operations. The use of these types of derivatives to hedge interest-earning assets and/or interest-bearing liabilities carries certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of securities and, that such losses may exceed the amount invested in such instruments. A hedge may not perform its intended purpose of offsetting losses or increased costs. Moreover, with respect to certain of the instruments used as hedges, the Company is exposed to the risk that the counterparties with which the Company trades may cease making markets and quoting prices in such instruments, which may render the Company unable to enter into an offsetting transaction with respect to an open position. If the Company anticipates that the income from any such hedging transaction will not be qualifying income for REIT income test purposes, the Company may conduct part or all of its hedging activities through a to-be-formed corporate subsidiary that is fully subject to federal corporate income taxation. The profitability of the Company may be adversely affected during any period as a result of changing interest rates.

The following tables quantify the potential changes in the Company's net portfolio value and net interest income under various interest rates and credit-spread scenarios. The Company views the probability of

34

interest rate changes in terms of standard deviation units. Based on historical data, there is a 68% and 95% statistical probability that rates remained in a range of one and two standard deviation units, respectively. This statistical computation provides an historical context for analyzing changes in interest rates. Net portfolio value is defined as the value of interest-earning assets net of the value of interest-bearing liabilities. It is evaluated using an assumption that interest rates, as defined by the U.S. Treasury yield curve, increase or decrease and the assumption that the yield curves of the rate shocks will be parallel to each other.

Net interest income is defined as interest income earned from interest-earning assets net of the interest expense incurred by the interest bearing liabilities. It is evaluated using the assumptions that interest rates, as defined by the U.S. LIBOR curve, increase or decrease and the assumption that the yield curves of the LIBOR rate shocks will be parallel to each other. Market value in this scenario is calculated using the assumption that the U.S. Treasury yield curve remains constant.

All changes in income and value are measured as percentage changes from the respective values calculated in the scenario labeled as "Base Case." The base interest rate scenario assumes interest rates as of March 31, 2003. Actual results could differ significantly from these estimates.

Projected Percentage Change In Portfolio Net Market Value
Given U.S. Treasury Yield Curve Movements

Change in Treasury Yield Curve, +/- Basis Points	Projected Change in Portfolio Net Market Value
-200	8.1%
-100	6.3%
-50	3.7%
Base Case	0
+50	(4.8)%
+100	(10.8)%
+200	(26.0)%

Projected Percentage Change In Portfolio Net Market Value
Given Credit Spread Movements

Change in Credit Spreads, +/- Basis Points	Projected Change in Portfolio Net Market Value
-200	27.1%
-100	15.8%
-50	8.4%
Base Case	0
+50	(9.6)%
+100	(20.2)%
+200	(44.9)%

Projected Percentage Change In Portfolio Net Interest Income
Given LIBOR Movements

Change in LIBOR, +/- Basis Points	Projected Change in Portfolio Net Interest Income	Projected Change in Portfoilo Net Ineterest Income per Share
-100	2.3%	$0.04
-50	1.2%	$0.02
Base Case	0	0
+50	(1.2)%	$(0.02)
+100	(2.3)%	$(0.04)
+200	(4.6)%	$(0.09)

After changes to RMBS hedging were fully implemented early in the second quarter of 2003, the Company's exposure to changes in short-term interest rates would result in a $0.045 change in net income for every 50 basis point change in LIBOR. The aggregate sensitivity to short-term rates has not changed year over year. However, as detailed above, a significant portion of the Company's illiquid credit sensitive CMBS was match funded in 2002 with no short-term rate risk. As of March 31, 2003 the majority of the Company's short-term rate

exposure was concentrated in the highly liquid RMBS portfolio which can be adjusted quickly to react to changes in short-term rates.

Credit Risk: The Company's portfolios of commercial real estate assets are subject to a high degree of credit risk. Credit risk is the exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply/demand factors, construction trends, consumer behavior, regional economics, interest rates, the strength of the American economy and other factors beyond the control of the Company.

All loans are subject to a certain probability of default. The Company underwrites its CMBS investments assuming the underlying loans will suffer a certain dollar amount of defaults and these defaults will lead to some level of realized losses. Loss adjusted yields are computed based on these assumptions and applied to each class of security supported by the cash flow on the underlying loans. The most significant variables affecting loss adjusted yields include, but are not limited to, the number of defaults, the severity of loss that occurs subsequent to a default and the timing of the actual loss. The different rating levels of CMBS will react differently to changes in these assumptions. The lowest rated securities (B- or lower) are generally more sensitive to changes in timing of actual losses. The higher rated securities (B or higher) are more sensitive to the severity of losses.

The Company generally assumes that all of the principal of a non-rated security and a significant portion, if not all, of CCC and a portion of B- rated securities will not be recoverable over time. The loss adjusted yields of these classes reflect that assumption; therefore, the timing of when the total loss of principal occurs is the key assumption. The interest coupon generated by a security will cease when there is a total loss of its principal regardless of whether that principal is paid. Therefore, timing is of paramount importance because the longer the principal balance remains outstanding the more interest coupon the holder receives to support a greater economic return. Alternatively, if principal is lost faster than originally assumed there is less opportunity to receive interest coupon therefore a lower or possibly negative return may result. Additional losses occurring due to greater severity will not have a

significant effect as all principal is already assumed to be non-recoverable.

If actual principal losses on the underlying loans exceed assumptions, the higher rated securities will be affected more significantly as a loss of principal may not have been assumed. The Company generally assumes that most if not all principal will be recovered by classes rated B or higher.

The Company manages credit risk through the underwriting process, establishing loss assumptions and careful monitoring of loan performance. Before acquiring a Controlling Class security that represents a proposed pool of loans, the Company will perform a rigorous analysis of the quality of all of the loans proposed. As a result of this analysis, loans with unacceptable risk profiles will be removed from the proposed pool. Information from this review is then used to establish loss assumptions. The Company will assume that a certain portion of the loans will default and calculate an expected or loss adjusted yield based on that assumption. After the securities have been acquired, the Company monitors the performance of the loans, as well as external factors that may affect their value.

Factors that indicate a higher loss severity or acceleration of the timing of an expected loss will cause a reduction in the expected yield and therefore reduce

the earnings of the Company. Furthermore, the Company may be required to write down a portion of the adjusted purchase price of the affected assets through its income statement.

For purposes of illustration, a doubling of the losses in the Company's Controlling Class CMBS, without a significant acceleration of those losses would reduce GAAP income going forward by approximately $0.21 per share of common stock per annum and cause a significant write down at the time the loss assumption is changed The amount of the write down depends on several factors, including which securities are most affected at the time of the write down, but is estimated to be in the range of $0.60 to $0.80 per share based on a doubling of expected losses. A significant acceleration of the timing of these losses would cause the Company's net income to decrease. The total adjusted purchase price of Controlling Class CMBS at March 31, 2003 was $10.53 per share. The amount of adjusted purchase price that is not match funded in a CDO is $4.84 per share. The Company's exposure to a write down is mitigated by the fact that most of these assets are financed on a non-recourse basis in the Company's CDOs, where a significant portion of the risk of loss is transferred to the CDO bondholders.

Asset and Liability Management: Asset and liability management is concerned with the timing and magnitude of the repricing and/or maturing of assets and liabilities. It is the objective of the Company to attempt to control risks associated with interest rate movements. In general, management's strategy is to match the term of the Company's liabilities as closely as possible with the expected holding period of the Company's assets. This is less important for those assets in the Company's portfolio considered liquid as there is a very stable market for the financing of these securities.

Other methods for evaluating interest rate risk, such as interest rate sensitivity "gap" (defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period), are used but are considered of lesser significance in the daily management of the Company's portfolio. Management considers this relationship when reviewing the Company's hedging strategies. Because different types of assets and liabilities with the same or similar maturities react differently to changes in overall market rates or conditions, changes in interest rates may affect the

Company's net interest income positively or negatively even if the Company were to be perfectly matched in each maturity category.

The Company currently has positions in forward currency exchange contracts to hedge currency exposure in connection with its commercial mortgage loan denominated in pounds sterling. The purpose of the Company's foreign currency-hedging activities is to protect the Company from the risk that the eventual U.S. dollar net cash inflows from the commercial mortgage loan will be adversely affected by changes in exchange rates. The Company's current strategy is to roll these contracts from time to time to hedge the expected cash flows from the loan. Fluctuations in foreign exchange rates are not expected to have a material impact on the Company's net portfolio value or net interest income.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness

of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's reports filed or submitted under the Exchange Act.

(b) Changes in Internal Controls. Since the Evaluation Date, there have not been any significant changes in the Company's internal controls or in other factors that could significantly affect such controls.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

At March 31, 2003 there were no pending legal proceedings to which the Company was a party or of which any of its property was subject.

Item 2. Changes in Securities and Use of Proceeds

None.

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

10.1 Amended and Restated Investment Advisory Agreement, dated as of March 27, 2003, between the Registrant and BlackRock Financial Management, Inc.

99.1 Certification of CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

On February 25, 2003, the Company filed a Current Report on Form 8-K to report under Item 5 the Company's earnings for the quarter and full year ended December 31, 2002.

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.

ANTHRACITE CAPITAL, INC.

Dated: May 15, 2003 By: /s/ Hugh R. Frater

Name: Hugh R. Frater
Title: President and Chief Executive Officer
(authorized officer of registrant)

Dated: May 15, 2003 By: /s/ Richard M. Shea

Name: Richard M. Shea
Title: Chief Operating Officer and Chief Financial Officer

41

CERTIFICATIONS

I, Hugh R. Frater, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Anthracite Capital, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

42

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003 By: /s/ Hugh R. Frater

Name: Hugh R. Frater
Title: President and Chief Executive Officer
(authorized officer of registrant)

43

I, Richard M. Shea, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Anthracite Capital, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls

and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003 By: /s/ Richard M. Shea

Name: Richard M. Shea
Title: Chief Operating Officer and Chief Financial Officer