



# **FORM 10-Q**

**ANNALY MORTGAGE MANAGEMENT INC – NLY**

**Filed: August 11, 2000 (period: June 30, 2000)**

Quarterly report which provides a continuing view of a company's financial position

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WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2000

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: 1-13447

ANNALY MORTGAGE MANAGEMENT, INC.  
(Exact name of Registrant as specified in its Charter)

MARYLAND 22-3479661  
(State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization)

12 EAST 41ST STREET, SUITE 700  
NEW YORK, NEW YORK  
(Address of principal executive offices)

10017  
(Zip Code)

(212) 696-0100  
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all documents and 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:

Yes X No  
-----

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of stock, as of the last practicable date:

| Class                         | Outstanding at August 11, 2000 |
|-------------------------------|--------------------------------|
| Common Stock, \$.01 par value | 14,210,645                     |

Annaly Mortgage Management, Inc.

FORM 10-Q

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ANNALY MORTGAGE MANAGEMENT, INC  
BALANCE SHEETS

|  | JUNE 30, 2000<br>(UNAUDITED) | DECEMBER 31,<br>1999 |
|--|------------------------------|----------------------|
| ASSETS   |                              |                      |
| Cash and cash equivalents  | \$ 121,512                   | \$ 71,918            |
| Mortgage-Backed Securities, at fair value  | 1,450,852,364                | 1,437,792,631        |
| Receivable for Mortgage-Backed Securities sold   | 12,653,699                   | 46,402,360           |
| Accrued interest receivable  | 6,898,611                    | 6,857,683            |
| Other assets   | 247,150                      | 197,896              |
|  | -----                        | -----                |
| Total assets   | \$1,470,773,336              | \$1,491,322,488      |
|  | =====                        | =====                |
| LIABILITIES AND STOCKHOLDERS' EQUITY   |                              |                      |
| Liabilities:   |                              |                      |
| Repurchase agreements  | \$1,349,682,000              | \$1,338,295,750      |
| Payable for Mortgage-Backed Securities purchased   |                              | 38,154,012           |
| Accrued interest payable   | 6,117,961                    | 6,682,687            |
| Dividends payable  | 4,262,402                    | 4,753,461            |
| Accounts payable   | 271,327                      | 164,100              |
|  | -----                        | -----                |
| Total liabilities  | 1,360,333,690                | 1,388,050,010        |
|  | -----                        | -----                |
| Stockholders' Equity:  |                              |                      |
| Common stock: par value \$.01 per share; 100,000,000<br>Authorized, 14,208,007 and 13,581,316 shares issued<br>and outstanding, respectively | 142,080                      | 135,813              |
| Additional paid-in capital   | 145,303,101                  | 140,262,657          |
| Accumulated other comprehensive loss   | (35,008,078)                 | (37,568,510)         |
| Retained earnings  | 2,543                        | 442,518              |
|  | -----                        | -----                |
| Total stockholders' equity   | 110,439,646                  | 103,272,478          |
|  | -----                        | -----                |
| Total liabilities and stockholders' equity   | \$1,470,773,336              | \$1,491,322,488      |
|  | =====                        | =====                |

See notes to financial statements

ANNALY MORTGAGE MANAGEMENT, INC  
INCOME STATEMENTS  
(UNAUDITED)

|   | For the<br>Quarter Ended<br>June 30,<br>2000 | For the<br>Quarter Ended<br>June 30,<br>1999 | For the Six<br>Months Ended<br>June 30,<br>2000 | For the Six<br>Months Ended<br>June 30,<br>1999 |
|---|--|--|---|---|
| INTEREST INCOME:  |  |  |   |   |
| Mortgage-Backed Securities  | \$25,732,165                                 | \$22,264,812                                 | \$50,347,932                                    | \$44,279,733                                    |
| Other interest income   | 2,355  | 118  | 3,370   | 138   |
| Total interest income   | 25,734,520                                   | 22,264,930                                   | 50,351,302                                      | 44,279,871                                      |
| INTEREST EXPENSE:   |  |  |   |   |
| Repurchase agreements   | 21,453,016                                   | 16,865,824                                   | 40,745,970                                      | 34,016,865                                      |
| NET INTEREST INCOME   | 4,281,504                                    | 5,399,106                                    | 9,605,332                                       | 10,263,006                                      |
| GAIN ON SALE OF MORTGAGE-BACKED<br>SECURITIES                             | 64,774                                       | 25,853                                       | 171,627   | 90,413  |
| GENERAL AND ADMINISTRATIVE<br>EXPENSES                                    | 507,322                                      | 561,010                                      | 1,089,641                                       | 1,171,014                                       |
| NET INCOME  | 3,838,956                                    | 4,863,949                                    | 8,687,318                                       | 9,182,405                                       |
| OTHER COMPREHENSIVE INCOME  |  |  |   |   |
| Unrealized gain (loss) on available-<br>for-sale securities               | (630,080)                                    | (13,419,555)                                 | 2,732,059                                       | (12,933,640)                                    |
| Less: reclassification adjustment<br>for net gains included in net income | (64,774)                                     | (25,853)                                     | (171,627)                                       | (90,413)  |
| Other comprehensive gain (loss)   | (694,854)                                    | (13,445,408)                                 | 2,560,432                                       | (13,024,053)                                    |
| COMPREHENSIVE INCOME  | \$ 3,144,102                                 | (\$ 8,581,459)                               | \$11,247,750                                    | (\$ 3,841,648)                                  |
| NET INCOME PER SHARE:   |  |  |   |   |
| Basic   | \$0.27                                       | \$0.38                                       | \$0.63  | \$0.72  |
| Diluted   | \$0.26                                       | \$0.37                                       | \$0.61  | \$0.71  |
| AVERAGE NUMBER OF SHARES OUTSTANDING:                                     |  |  |   |   |
| Basic   | 14,039,741                                   | 12,697,338                                   | 13,850,140                                      | 12,677,718                                      |
| Diluted   | 14,631,940                                   | 13,110,275                                   | 14,152,881                                      | 12,957,718                                      |

See notes to financial statements

ANNALY MORTGAGE MANAGEMENT, INC  
STATEMENT OF STOCKHOLDER'S EQUITY  
FOR THE SIX MONTHS ENDED JUNE 30, 2000  
(UNAUDITED)

|   | Common<br>Stock<br>Par Value | Additional<br>Paid-In<br>Capital | Comprehensive<br>Income | Retained<br>Earnings |
|---|------------------------------|----------------------------------|-------------------------|----------------------|
| BALANCE, DECEMBER 31, 1999  | \$135,813                    | \$140,262,657                    |                         | \$442,518            |
| Net Income  |                              |                                  | \$4,848,362             | 4,848,362            |
| Other comprehensive income:   |                              |                                  |                         |                      |
| Unrealized net gains on securities,<br>net of reclassification adjustment               |                              |                                  | 3,255,286               |                      |
| Comprehensive income  |                              |                                  | \$8,103,648             |                      |
| Exercise of stock options   | 346                          | 138,150                          |                         |                      |
| Proceeds from direct purchase   | 2,838                        | 2,313,779                        |                         |                      |
| Dividends declared for the quarter<br>ended March 31, 2000,<br>\$0.35 per average share |                              |                                  |                         | (4,864,891)          |
| BALANCE, MARCH 31, 2000   | \$138,997                    | \$142,714,586                    |                         | \$425,989            |
| Net Income  |                              |                                  | \$3,838,956             | 3,838,956            |
| Other comprehensive income:   |                              |                                  |                         |                      |
| Unrealized net losses on securities,<br>net of reclassification adjustment              |                              |                                  | (694,854)               |                      |
| Comprehensive income  |                              |                                  | \$3,144,102             |                      |
| Exercise of stock options   | 10                           | 8,115                            |                         |                      |
| Proceeds from direct purchase   | 3,073                        | 2,580,400                        |                         |                      |
| Dividends declared for the quarter<br>ended June 30, 2000,<br>\$0.30 per average share  |                              |                                  |                         | (4,262,402)          |
| BALANCE, JUNE 30, 2000  | \$142,080                    | \$145,303,101                    |                         | \$ 2,543             |

Disclosure of reclassification amount:

|   |             |
|---|-------------|
| Unrealized holding gains arising<br>during the period                 | \$2,732,059 |
| Less: reclassification adjustment for<br>gains included in net income | (171,627)   |
| Net unrealized gains on securities                                    | \$2,560,432 |

|   | Other<br>Comprehensive<br>Income | Total         |
|---|----------------------------------|---------------|
| BALANCE, DECEMBER 31, 1999  | (\$37,568,510)                   | \$103,272,478 |
| Net Income  |                                  |               |
| Other comprehensive income:   |                                  |               |
| Unrealized net gains on securities,<br>net of reclassification adjustment               | 3,255,286                        |               |
| Comprehensive income  |                                  | 8,103,648     |
| Exercise of stock options   |                                  | 138,496       |
| Proceeds from direct purchase   |                                  | 2,316,617     |
| Dividends declared for the quarter<br>ended March 31, 2000,<br>\$0.35 per average share |                                  | (4,864,891)   |
| BALANCE, MARCH 31, 2000   | (\$34,313,224)                   | \$108,966,348 |
| Net Income  |                                  |               |
| Other comprehensive income:   |                                  |               |
| Unrealized net losses on securities,<br>net of reclassification adjustment              | (694,854)                        |               |
| Comprehensive income  |                                  | 3,144,102     |
| Exercise of stock options   |                                  | 8,125         |
| Proceeds from direct purchase   |                                  | 2,583,473     |
| Dividends declared for the quarter<br>ended June 30, 2000,<br>\$0.30 per average share  |                                  | (4,262,402)   |
| BALANCE, JUNE 30, 2000  | (\$35,008,078)                   | \$110,439,646 |

Disclosure of reclassification amount:

|   |  |
|---|--|
| Unrealized holding gains arising<br>during the period                 |  |
| Less: reclassification adjustment for<br>gains included in net income |  |
| Net unrealized gains on securities                                    |  |

See notes to financial statements

ANNALY MORTGAGE MANAGEMENT, INC  
STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|  | For the Quarter<br>Ended<br>June 30,<br>2000 | For the Quarter<br>Ended<br>June 30,<br>1999 | For the Six<br>Months Ended<br>June 30, 2000 | For the Six<br>Months Ended June<br>30, 1999 |
|--|--|--|--|--|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |  |  |  |  |
| Net income   | \$3,838,956                                  | \$4,863,949                                  | \$8,687,318                                  | \$9,182,405                                  |
| Adjustments to reconcile net income to net cash<br>Provided by operating activities: |  |  |  |  |
| Amortization of mortgage premiums and<br>discounts, net                              | 519,905                                      | 1,886,272                                    | 994,611                                      | 4,050,915                                    |
| Gain on sale of mortgage-backed securities   | (64,774)                                     | (25,853)                                     | (171,627)                                    | (90,413)                                     |
| Decrease (increase) in accrued interest<br>receivable                                | (128,822)                                    | 16,798                                       | (40,928)                                     | (620,322)                                    |
| Increase in other assets   | (30,959)                                     | (171,534)                                    | (49,254)                                     | (190,951)                                    |
| Increase (decrease) in accrued interest payable                                      | 678,168                                      | (814,852)                                    | (564,726)                                    | 3,715,195                                    |
| Increase (decrease) in accounts payable  | (568)  | 100,425                                      | 107,227                                      | 291,092                                      |
| <b>Net cash provided by operating activities</b>                                     | <b>4,811,906</b>                             | <b>5,855,205</b>                             | <b>8,962,621</b>                             | <b>16,337,921</b>                            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |  |  |  |  |
| Purchase of Mortgage-Backed Securities   | (85,683,125)                                 | (101,582,524)                                | (174,111,811)                                | (356,751,056)                                |
| Proceeds from sale of Mortgage-Backed Securities                                     | 18,877,266                                   | 16,443,000                                   | 88,659,898                                   | 48,212,366                                   |
| Principal payments of Mortgage-Backed<br>Securities                                  | 38,538,346                                   | 110,312,495                                  | 69,724,277                                   | 235,805,426                                  |
| <b>Net cash provided (used) in investing<br/>activities</b>                          | <b>(28,267,513)</b>                          | <b>25,172,971</b>                            | <b>(15,727,636)</b>                          | <b>(72,733,264)</b>                          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |  |  |  |  |
| Proceeds from repurchase agreements  | 3,414,378,000                                | 2,619,594,000                                | 6,516,210,500                                | 5,272,183,000                                |
| Purchase of Mortgage-Backed Securities   | 3,388,683,500                                | (2,646,710,000)                              | (6,504,824,250)                              | (5,207,953,000)                              |
| Proceeds from exercise of stock options  | 8,125  | 1,000  | 146,621                                      | 196,496                                      |
| Proceeds from direct purchase  | 2,583,471                                    |  | 4,900,090                                    |  |
| Dividends paid   | (4,864,891)                                  | (4,190,108)                                  | (9,618,352)                                  | (8,047,771)                                  |
| <b>Net cash provided (used) by<br/>financing activities</b>                          | <b>23,421,205</b>                            | <b>(31,305,108)</b>                          | <b>6,814,609</b>                             | <b>56,378,725</b>                            |
| <b>Net increase (decrease) in cash and cash equivalents</b>                          | <b>(34,402)</b>                              | <b>(276,932)</b>                             | <b>49,594</b>                                | <b>(16,618)</b>                              |
| Cash and cash equivalents, beginning of period                                       | 155,914                                      | 329,334                                      | 71,918                                       | 69,020                                       |
| Cash and cash equivalents, end of period   | \$ 121,512                                   | \$ 52,402                                    | \$ 121,512                                   | \$ 52,402                                    |
| <b>Supplemental disclosure of cash flow information:</b>                             |  |  |  |  |
| Interest paid  | \$20,774,848                                 | \$17,680,676                                 | \$41,310,696                                 | \$30,241,491                                 |
| <b>Noncash financing activities:</b>   |  |  |  |  |
| Net change in unrealized losses on available-for-<br>sale securities                 | (\$694,854)                                  | (\$13,445,408)                               | \$2,560,432                                  | (\$13,024,053)                               |
| Dividends declared, not yet paid   | \$4,262,402                                  | \$4,444,142                                  | \$4,262,402                                  | \$4,444,142                                  |

See notes to financial statements

ANNALY MORTGAGE MANAGEMENT, INC  
NOTES TO FINANCIAL STATEMENTS  
(UNAUDITED)

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Annaly Mortgage Management, Inc. (the "Company") was incorporated in Maryland on November 25, 1996. The Company commenced its operations of purchasing and managing Mortgage-Backed Securities on February 18, 1997, upon receipt of the net proceeds from the private placement of equity capital. An initial public offering was completed on October 14, 1997.

A summary of the Company's significant accounting policies follows:

**BASIS OF PRESENTATION** - 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. The interim financial statements for the three and six month periods are unaudited; however, in the opinion of the Company's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair statement of the results of operations have been included. These unaudited financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 1999. The nature of the Company's business is such that the results of any interim period are not necessarily indicative of results for a full year.

**CASH AND CASH EQUIVALENTS** - Cash and cash equivalents include cash on hand and money market funds. The carrying amounts of cash equivalents approximate their value.

**MORTGAGE-BACKED SECURITIES** - The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively, "Mortgage-Backed Securities").

Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"), requires the Company to classify its investments as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold most of its Mortgage-Backed Securities until maturity, it may, from time to time, sell any of its Mortgage-Backed Securities as part of its overall management of its balance sheet. Accordingly, this flexibility requires the Company to classify all of its Mortgage-Backed Securities as available-for-sale. All assets classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity.

Unrealized losses on Mortgage-Backed Securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to factors other than temporary, are recognized in income and the cost basis of the Mortgage-Backed Securities is adjusted. There were no such adjustments for the six months ended June 30, 2000 and the year ended December 31, 1999.

Interest income is accrued based on the outstanding principal amount of the Mortgage-Backed Securities and their contractual terms. Premiums and discounts associated with the purchase of the Mortgage-Backed Securities are amortized into interest income over the lives of the securities using the effective yield method.

Mortgage-Backed Securities transactions are recorded on the date the securities are purchased or sold. Purchases of newly issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gains and losses on Mortgage-Backed Securities transactions are determined on the specific identification basis.

**CREDIT RISK** - At June 30, 2000 and December 31, 1999, the Company has limited exposure to credit losses on its portfolio of Mortgage-Backed Securities by only purchasing securities from Federal Home Loan Mortgage Corporation ("FHLMC"), Federal National Mortgage Association ("FNMA"), or Government National Mortgage Association ("GNMA"). The payment of principal and interest on the FHLMC and FNMA Mortgage-Backed Securities are guaranteed by those respective agencies and the payment of principal and interest on the GNMA Mortgage-Backed Securities are backed by the full-faith-and-credit of the U.S. government. At June 30, 2000 and December 31, 1999, all of the Company's Mortgage-Backed Securities have a "AAA" rating or an implied a "AAA" rating.

INCOME TAXES - The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") and intends to comply with the provisions of the Internal Revenue Code of 1986, as amended (the "Code") with respect thereto. Accordingly, the Company will not be subjected to Federal income tax to the extent of its distributions to shareholders and as long as certain asset, income and stock ownership tests are met.

USE OF ESTIMATES - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. MORTGAGE-BACKED SECURITIES

The following table pertains to the Company's Mortgage-Backed Securities classified as available-for-sale as of June 30, 2000, which are carried at their fair value:

|                                   | FEDERAL<br>HOME LOAN<br>MORTGAGE<br>CORPORATION | FEDERAL<br>NATIONAL<br>MORTGAGE<br>ASSOCIATION | GOVERNMENT<br>NATIONAL<br>MORTGAGE<br>ASSOCIATION | TOTAL<br>MORTGAGE-BACKED<br>SECURITIES |
|-----------------------------------|---|--|---|--|
| Mortgage-Backed Securities, gross | \$ 502,002,481                                  | \$ 870,659,962                                 | \$ 92,305,316                                     | \$ 1,464,967,759                       |
| Unamortized discount              | (209,156)                                       | (1,177,013)                                    | --  | (1,386,169)                            |
| Unamortized premium               | 8,423,271                                       | 12,194,445                                     | 1,661,136   | 22,278,852                             |
| Amortized cost                    | 510,216,596                                     | 881,677,394                                    | 93,966,452  | 1,485,860,442                          |
| Gross unrealized gains            | 168,383   | 699,235  | 867,618   |  |
| Gross unrealized losses           | (11,973,876)                                    | (20,725,170)                                   | (3,176,650)                                       | (35,875,696)                           |
| Estimated fair value              | \$ 498,411,103                                  | \$ 861,651,459                                 | \$ 90,789,802                                     | \$ 1,450,852,364                       |

The following table pertains to the Company's Mortgage-Backed Securities classified as available-for-sale as of December 31, 1999, which are carried at their fair value:

|                                   | FEDERAL<br>HOME LOAN<br>MORTGAGE<br>CORPORATION | FEDERAL<br>NATIONAL<br>MORTGAGE<br>ASSOCIATION | GOVERNMENT<br>NATIONAL<br>MORTGAGE<br>ASSOCIATION | TOTAL<br>MORTGAGE-BACKED<br>SECURITIES |
|-----------------------------------|---|--|---|--|
| Mortgage-Backed Securities, gross | \$ 454,711,462                                  | \$ 900,782,563                                 | \$ 97,423,038                                     | \$ 1,452,917,063                       |
| Unamortized discount              | (171,241)                                       | (964,133)                                      | --  | (1,135,374)                            |
| Unamortized premium               | 8,454,547                                       | 13,359,448                                     | 1,765,457   | 23,579,452                             |
| Amortized cost                    | 462,994,768                                     | 913,177,878                                    | 99,188,495  | 1,475,361,141                          |
| Gross unrealized gains            | 359,888   | 1,171,250                                      | 1,531,138   |  |
| Gross unrealized losses           | (12,091,145)                                    | (22,966,353)                                   | (4,042,150)                                       | (39,099,648)                           |
| Estimated fair value              | \$ 451,263,511                                  | \$ 891,382,775                                 | \$ 95,146,345                                     | \$ 1,437,792,631                       |

The adjustable rate Mortgage-Backed Securities are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months) and lifetime caps. At June 30, 2000, and December 31, 1999, the weighted average lifetime cap was 10.4% and 10.6% respectively.

During the six months ended June 30, 2000 and 1999, the Company's realized \$171,627 and \$90,413 in gains from sales of Mortgage-Backed Securities, respectively. During the year ended December 31, 1999, the Company realized \$563,259 in gains for sales of Mortgage-Backed Securities. There were no losses on sales of Mortgage-Backed Securities for the six months ended June 30, 2000. Losses totaled \$108,477 for the year ended December 31, 1999.

### 3. REPURCHASE AGREEMENTS

As of June 30, 2000, the Company had outstanding \$1,349,682,000 of repurchase agreements with a weighted average borrowing rate of 6.30%. The weighted average remaining maturity was 24 days and a weighted average original term was 39 days. As of December 31, 1999, the Company had outstanding \$1,338,295,750 of repurchase agreements with a weighted average borrowing rate of 5.26%. The weighted average remaining maturity was 20 days.

At June 30, 2000 and December 31, 1999, the repurchase agreements had the following remaining maturities:

|                  | June 30, 2000    | December 31, 1999 |
|------------------|------------------|-------------------|
| Within 30 days   | \$ 907,214,000   | \$ 1,197,416,250  |
| 30 to 59 days    | 265,017,000      | 25,767,000        |
| 60 to 89 days    | 83,520,000       | -                 |
| 90 to 119 days   | 54,676,000       | 115,112,500       |
| 120 days or over | 39,255,000       | -                 |
|                  | -----            | -----             |
|                  | \$ 1,349,682,000 | \$ 1,338,295,750  |
|                  | -----            | -----             |

### 4. COMMON STOCK

Options were exercised and the share purchase and dividend reinvestment plan was in effect during the six month period ending June 30, 2000 increasing the total number of shares outstanding to 14,208,007. The number of stock options exercised was 35,624, with an aggregate purchase price of \$146,621. The number of shares issued in the direct purchase plan was 591,067 with an aggregate purchase price of \$4,900,090. During the year ended December 31, 1999, 57,204 options were exercised at an aggregate price of \$233,276. Also, 875,688 shares were purchased in direct offering, total \$8,170,602.

During the six months ending June 30, 2000, the Company declared dividends to shareholders totaling \$9,127,293 or \$0.66 per weighted average share, of which \$4,262,402 was paid on July 27, 2000. During the Company's year ending December 31, 1999, the Company declared dividends to shareholders totaling \$17,977,754, or \$1.39 per weighted average share, of which \$13,224,293 was paid during the period and \$4,753,461 was paid on January 27, 2000. For Federal income tax purposes dividends paid for the year ended December 31, 1999 are ordinary income to the Company stockholders.

### 5. EARNINGS PER SHARE (EPS)

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting No. 128, Earnings Per Share (SFAS No. 128), which requires dual presentation of Basic EPS and Diluted EPS on the face of the income statement for all entities with complex capital structures. SFAS No. 128 also requires a reconciliation of the numerator and denominator of Basic EPS and Diluted EPS computation.

For the three months ended June 30, 2000 the reconciliation is as follows:

| FOR THE THREE MONTHS ENDED<br>JUNE 30, 2000              |                       |                         |                     |
|--|-----------------------|-------------------------|---------------------|
|  | INCOME<br>(NUMERATOR) | SHARES<br>(DENOMINATOR) | PER-SHARE<br>AMOUNT |
| Net income   | \$ 3,838,956          |                         |                     |
| Basic EPS  | 3,838,956             | 14,039,741              | \$ 0.27             |
| Effect of dilutive securities:<br>Dilutive stock options | -                     | 592,199                 |                     |
| Diluted EPS  | \$ 3,838,956          | 14,631,940              | \$ 0.26             |

For the six months ended June 30, 2000 the reconciliation is as follows:

| FOR THE SIX MONTHS ENDED<br>JUNE 30, 2000                |                       |                         |                     |
|--|-----------------------|-------------------------|---------------------|
|  | INCOME<br>(NUMERATOR) | SHARES<br>(DENOMINATOR) | PER-SHARE<br>AMOUNT |
| Net income   | \$ 8,687,318          |                         |                     |
| Basic EPS  | 8,687,318             | 13,850,140              | \$ 0.63             |
| Effect of dilutive securities:<br>Dilutive stock options | -                     | 302,741                 |                     |
| Diluted EPS  | \$ 8,687,318          | 14,152,881              | \$ 0.61             |

Options to purchase 653,256 shares were outstanding during the quarter ended June 30, 2000 and dilutive, as the exercise price (between \$4.00 and \$8.63) was less than the average stock price for the three month period for the Company of \$8.69. Options to purchase 155,176 shares of stock were outstanding during the period and are not considered dilutive. The exercise price (between \$8.94 and \$11.25) was greater than the average stock price for the three month period of \$8.69.

Options to purchase 354,256 shares were outstanding during the six months ended June 30, 2000 and dilutive, as the exercise price (between \$4.00 and \$8.125) was less than the average stock price for the six month period for the Company of \$8.47. Options to purchase 454,176 shares of stock were outstanding during the period and are not considered dilutive. The exercise price (between \$8.63 and \$11.25) was greater than the average stock price for the three month period of \$8.47.

#### 6. COMPREHENSIVE INCOME

The Company adopted FASB Statement no. 130, Reporting Comprehensive Income, Statement no. 130 requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. The Company at June 30, 2000 and December 31, 1999 held securities classified as available-for-sale. At June 30, 2000 and December 31, 1999, the net unrealized losses totaled \$35,008,078 and \$37,568,510, respectively.

7. LEASE COMMITMENTS

The Corporation has non-cancelable lease for office space, which commenced in April 1998 and expires in December 2007.

The Corporation's aggregate minimum lease payments are as follows:

|                        |            |
|------------------------|------------|
| 2000                   | 95,299     |
| 2001                   | 97,868     |
| 2002                   | 100,515    |
| 2003                   | 110,261    |
| 2004 through 2007      | 472,145    |
|                        | -----      |
| Total lease obligation | \$ 876,088 |
|                        | =====      |

8. RELATED PARTY TRANSACTIONS

Included in "Other Assets" on the Balance sheet is an investment in Annaly International Money Management, Inc. On June 24, 1998, the Company acquired 99,960 nonvoting shares, at a cost of \$49,980. The officers and directors of Annaly International Money Management Inc. are also officers and directors of the Company.

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

OVERVIEW

We are a real estate investment trust that owns and manages a portfolio of mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our mortgage-backed securities and the costs of borrowing to finance our acquisition of mortgage-backed securities.

We commenced operations on February 18, 1997 upon the consummation of a private placement. We completed our initial public offering on October 14, 1997. The 317-day period ended December 31, 1997 was a short operating period and not a full twelve months

RESULTS OF OPERATIONS: FOR THE QUARTER ENDED JUNE 30, 2000 AND 1999

NET INCOME SUMMARY

For the quarter ended June 30, 2000, our GAAP net income was \$3.8 million, or \$.27 basic earnings per average share, as compared to \$4.9 million, or \$.38 basic earnings per average share, for the quarter ended June 30, 1999. We compute our GAAP net income per share by dividing net income by the weighted average number of shares of outstanding common stock during the period, which was 14,039,741 for the quarter ended June 30, 2000 and 12,697,338 for the quarter ended June 30, 1999. Dividends per weighted average number of shares outstanding for the quarter ended June 30, 2000 was \$.30 per share, or \$4.3 million in total. Dividends per weighted average number of shares outstanding for the quarter ended March 31, 1999 was \$.35 per share, or \$4.4 million in total. Our return on average equity was 14.00% for the quarter ended June 30, 2000 and 16.20% for the quarter ended June 30, 1999.

|  | NET INCOME SUMMARY                   |                                      |   |   |
|--|--------------------------------------|--------------------------------------|---|---|
|  | Quarter<br>Ended<br>June 30,<br>2000 | Quarter<br>Ended<br>June 30,<br>1999 | Six Months<br>Ended<br>June 30,<br>2000 | Six Months<br>Ended<br>June 30,<br>1999 |
| Interest Income                              | \$25,734                             | \$22,265                             | \$50,351                                | \$44,280                                |
| Interest Expense                             | 21,453                               | 16,866                               | 40,746                                  | 34,017                                  |
| Net Interest Income                          | 4,281                                | 5,399                                | 9,605                                   | 10,263                                  |
| Gain on Sale of Mortgage-Backed Securities   | 65                                   | 26                                   | 172                                     | 90                                      |
| General and Administrative Expenses          | 507                                  | 561                                  | 1,090                                   | 1,171                                   |
| Net Income                                   | \$ 3,839                             | \$4,864                              | \$8,687                                 | \$9,182                                 |
| Average Number of Basic Shares Outstanding   | 14,039,741                           | 12,697,338                           | 13,850,140                              | 12,677,718                              |
| Average Number of Diluted Shares Outstanding | 14,631,940                           | 13,110,275                           | 14,152,881                              | 12,957,718                              |
| Basic Net Income Per Share                   | \$0.27                               | \$0.38                               | \$0.63                                  | \$0.72                                  |
| Diluted Net Income Per Share                 | \$0.26                               | \$0.37                               | \$0.61                                  | \$0.71                                  |
| Average Total Assets                         | \$1,457,152                          | \$1,496,793                          | \$1,456,436                             | \$1,508,688                             |
| Average Equity                               | \$109,703                            | \$120,104                            | \$107,911                               | \$123,112                               |
| Annualized Return on Average Assets          | 1.05%                                | 1.30%                                | 1.20%                                   | 1.22%                                   |
| Annualized Return on Average Equity          | 14.00%                               | 16.20%                               | 16.10%                                  | 14.92%                                  |

TAXABLE INCOME AND GAAP INCOME

For the quarter ended June 30, 2000 and 1999, our income as calculated for tax purposes (taxable income) differed from income as calculated according to GAAP (GAAP income). Our taxable income for the quarter ended June 30, 2000 was approximately \$3.4 million, or \$0.25 per share, as compared to taxable income of \$4.9 million, or \$0.38 per share, for the quarter ended June 30, 1999. The differences were in the calculations of premium and discount amortization, gains on sale of mortgage-backed securities, and general and administrative expenses.

The distinction between taxable income and GAAP income is important to our stockholders because dividends are declared on the basis of taxable income. While we do not pay taxes so long as we satisfy the requirements for exemption from taxation pursuant to the REIT provisions of the Internal Revenue Code, each year we complete a corporate tax form on which taxable income is calculated as if we were to be taxed. This taxable income level determines the amount of dividends we can pay out over time. The table below presents the major differences between our GAAP and taxable income for the quarters ended June 30, 2000 and March 31, 2000, the year ended December 31, 1999, and the four quarters in 1999

|   | TAXABLE INCOME     |   |  |   | Taxable Net<br>Income |
|---|--------------------|---|--|---|-----------------------|
|   | GAAP Net<br>Income | Taxable General<br>&<br>Administrative<br>Differences | Taxable<br>Mortgage<br>Amortization<br>Differences | Taxable Gain<br>on Sale of<br>Securities<br>Differences |                       |
| (dollars in thousands)                      |                    |   |  |   |                       |
| For the Quarter Ended<br>June 30, 2000      | \$3,839            | \$1   | (\$323)  | (\$69)  | \$3,448               |
| For the Quarter Ended<br>March 31, 2000     | \$4,848            | \$1   | \$16   | (\$25)  | \$4,840               |
| For the Year Ended<br>December 31, 1999     | \$18,139           | \$9   | \$814  | (\$525)   | \$18,437              |
| For the Quarter Ended<br>December 31, 1999  | \$4,444            | \$2   | \$21   | (\$288)   | \$4,179               |
| For the Quarter Ended<br>September 30, 1999 | \$4,513            | \$5   | (\$14)   | (\$235)   | \$4,269               |
| For the Quarter Ended<br>June 30, 1999      | \$4,864            | \$2   | \$363  | -   | \$5,229               |
| For the Quarter Ended<br>March 31, 1999     | \$4,318            | -   | \$444  | (\$2)   | \$4,760               |

INTEREST INCOME AND AVERAGE EARNING ASSET YIELD

We had average earning assets of \$1.5 billion for the quarters ended June 30, 2000 and 1999. Our primary source of income for the quarters ended June 30, 2000 and 1999 was interest income. A portion of our income was generated by gains on the sales of our mortgage-backed securities. Our interest income was \$25.7 million for the quarter ended June 30, 2000 and \$22.3 million for the quarter ended June 30, 1999. Our yield on average earning assets was 6.97% and 5.95% for the same respective periods. Our average earning asset balance decreased by \$20.5 million for the quarter ended June 30, 2000 as compared to the quarter ended June 30, 1999. Interest income increased by \$3.4 million for the quarter ended June 30, 2000 over the quarter ended June 30, 1999, due to the decline in the portfolio CPR and an increase in the coupons on adjustable rate securities. The table below shows our average balance of cash equivalents and mortgage-backed securities, the yields we earned on each type of earning assets, our yield on average earning assets and our interest income for the quarters ended June 30, 2000 and March 31, 2000, the year ended December 31, 1999, and the four quarters in 1999.

AVERAGE EARNING ASSET YIELD

|  | Average<br>Cash<br>Equivalents | Average<br>Mortgage-<br>Backed<br>Securities | Average<br>Earning<br>Assets | Yield on<br>Average<br>Cash<br>Equivalents | Yield on<br>Average<br>Mortgage-<br>Backed<br>Securities | Yield on<br>Average<br>Earning<br>Assets | Interest<br>Income |
|--|--------------------------------|--|------------------------------|--|--|--|--------------------|
|  |                                |  |                              |  |  |  |                    |
|  |                                |  |                              | (dollars in thousands)                     |  |  |                    |
| For the Quarter ended June 30, 2000      | \$243                          | \$1,476,283                                  | \$1,476,526                  | 3.29%                                      | 6.97%  | 6.97%                                    | \$25,735           |
| For the Quarter ended March 31, 2000     | \$226                          | \$1,448,148                                  | \$1,448,374                  | 1.79%                                      | 6.80%  | 6.80%                                    | \$24,617           |
| For the Year Ended December 31, 1999     | \$221                          | \$1,461,033                                  | \$1,461,254                  | 4.10%                                      | 6.15%  | 6.15%                                    | \$89,812           |
| For the Quarter Ended December 31, 1999  | \$2                            | \$1,420,308                                  | \$1,420,310                  | 4.05%                                      | 6.58%  | 6.58%                                    | \$23,371           |
| For the Quarter Ended September 30, 1999 | \$877                          | \$1,416,525                                  | \$1,417,404                  | 4.10%                                      | 6.26%  | 6.25%                                    | \$22,161           |
| For the Quarter Ended June 30, 1999      | \$2                            | \$1,496,793                                  | \$1,496,795                  | 4.30%                                      | 5.95%  | 5.95%                                    | \$22,265           |
| For the Quarter Ended March 31, 1999     | \$2                            | \$1,502,627                                  | \$1,502,629                  | 4.01%                                      | 5.87%  | 5.87%                                    | \$22,015           |

The constant prepayment rate (or CPR) on our mortgage-backed securities for the quarter ended June 30, 2000 was 11% and for the quarter ended June 30, 1999 was 21%. CPR is an assumed rate of prepayment for our mortgage-backed securities, expressed as an annual rate of prepayment relative to the outstanding principal balance of our mortgage-backed securities. CPR does not purport to be either a historical description of the prepayment experience of our mortgage-backed securities or a prediction of the anticipated rate of prepayment of our mortgage-backed securities.

Principal prepayments had a negative effect on our earning asset yield for the quarters ended June 30, 2000 and 1999 because we adjust our rates of premium amortization and discount accretion monthly based upon the effective yield method, which takes into consideration changes in prepayment speeds.

INTEREST EXPENSE AND THE COST OF FUNDS

We anticipate that our largest expense will be the cost of borrowed funds. We had average borrowed funds of \$1.4 billion and total interest expense of \$21.5 million for the quarter ended June 30, 2000. We had average borrowed funds of \$1.4 billion and total interest expense of \$16.9 million for the quarter ended June 30, 1999. Our average cost of funds was 6.30% for the quarter ended June 30, 2000 and 4.91% for the quarter ended June 30, 1999. The cost of funds rate increased 1.39% for the quarter ended June 30, 2000 when compared to the quarter ended June 30, 1999; consequently, interest expense increased by 27%. With our current asset/liability management strategy, changes in our cost of funds are expected to be closely correlated with changes in short-term LIBOR, although we may choose to extend the maturity of our liabilities at any time. Our average cost of funds was 0.16% below one-month LIBOR for the quarter ended June 30, 2000 and 0.05% below average one-month LIBOR for the quarter ended June 30, 1999. We generally have structured our borrowings to adjust with one-month LIBOR because we believe that one-month LIBOR may continue to be lower than six-month LIBOR in the present interest rate environment. During the quarter ended June 30, 2000, average one-month LIBOR, was 6.46%, which was 0.38% lower than average six-month LIBOR, which was 6.84%. During the quarter ended June 30, 1999, average one-month LIBOR, was 4.96%, 0.23% lower than average six-month LIBOR, which was 5.19%.

The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the quarters ended June 30, 2000 and March 31, 2000, the year ended December 31, 1999 and the four quarters in 1999.

AVERAGE COST OF FUNDS

|   | Average<br>Borrowed<br>Funds | Interest<br>Expense | Average<br>Cost of<br>Funds | Average<br>One-Month<br>LIBOR | Average<br>Six-Month<br>LIBOR | Average<br>One-Month<br>LIBOR<br>Relative to<br>Average<br>Six-Month<br>LIBOR | Average Cost<br>of Funds<br>Relative to<br>Average<br>One-Month<br>LIBOR | Average Cost<br>of Funds<br>Relative to<br>Average<br>Six-Month<br>LIBOR |
|---|------------------------------|---------------------|-----------------------------|-------------------------------|-------------------------------|---|--|--|
|   | -----                        | -----               | -----                       | -----                         | -----                         | -----   | -----  | -----  |
|   | (dollars in thousands)       |                     |                             |                               |                               |   |  |  |
| For the Quarter Ended<br>June 30, 2000      | \$1,360,419                  | \$21,453            | 6.30%                       | 6.46%                         | 6.84%                         | (0.38%)   | (0.16%)  | (0.54%)  |
| For the Quarter Ended<br>March 31, 2000     | \$1,329,900                  | \$19,293            | 5.80%                       | 5.92%                         | 6.32%                         | (0.40%)   | (0.12%)  | (0.52%)  |
| For the Year Ended<br>December 31, 1999     | \$1,350,230                  | \$69,846            | 5.17%                       | 5.25%                         | 5.53%                         | (0.28%)   | (0.08%)  | (0.36%)  |
| For the Quarter Ended<br>December 31, 1999  | \$1,324,326                  | \$18,597            | 5.61%                       | 5.78%                         | 6.08%                         | (0.30%)   | (0.17%)  | (0.47%)  |
| For the Quarter Ended<br>September 30, 1999 | \$1,320,776                  | \$17,232            | 5.22%                       | 5.28%                         | 5.80%                         | (0.52%)   | (0.06%)  | (0.58%)  |
| For the Quarter Ended<br>June 30, 1999      | \$1,374,154                  | \$16,865            | 4.91%                       | 4.96%                         | 5.19%                         | (0.23%)   | (0.05%)  | (0.28%)  |
| For the Quarter Ended<br>March 31, 1999     | \$1,381,663                  | \$17,151            | 4.97%                       | 4.96%                         | 5.05%                         | (0.09%)   | 0.01%  | (0.08%)  |

NET INTEREST RATE AGREEMENT EXPENSE

We have not entered into any interest rate agreements to date. As part of our asset/liability management process, we may enter into interest rate agreements such as interest rate caps, floors or swaps. These agreements would be entered into with the intent to reduce interest rate or prepayment risk and would be designed to provide us income and capital appreciation in the event of certain changes in interest rates. However, even after entering into these agreements, we would still be exposed to interest rate and prepayment risks. We review the need for interest rate agreements on a regular basis consistent with our capital investment policy.

NET INTEREST INCOME

Our net interest income, which equals interest income less interest expense, totaled \$4.3 million for the quarter ended June 30, 2000 and \$5.4 million for the quarter ended June 30, 1999. Our net interest income decreased because of the increase in asset yields of 1.02% was not as great as the increase of 1.39% in funding cost. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was .67% for the quarter ended June 30, 2000 as compared to 1.04% for the quarter ended June 30, 1999. This 0.37% decrease in spread income is reflected in the \$1.1 million decline in net interest income. Net interest margin, which equals net interest income divided by average total assets, was 1.16% on an annualized basis for the quarter ended June 30, 2000 and 1.44% for the quarter ended June 30, 1999. The principal reason that net interest margin exceeded net interest spread is that average interest earning assets exceeded average interest bearing liabilities. A portion of our assets is funded with equity rather than borrowings. We did not have any interest rate agreement expenses to date.

The table below shows our interest income by earning asset type, average earning assets by type, total interest income, interest expense, average repurchase agreements, average cost of funds, and net interest income for the quarters ended June 30, 2000 and March 31, 2000, the year ended December 31, 1999, and the four quarters in 1999.

## GAAP NET INTEREST INCOME

(dollars in thousands)

|   | Amortized<br>Cost of<br>Average<br>Mortgage-<br>Backed<br>Securities<br>Held | Interest<br>Income on<br>Mortgage-<br>Backed<br>Securities | Average<br>Cash<br>Equivalents | Total<br>Interest<br>Income | Yield on<br>Average<br>Interest<br>Earning<br>Assets | Average<br>Balance of<br>Repurchase<br>Agreements | Interest<br>Expense | Average<br>Cost of<br>Funds | Net<br>Interest<br>Income |
|---|--|--|--------------------------------|-----------------------------|--|---|---------------------|-----------------------------|---------------------------|
| For the Quarter<br>Ended June 30, 2000      | \$1,476,283  | \$25,732   | \$243                          | \$25,735                    | 6.97%  | \$1,360,419                                       | \$21,453            | 6.30%                       | 4,282                     |
| For the Quarter<br>Ended March 31, 2000     | \$1,448,148  | \$24,616   | \$226                          | \$24,617                    | 6.80%  | \$1,329,900                                       | \$19,293            | 5.80%                       | \$4,848                   |
| For the Year<br>Ended December 31, 1999     | \$1,461,033  | \$89,801   | \$221                          | \$89,812                    | 6.15%  | \$1,350,230                                       | \$69,846            | 5.17%                       | \$ 19,966                 |
| For the Quarter<br>Ended December 31, 1999  | \$1,420,308  | \$23,372   | \$2                            | \$23,372                    | 6.58%  | \$1,324,326                                       | \$18,597            | 5.61%                       | \$4,774                   |
| For the Quarter<br>Ended September 30, 1999 | \$1,416,525  | \$22,151   | \$877                          | \$22,160                    | 6.26%  | \$1,320,776                                       | \$17,232            | 5.22%                       | \$4,929                   |
| For the Quarter<br>Ended June 30, 1999      | \$1,493,532  | \$22,265   | \$2                            | \$22,265                    | 5.95%  | \$1,374,154                                       | \$16,865            | 4.91%                       | \$5,399                   |
| For the Quarter<br>Ended March 31, 1999     | \$1,502,629  | \$22,015   | \$2                            | \$22,015                    | 5.87%  | \$1,381,663                                       | \$17,151            | 4.97%                       | \$4,864                   |

## GAINS AND LOSSES ON SALES OF MORTGAGE-BACKED SECURITIES

For the quarter ended June 30, 2000, we sold mortgage-backed securities with an aggregate historical amortized cost of \$18.8 million for an aggregate gain of \$64,774. For the quarter ended June 30, 1999, we sold mortgage-backed securities with an aggregate historical amortized cost of \$16.4 million for an aggregate gain of \$25,853. The difference between the sale price and the historical amortized cost of our mortgage-backed securities is a realized gain and increases income accordingly. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to move into new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

## CREDIT LOSSES

We have not experienced credit losses on our mortgage-backed securities to date. We have limited our exposure to credit losses on our mortgage-backed securities by purchasing only securities, issued or guaranteed by FNMA, FHLMC or GNMA, which, although not rated, carry an implied "AAA" rating.

## GENERAL AND ADMINISTRATIVE EXPENSES

G&A expenses were \$507,322 for the quarter ended June 30, 2000 and \$561,010 for the quarter ended June 30, 1999. G&A expenses as a percentage of average assets was 0.14% and 0.15% for the quarters ended June 30, 2000 and 1999, respectively. The Company is internally managed and continues to be a low cost provider. G&A expenses decreased by \$53,688 for the quarter ended June 30, 2000, when compared to the quarter ended June 30, 1999.

GAAP GAEXPENSES AND OPERATING EXPENSE RATIOS

|  | Total GAExpenses | Total GA<br>Assets (annualized) | Total GA<br>Equity (annualized) |
|--|------------------|---------------------------------|---------------------------------|
| For the Quarter Ended June 30, 2000      | \$507            | 0.15%                           | 1.39%                           |
| For the Quarter Ended March 31, 2000     | \$582            | 0.16%                           | 2.19%                           |
| For the Year Ended December 31, 1999     | \$2,281          | 0.15%                           | 1.94%                           |
| For the Quarter Ended December 31, 1999  | \$596            | 0.16%                           | 2.21%                           |
| For the Quarter Ended September 30, 1999 | \$514            | 0.14%                           | 1.81%                           |
| For the Quarter Ended June 30, 1999      | \$561            | 0.15%                           | 1.44%                           |
| For the Quarter Ended March 31, 1999     | \$610            | 0.16%                           | 1.93%                           |

NET INCOME AND RETURN ON AVERAGE EQUITY

Our net income was \$3.8 million for the quarter ended June 30, 2000 and \$4.9 million for the quarter ended June 30, 1999. Our return on average equity was 14.00% for the quarter ended June 30, 2000 and 16.20% for the quarter ended June 30, 1999. The decrease in net income is a direct result of an decrease in spread income. As previously mentioned, the substantial increases in funding cost were only partially offset by an increase in the yield on assets. The table below shows our net interest income, gain on sale of mortgage-backed securities and G&A expenses each as a percentage of average equity, and the return on average equity for the quarters ended June 30, 2000 and March 31, 2000, the year ended December 31, 1999, and for the four quarters in 1999.

COMPONENTS OF RETURN ON AVERAGE EQUITY

(Ratios for all Quarters are annualized)

|  | Net Interest<br>Income/Average<br>Equity | Gain on Sale of<br>Mortgage-Backed<br>Securities/Average<br>Equity | GA<br>Expenses/Average<br>Equity | Return on<br>Average<br>Equity |
|--|--|--|----------------------------------|--------------------------------|
| For the Quarter Ended June 30, 2000      | 15.61%                                   | 0.24%  | 1.85%                            | 14.00%                         |
| For the Quarter Ended March 31, 2000     | 20.07%                                   | 0.40%  | 2.19%                            | 18.28%                         |
| For the Year Ended December 31, 1999     | 16.97%                                   | 0.38%  | 1.94%                            | 15.41%                         |
| For the Quarter Ended December 31, 1999  | 17.65%                                   | 0.99%  | 2.21%                            | 16.43%                         |
| For the Quarter Ended September 30, 1999 | 17.40%                                   | 0.34%  | 1.81%                            | 15.93%                         |
| For the Quarter Ended June 30, 1999      | 17.99%                                   | 0.08%  | 1.87%                            | 16.20%                         |
| For the Quarter Ended March 31, 1999     | 15.43%                                   | 0.20%  | 1.93%                            | 13.70%                         |

DIVIDENDS AND TAXABLE INCOME

We have elected to be taxed as a REIT under the Internal Revenue Code. Accordingly, we have distributed substantially all of our taxable income for each year since inception to our stockholders, including income resulting from gains on sales of our mortgage-backed securities. From inception through June 30, 2000, approximate taxable income exceeded dividend declarations by \$859,000, or \$0.06 per share, based on the number of shares of common stock outstanding at period end.

DIVIDEND SUMMARY  
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|   | Taxable<br>Net<br>Income                      | Weighted<br>Average<br>Common<br>Shares<br>Outstanding | Taxable Net<br>Income Per<br>Share | Dividends<br>Declared<br>Per Share | Total<br>Dividends | Dividend<br>Pay-out<br>Ratio | Cumulative<br>Undistributed<br>Taxable Income |
|---|---|--|------------------------------------|------------------------------------|--------------------|------------------------------|---|
|   | (dollars in thousands, except per share data) |  |                                    |                                    |                    |                              |   |
| For the Quarter Ended<br>June 30, 2000      | \$3,448                                       | 14,039,741   | \$0.25                             | \$0.30                             | \$4,262            | 123.6%                       | \$859   |
| For the Quarter Ended<br>March 31, 2000     | \$4,840                                       | 13,660,539   | \$0.36                             | \$0.35                             | \$4,864            | 100.5%                       | \$1,673                                       |
| For the Year Ended<br>December 31, 1999     | \$18,437                                      | 12,889,510   | \$1.43                             | \$1.39                             | \$17,978           | 97.5%                        | \$1,697                                       |
| For the Quarter Ended<br>December 31, 1999  | \$4,179                                       | 13,383,426   | \$0.31                             | \$0.35                             | \$4,754            | 113.74%                      | \$1,697                                       |
| For the Quarter Ended<br>September 30, 1999 | \$4,269                                       | 12,745,416   | \$0.34                             | \$0.35                             | \$4,588            | 91.1%                        | \$2,271                                       |
| For the Quarter Ended<br>June 30, 1999      | \$5,229                                       | 12,697,338   | \$0.41                             | \$0.35                             | \$4,444            | 87.1%                        | \$2,589                                       |
| For the Quarter Ended<br>March 31, 1999     | \$4,760                                       | 12,657,884   | \$0.37                             | \$0.33                             | \$4,190            | 94.9%                        | \$1,804                                       |

FINANCIAL CONDITION

MORTGAGE-BACKED SECURITIES

All of our mortgage-backed securities at June 30, 2000 were adjustable-rate or fixed-rate mortgage-backed securities backed by single-family mortgage loans. All of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. All our mortgage-backed securities were FHLMC, FNMA or GNMA mortgage pass-through certificates or CMOs, which carry an implied "AAA" rating. We mark-to-market all of our earning assets at liquidation value.

We accrete discount balances as an increase in interest income over the life of discount mortgage-backed securities and we amortize premium balances as a decrease in interest income over the life of premium mortgage-backed securities. At June 30, 2000 and 1999, we had on our balance sheet a total of \$1.4 million and \$1.0 million respectively, of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of our mortgage-backed securities acquired at a price below principal value) and a total of \$22.3 million and \$26.0 million, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our mortgage-backed securities acquired at a price above principal value).

We received mortgage principal repayments of \$38.5 million for the quarter ended June 30, 2000 and \$110.3 million for the quarter ended June 30, 1999. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities, as we would amortize our net premium balance over a longer time period.

The table below summarizes our mortgage-backed securities at June 30, 2000, March 31, 2000, December 31, 1999, September 30, 1999, June 30, 1999, and March 31, 1999.

MORTGAGE-BACKED SECURITIES

|                       | Principal Value        | Net Premium | Amortized Cost | Amortized Cost/Principal Value | Estimated Fair Value | Estimated Fair Value/Principal Value | Weighted Average Yield |
|-----------------------|------------------------|-------------|----------------|--------------------------------|----------------------|--------------------------------------|------------------------|
|                       | -----                  | -----       | -----          | -----                          | -----                | -----                                | -----                  |
|                       | (dollars in thousands) |             |                |                                |                      |                                      |                        |
| At June 30, 2000      | \$1,464,968            | \$20,893    | \$1,485,861    | 101.43%                        | \$1,450,853          | 99.04%                               | 7.32%                  |
| At March 31, 2000     | \$1,448,875            | \$21,826    | \$1,470,701    | 101.51%                        | \$1,436,389          | 99.14%                               | 7.02%                  |
| At December 31, 1999  | \$1,452,917            | \$22,444    | \$1,475,361    | 101.54%                        | \$1,437,793          | 98.96%                               | 6.77%                  |
| At September 30, 1999 | \$1,402,565            | \$22,981    | \$1,425,546    | 101.64%                        | \$1,401,770          | 99.94%                               | 6.41%                  |
| At June 30, 1999      | \$1,468,547            | \$24,985    | \$1,493,532    | 101.70%                        | \$1,474,104          | 100.38%                              | 6.21%                  |
| At March 31, 1999     | \$1,527,530            | \$26,071    | \$1,553,601    | 101.71%                        | \$1,547,618          | 101.32%                              | 5.94%                  |

The tables below set forth certain characteristics of our mortgage-backed securities. The index level for adjustable-rate mortgage-backed securities is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

ADJUSTABLE-RATE MORTGAGE-BACKED SECURITY CHARACTERISTICS

|                       | Principal Value        | Weighted Average Coupon Rate | Weighted Average Index Level | Weighted Average Net Margin | Weighted Average Term to Next Adjustment | Weighted Average Lifetime Cap | Weighted Average Asset Yield | Principal Value at Period End as % of Total Mortgage-Backed Securities |
|-----------------------|------------------------|------------------------------|------------------------------|-----------------------------|--|-------------------------------|------------------------------|--|
|                       | -----                  | -----                        | -----                        | -----                       | -----                                    | -----                         | -----                        | -----  |
|                       | (dollars in thousands) |                              |                              |                             |  |                               |                              |  |
| At June 30, 2000      | \$986,046              | 7.53%                        | 6.02%                        | 1.51%                       | 9 months                                 | 10.41%                        | 7.46%                        | 67.31%   |
| At March 31, 2000     | \$957,419              | 7.18%                        | 5.63%                        | 1.55%                       | 10 months                                | 10.59%                        | 7.006%                       | 66.08%   |
| At December 31, 1999  | \$951,839              | 7.33%                        | 5.84%                        | 1.49%                       | 11 months                                | 10.30%                        | 7.64%                        | 65.51%   |
| At September 30, 1999 | \$889,293              | 6.76%                        | 5.13%                        | 1.63%                       | 9 months                                 | 10.82%                        | 6.14%                        | 63.40%   |
| At June 30, 1999      | \$941,559              | 6.67%                        | 4.96%                        | 1.71%                       | 11 months                                | 11.00%                        | 5.84%                        | 64.12%   |
| At March 31, 1999     | \$1,036,947            | 6.63%                        | 4.97%                        | 1.66%                       | 11 months                                | 11.01%                        | 5.64%                        | 67.88%   |

FIXED-RATE MORTGAGE-BACKED SECURITY CHARACTERISTICS

|                       | Principal Value        | Weighted Average Coupon Rate | Weighted Average Asset Yield | Principal Value as % of Total Mortgage-Backed Securities |
|-----------------------|------------------------|------------------------------|------------------------------|--|
|                       | -----                  | -----                        | -----                        | -----  |
|                       | (dollars in thousands) |                              |                              |  |
| At June 30, 2000      | \$478,922              | 6.58%                        | 7.05%                        | 32.69%   |
| At March 31, 2000     | \$491,456              | 6.58%                        | 7.04%                        | 33.92%   |
| At December 31, 1999  | \$501,078              | 6.58%                        | 7.01%                        | 34.49%   |
| At September 30, 1999 | \$513,272              | 6.58%                        | 6.91%                        | 36.60%   |
| At June 30, 1999      | \$526,988              | 6.58%                        | 6.88%                        | 35.88%   |
| At March 31, 1999     | \$490,583              | 6.54%                        | 6.37%                        | 32.12%   |

At June 30, 2000 and December 31, 1999 we held mortgage-backed securities with coupons linked to the one-year, three-year, and five-year Treasury indices, one-month LIBOR and the six-month CD rate.

ADJUSTABLE-RATE MORTGAGE-BACKED SECURITIES BY INDEX

JUNE 30, 2000

|   | One-Month<br>LIBOR | Six-Month<br>CD Rate | 1-Year<br>Treasury<br>Index | 3-Year<br>Treasury<br>Index | 5-Year<br>Treasury<br>Index |
|---|--------------------|----------------------|-----------------------------|-----------------------------|-----------------------------|
| Weighted Average Adjustment Frequency   | 1 mo.              | 6 mo.                | 12 mo.                      | 36 mo.                      | 60 mo.                      |
| Weighted Average Term to Next Adjustment  | 1 mo.              | 2 mo.                | 25 mo.                      | 17 mo.                      | 32 mo.                      |
| Weighted Average Annual Period Cap  | None               | 1.00%                | 1.93%                       | 2%                          | 1.34%                       |
| Weighted Average Lifetime Cap at<br>June 30, 2000   | 9.15%              | 11.37%               | 12.16%                      | 13.23%                      | 11.71%                      |
| Mortgage Principal Value as Percentage of<br>Mortgage-Backed Securities at<br>June 30, 2000 | 40.32%             | 1.91%                | 19.83%                      | 4.66%                       | 0.59%                       |

ADJUSTABLE-RATE MORTGAGE-BACKED SECURITIES BY INDEX

DECEMBER 31, 1999

|   | One-Month<br>LIBOR | Six-Month<br>CD Rate | 1-Year<br>Treasury<br>Index | 3-Year<br>Treasury<br>Index | 5-Year<br>Treasury<br>Index |
|---|--------------------|----------------------|-----------------------------|-----------------------------|-----------------------------|
| Weighted Average Adjustment Frequency   | 1 mo.              | 6 mo.                | 12 mo.                      | 36 mo.                      | 60 mo.                      |
| Weighted Average Term to Next Adjustment  | 1 mo.              | 2 mo.                | 25 mo.                      | 16 mo.                      | 36 mo.                      |
| Weighted Average Annual Period Cap  | None               | 1.00%                | 1.93%                       | 1.57%                       | 1.35%                       |
| Weighted Average Lifetime Cap at<br>December 31, 1999   | 9.20%              | 11.36%               | 11.19%                      | 13.23%                      | 11.68%                      |
| Mortgage Principal Value as Percentage of<br>Mortgage-Backed Securities at<br>December 31, 1999 | 34.89%             | 2.12%                | 22.62%                      | 5.22%                       | 0.66%                       |

INTEREST RATE AGREEMENTS

Interest rate agreements are assets that are carried on a balance sheet at estimated liquidation value. We have not entered into any interest rate agreements since our inception.

BORROWINGS

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our mortgage-backed securities. These borrowings appear on our balance sheet as repurchase agreements. At June 30, 2000, we had established uncommitted borrowing facilities in this market with twenty lenders in amounts, which we believe, are in excess of our needs. All of our mortgage-backed securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet.

For the quarters ended June 30, 2000 and 1999, the term to maturity of our borrowings ranged from one day to 3 months, with a weighted average original term to maturity of 39 days at June 30, 2000. At June 30, 2000, the weighted average cost of funds for all of our borrowings was 6.30% and the weighted average term to next rate adjustment was 24 days. At June 30, 1999, the term to maturity ranged from one day to one year, with a weighted average original term of 72 days. The weighted average cost of funds for all of our borrowings was 4.87% and weighted average term to the next adjustment was 24 days.

## LIQUIDITY

Liquidity, which is our ability to turn non-cash assets into cash, allows us to purchase additional mortgage-backed securities and to pledge additional assets to secure existing borrowings should the value of our pledged assets decline. Potential immediate sources of liquidity for us include cash balances and unused borrowing capacity. Unused borrowing capacity will vary over time as the market value of our mortgage-backed securities varies. Our balance sheet also generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should our needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, we believe that our mortgage-backed securities could in most circumstances be sold to raise cash. The maintenance of liquidity is one of the goals of our capital investment policy. Under this policy, we limit asset growth in order to preserve unused borrowing capacity for liquidity management purposes.

## STOCKHOLDERS' EQUITY

We use "available-for-sale" treatment for our mortgage-backed securities; we carry these assets on our balance sheet at estimated market value rather than historical amortized cost. Based upon this "available-for-sale" treatment, our equity base at June 30, 2000 was \$110.4 million, or \$7.77 per share. If we had used historical amortized cost accounting, our equity base at June 30, 2000 would have been \$145.4 million, or \$10.24 per share. Our equity base at June 30, 1999 was \$113.6 million, or \$8.95 per share. If we had used historical amortized cost accounting, our equity base at June 30, 1999 would have been \$133.0 million, or \$10.48 per share. During the quarter ended June 30, 2000, the Company raised additional capital in the amount of \$2.6 million through its share purchase and dividend reinvestment plan.

With our "available-for-sale" accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders' equity under "Accumulated Other Comprehensive Income (Loss)." By accounting for our assets in this manner, we hope to provide useful information to stockholders and creditors and to preserve flexibility to sell assets in the future without having to change accounting methods.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows unrealized gains and losses on the mortgage-backed securities in our portfolio.

| UNREALIZED GAINS AND LOSSES  |                        |                         |                            |                             |                        |                         |
|--|------------------------|-------------------------|----------------------------|-----------------------------|------------------------|-------------------------|
| (dollars in thousands)   |                        |                         |                            |                             |                        |                         |
|  | At<br>June 30,<br>2000 | At<br>March 31,<br>2000 | At<br>December 31,<br>1999 | At<br>September 30,<br>1999 | At<br>June 30,<br>1999 | At<br>March 31,<br>1999 |
| Unrealized Gain  | \$ 864                 | \$ 1,320                | \$ 1,531                   | \$ 998                      | \$ 1,744               | \$ 2,801                |
| Unrealized Loss  | (35,872)               | (35,633)                | (39,100)                   | (24,773)                    | (21,172)               | (8,784)                 |
| Net Unrealized Loss  | (\$35,008)             | (\$34,313)              | (\$37,569)                 | (\$23,775)                  | (\$19,428)             | (\$5,983)               |
| Net Unrealized Loss as % of Mortgage-Backed Securities Principal Value | (2.39%)                | (2.37%)                 | (2.59%)                    | (1.70%)                     | (1.32%)                | (0.39%)                 |
| Net Unrealized Loss as % of Mortgage-Backed Securities Amortized Cost  | (2.36%)                | (2.33%)                 | (2.54%)                    | (1.68%)                     | (1.30%)                | (0.39%)                 |

Unrealized changes in the estimated net market value of mortgage-backed securities have one direct effect on our potential earnings and dividends: positive market-to-market changes increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our capital investment policy. A very large negative change in the net market value of our mortgage-backed securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale. "Unrealized Losses on Available for Sale Securities" was \$35.0 million, or 2.36% of the amortized cost of our mortgage-backed securities at June 30, 2000. "Unrealized Losses on Available for Sale Securities" was \$19.4 million or 1.30% of the amortized cost of our mortgage-backed securities at June 30, 1999.

The table below shows our equity capital base as reported and on a historical amortized cost basis at June 30, 2000, March 31, 2000, December 31, 1999, September 30, 1999, June 30, 1999 and March 31, 1999. Issuances of common stock, the level of GAAP earnings as compared to dividends declared, and other factors influence our historical cost equity capital base. The GAAP reported equity capital base is influenced by these factors plus changes in the "Net Unrealized Losses on Assets Available for Sale" account.

| STOCKHOLDERS' EQUITY  |   |   |  |   |   |
|-----------------------|---|---|--|---|---|
|                       | Historical<br>Amortized Cost<br>Equity Base   | Net Unrealized<br>Gains on Assets<br>Available for Sale | GAAP Reported<br>Equity Base<br>(Book Value) | Historical<br>Amortized Cost<br>Equity Per<br>Share | GAAP Reported<br>Equity (Book<br>Value) Per Share |
|                       | (dollars in thousands, except per share data) |   |  |   |   |
| At June 30, 2000      | \$145,448                                     | (35,008)  | \$110,440                                    | \$10.24   | \$7.77  |
| At March 31, 2000     | \$143,279                                     | (\$34,313)  | \$108,966                                    | \$10.31   | \$7.84  |
| At December 31, 1999  | \$140,841                                     | (\$37,569)  | \$103,272                                    | \$10.37   | \$7.60  |
| At September 30, 1999 | \$136,850                                     | (\$23,776)  | \$113,074                                    | \$10.44   | \$8.63  |
| At June 30, 1999      | \$133,020                                     | (\$19,428)  | \$113,592                                    | \$10.48   | \$8.95  |
| At March 31, 1999     | \$132,599                                     | (\$5,983)   | \$126,617                                    | \$10.44   | \$9.97  |

#### LEVERAGE

Our debt-to-GAAP reported equity ratio at June 30, 2000 and, 1999 was 12:1 and 11.8:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings.

Our target debt-to-GAAP reported equity ratio is determined under our capital investment policy. Should our actual debt-to-equity ratio increase above the target level due to asset acquisition or market value fluctuations in assets, we will cease to acquire new assets. Our management will, at that time, present a plan to our Board of Directors to bring us back to our target debt-to-equity ratio; in many circumstances, this would be accomplished in time by the monthly reduction of the balance of our mortgage-backed securities through principal repayments.

#### ASSET/LIABILITY MANAGEMENT AND EFFECT OF CHANGES IN INTEREST RATES

We continually review our asset/liability management strategy with respect to interest rate risk, mortgage prepayment risk, credit risk and the related issues of capital adequacy and liquidity. We seek attractive risk-adjusted stockholder returns while maintaining a strong balance sheet.

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, although we have not done so to date, we may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in our portfolio of mortgage-backed securities by entering into interest rate agreements such as interest rate caps and interest rate swaps.

Changes in interest rates may also have an effect on the rate of mortgage principal prepayments and, as a result, prepayments on mortgage-backed securities. We will seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets we purchase at a premium with assets we purchase at a discount. To date, the aggregate premium exceeds the aggregate discount on our mortgage-backed securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce our net income compared to what net income would be absent such prepayments.

#### INFLATION

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors drive our performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or

changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our dividends based upon our net income as calculated for tax purposes; in each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

#### OTHER MATTERS

We calculate that our qualified REIT assets, as defined in the Internal Revenue Code, are 99.5% of our total assets at June 30, 2000 and 1999, as compared to the Internal Revenue Code requirement that at least 75% of our total assets be qualified REIT assets. We also calculate that 99.7% and 99.9% of our revenue qualifies for the 75% source of income test, and 100% of its revenue qualifies for the 95% source of income test, under the REIT rules for the quarters ended June 30, 2000 and 1999, respectively. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, as of June 30, 2000 and 1999, we believe that we qualified as a REIT under the Internal Revenue Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act. If we were to become regulated as an investment company, then our use of leverage would be substantially reduced. The Investment Company Act exempts entities that are "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate" (qualifying interests). Under current interpretation of the staff of the SEC, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in qualifying interests. In addition, unless certain mortgage securitites represent all the certificates issued with respect to an underlying pool of mortgages, the mortgage-backed securities may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of June 30, 2000 and 1999 we were in compliance with this requirement.

ITEM. 2 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risk to which we are exposed is interest rate risk, which is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of our mortgage-backed securities and our ability to realize gains from the sale of these assets. We 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 interest rates on our operations. If we use these types of derivatives to hedge the risk of interest-earning assets or interest-bearing liabilities, we may be subject to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of securities and that the losses may exceed the amount we invested in the instruments. To date, we have not purchased any hedging instruments.

Our profitability and the value of our portfolio may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income and portfolio value should interest rates go up or down 200 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at June 30, 2000 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

| Change in Interest Rate | Projected Percentage Change in Net Interest Income | Projected Percentage Change in Portfolio Value |
|-------------------------|--|--|
| -200 Basis Points       | 72%  | 3%   |
| -100 Basis Points       | 33%  | 2%   |
| -50 Basis Points        | 17%  | 1%   |
| Base Interest Rate      |  |  |
| +50 Basis Points        | (24%)  | (1%)   |
| +100 Basis Points       | (45%)  | (2%)   |
| +200 Basis Points       | (87%)  | (5%)   |

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap", which is the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at June 30, 2000. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature. Mortgage-backed securities reflect estimated prepayments that were estimated based on analyses of broker estimates, the results of a

prepayment model that we utilized and empirical data. Our management believes that these assumptions approximate actual experience and considers them reasonable; however, the interest rate sensitivity of our assets and liabilities in the table could vary substantially if different assumptions were used or actual experience differs from the historical experience on which the assumptions are based.

| (IN THOUSANDS)  |                    |             |                                   |                     |             |
|---|--------------------|-------------|-----------------------------------|---------------------|-------------|
|   | Within 3<br>Months | 4-12 Months | More than 1<br>Year to 3<br>Years | 3 Years and<br>Over | Total       |
| (in thousands)  |                    |             |                                   |                     |             |
| Rate Sensitive Assets:  |                    |             |                                   |                     |             |
| Mortgage-Backed Securities  | \$ 653,114         | \$ 101,655  | \$ 134,451                        | \$ 575,719          | \$1,464,969 |
| Rate Sensitive Liabilities:   |                    |             |                                   |                     |             |
| Repurchase Agreements   | 1,349,682          |             |                                   |                     | \$1,349,682 |
| Interest rate sensitivity gap   | (\$ 696,568)       | \$ 101,655  | \$ 134,481                        | \$ 575,719          | \$ 115,287  |
| Cumulative rate sensitivity gap   | (\$ 696,568)       | (\$594,913) | (\$460,432)                       | \$ 115,287          |             |
| Cumulative interest rate<br>sensitivity gap as a percentage of<br>total rate-sensitive assets | (48%)              | (41%)       | (31%)                             | 8%                  |             |

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models, which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this report. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 1 - Financial Data Schedule

(b) Reports

None

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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.

ANNALY MORTGAGE MANAGEMENT, INC.

Dated: August 11, 2000

By: /s/ Michael A.J. Farrell

-----  
Michael A.J. Farrell  
Chairman of the Board and Chief  
Executive Officer  
(authorized officer of registrant)

Dated: August 11, 2000

By: /s/ Kathryn F. Fagan

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Kathryn F. Fagan  
Chief Financial Officer and Treasurer  
(principal accounting officer)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM JUNE 30, 2000 QUARTERLY REPORT ON FORM 10-Q AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH

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|           |             |     |
|-----------|-------------|-----|
| 3-MOS     |             |     |
|           | DEC-31-2000 |     |
|           | APR-01-2000 |     |
|           | JUN-30-2000 | 121 |
|           | 1,450,852   |     |
|           | 0           |     |
|           | 0           |     |
|           | 0           |     |
|           | 1,443,453   | 54  |
|           | 0           |     |
|           | 1,470,773   |     |
|           | 1,360,334   | 0   |
|           | 0           |     |
|           | 0           |     |
|           | 145,448     |     |
| 1,470,773 | (35,008)    | 0   |
|           | 25,735      | 0   |
|           | 0           |     |
|           | 507         |     |
|           | 0           |     |
|           | 21,453      |     |
|           | 3,839       |     |
|           | 0           |     |
|           | 3,839       |     |
|           | 0           |     |
|           | 0           | 0   |
|           | 3,839       |     |
|           | 0.27        |     |
|           | 0.26        |     |