

NEW YORK MORTGAGE TRUST INC
Form 10-Q
May 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006.

OR

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

For the Transition Period From _____ to _____

Commission File Number 001-32216

NEW YORK MORTGAGE TRUST, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

47-0934168
(I.R.S. Employer
Identification No.)

1301 Avenue of the Americas, New York, New York 10019
(Address of principal executive office) (Zip Code)

(212) 634-9400
(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filers" and "large accelerated filers" in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer ☐

Accelerated Filer ☒

Non-Accelerated Filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No p

The number of shares of the registrant's common stock, par value \$.01 per share, outstanding on May 1, 2006 was 17,918,618.

NEW YORK MORTGAGE TRUST, INC.

FORM 10-Q

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PART I: FINANCIAL INFORMATION
NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollar amounts in thousands)

	March 31, 2006 (unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	\$ 5,549	\$ 9,056
Restricted cash	3,287	5,468
Investment securities - available for sale	485,483	716,482
Receivable for securities sold	197,856	—
Due from loan purchasers	101,201	121,813
Escrow deposits - pending loan closings	2,947	1,434
Accounts and accrued interest receivable	17,219	14,866
Mortgage loans held for sale	114,254	108,271
Mortgage loans held in securitization trusts	740,546	776,610
Mortgage loans held for investment	—	4,060
Prepaid and other assets	18,683	16,505
Derivative assets	10,741	9,846
Property and equipment, net	7,010	6,882
TOTAL ASSETS	\$ 1,704,776	\$ 1,791,293
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Financing arrangements, portfolio investments	\$ 1,056,744	\$ 1,166,499
Financing arrangements, loans held for sale/for investment	210,046	225,186
Collateralized debt obligations	220,532	228,226
Due to loan purchasers	1,631	1,652
Accounts payable and accrued expenses	15,645	22,794
Subordinated debentures	45,000	45,000
Derivative liabilities	585	394
Payable for securities purchased	60,000	—
Other liabilities	890	584
Total liabilities	1,611,073	1,690,335
COMMITMENTS AND CONTINGENCIES (Note 13)		
STOCKHOLDERS' EQUITY:		
Common stock, \$0.01 par value, 400,000,000 shares authorized, 18,191,996 shares issued and 17,918,618 outstanding at March 31, 2006 and 18,258,221 shares issued and 17,953,674 outstanding at December 31, 2005	182	183
Additional paid-in capital	104,996	107,573
Accumulated other comprehensive (loss)/income	(971)	1,910
Accumulated deficit	(10,504)	(8,708)
Total stockholders' equity	93,703	100,958
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,704,776	\$ 1,791,293

See notes to consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollar amounts in thousands, except per share data)
(unaudited)

	For the Three Months Ended			
	March 31,			
	2006		2005	
REVENUE:				
Interest income:				
Investment securities and loans held in securitization trusts	\$	17,584	\$	12,863
Loans held for investment		—		1,661
Loans held for sale		5,042		2,593
Total interest income		22,626		17,117
Interest expense:				
Investment securities and loans held in securitization trusts		14,079		8,620
Loans held for investment		—		1,144
Loans held for sale		3,315		1,848
Subordinated debentures		885		78
Total interest expense		18,279		11,690
Net interest income		4,347		5,427
OTHER INCOME (EXPENSE):				
Gain on sales of mortgage loans		4,070		4,321
Brokered loan fees		2,777		2,000
Loss on sale of current period securitized loans		(773)		—
Gain on sale of securities and related hedges		—		377
Realized loss on investment securities		(969)		—
Miscellaneous income		119		114
Total other income (expense)		5,224		6,812
EXPENSES:				
Salaries, commissions and benefits		6,341		7,143
Brokered loan expenses		2,168		1,519
Occupancy and equipment		1,326		2,135
Marketing and promotion		787		1,400
Data processing and communications		661		518
Office supplies and expenses		605		573
Professional fees		1,281		744
Travel and entertainment		182		215
Depreciation and amortization		565		343
Other		367		377
Total expenses		14,283		14,967
LOSS BEFORE INCOME TAX BENEFIT		(4,712)		(2,728)
Income tax benefit		2,916		2,690
NET LOSS	\$	(1,796)	\$	(38)
Basic and diluted loss per share	\$	(0.10)	\$	0.00
Weighted average shares outstanding-basic and diluted		17,967		17,797

See notes to consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Three Months Ended March 31, 2006

(dollar amounts in thousands)

(unaudited)

	Common Stock	Additional Paid-In Capital	Stockholders' Deficit	Accumulated Other Comprehensive (Loss)/ Income	Comprehensive (Loss)/ Income	Total
BALANCE, JANUARY 1, 2006 -- Stockholders' Equity	183	\$ 107,573	\$ (8,708)	\$ 1,910	—\$	100,958
Net loss	—	—	(1,796)	—\$	(1,796)	(1,796)
Dividends declared	—	(2,547)	—	—	—	(2,547)
Repurchase of common stock	(1)	(299)	—	—	—	(300)
Vested restricted stock	—	241	—	—	—	241
Vested performance shares	—	24	—	—	—	24
Vested stock options	—	4	—	—	—	4
Decrease in net unrealized gain on available for sale securities	—	—	—	(7,562)	(7,562)	(7,562)
Increase in net unrealized gain on derivative instruments	—	—	—	4,681	4,681	4,681
Comprehensive loss	—	—	—	—\$	(4,677)	—
BALANCE, MARCH 31, 2006 -- Stockholders' Equity	182	\$ 104,996	\$ (10,504)	\$ (971)	\$	93,703

See notes to consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollar amounts in thousands)
(unaudited)

	For the Three Months Ended	
	March 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,796)	\$ (38)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	565	343
Amortization of premium on investment securities and mortgage loans	446	1,185
Loss on sale of current period securitized loans	773	—
Realized loss on sale of investment securities	969	—
Gain on sale of securities and related hedges	—	(377)
Purchase of mortgage loans held for sale	(213,367)	—
Origination of mortgage loans held for sale	(422,247)	(426,768)
Proceeds from sales of mortgage loans	628,314	411,670
Restricted stock compensation expense	264	997
Stock option grants - compensation expense	4	9
Deferred tax benefit	(2,916)	(2,690)
Change in value of derivatives	(125)	(977)
(Increase) decrease in operating assets:		
Due from loan purchasers	20,612	(11,436)
Escrow deposits - pending loan closings	(1,513)	(6,206)
Accounts and accrued interest receivable	(2,353)	2,508
Prepaid and other assets	583	(1,021)
Increase (decrease) in operating liabilities:		
Due to loan purchasers	(21)	64
Accounts payable and accrued expenses	(5,861)	124
Other liabilities	307	110
Net cash provided by (used in) operating activities	2,638	(32,503)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Restricted cash	2,181	1,926
Purchase of investment securities	(124,896)	(2,355)
Purchase of mortgage loans held in securitization trusts	—	(167,874)
Principal repayments received on mortgage loans held in securitization trusts	40,405	5,600
Proceeds from sale of investment securities	159,040	—
Origination of mortgage loans held for investment	—	(136,393)
Principal paydown on investment securities	54,475	86,656
Payments received on loans held for investment	—	3,816
Purchases of property and equipment	(626)	(526)
Net cash provided by (used in) investing activities	130,579	(209,150)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common stock	(299)	—
Change in financing arrangements, net	(132,591)	220,293
Dividends paid	(3,834)	(4,347)

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Issuance of subordinated debentures	—	25,000
Net cash (used in) provided by financing activities	(136,724)	240,946
NET DECREASES IN CASH AND CASH EQUIVALENTS	(3,507)	(707)
CASH AND CASH EQUIVALENTS - Beginning of period	9,056	7,613
CASH AND CASH EQUIVALENTS - End of period	\$ 5,549	\$ 6,906
SUPPLEMENTAL DISCLOSURE		
Cash paid for interest	\$ 22,688	\$ 15,408
NON CASH FINANCING ACTIVITIES		
Dividends declared to be paid in subsequent period	\$ 2,547	\$ 4,529
NON CASH INVESTING ACTIVITIES		
Non-cash purchase of investment securities	\$ 60,000	—

See notes to consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2006 (Unaudited)

1. Summary of Significant Accounting Policies

Organization - New York Mortgage Trust, Inc. ("NYMT" or the "Company") is a fully-integrated, self-advised, residential mortgage finance company formed as a Maryland corporation in September 2003. The Company earns net interest income from residential mortgage-backed securities and fixed-rate and adjustable-rate mortgage loans and securities originated through its wholly-owned subsidiary, The New York Mortgage Company, LLC ("NYMC") or acquired from third parties. The Company also earns net interest income from its investment in and the securitization of certain adjustable rate mortgage loans that meet the Company's investment criteria. Licensed, or exempt from licensing, in 44 states and the District of Columbia and through a network of 27 full-service loan origination locations and 26 satellite loan origination locations, NYMC originates a wide range of mortgage loans, with a primary focus on prime, residential mortgage loans.

The Company is organized and conducts its operations to qualify as a real estate investment trust ("REIT") for federal income tax purposes. As such, the Company will generally not be subject to federal income tax on that portion of its income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by the due date of its federal income tax return and complies with various other requirements.

On January 9, 2004, the Company capitalized New York Mortgage Funding, LLC ("NYMF") as a wholly-owned subsidiary of the Company. NYMF is a qualified REIT subsidiary, or QRS, in which the Company accumulates mortgage loans that the Company intends to securitize.

On March 30, 2006 the NYMT completed its fourth loan securitization transaction of approximately \$277.4 million of high-credit quality, first-lien, adjustable rate mortgage ("ARM") loans, 24% of which were self-originated through NYMC. The securitization is comprised of approximately \$274.6 million of certificates issued by New York Mortgage Trust 2006-1 (the "Trust"). The terms of this securitization were structured to meet the criteria for sale as required in SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. As a result of this transaction, the Company recorded a \$0.4 million servicing asset related to self-originated loans.

As used herein, references to the "Company," "NYMT," "we," "our" and "us" refer to New York Mortgage Trust, Inc. collectively with its subsidiaries.

Basis of Presentation - The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. As permitted by the rules and regulations of the Securities and Exchange Commission (the "SEC"), the financial statements contain certain condensed financial information and exclude certain footnote disclosures normally included in audited consolidated financial statements prepared in accordance with United States generally accepted accounting principles ("GAAP"). In the opinion of management, the accompanying financial statements contain all adjustments, including normal recurring accruals, necessary to fairly present the accompanying financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K, for the year ended December 31, 2005. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006. Certain prior period amounts have been reclassified to conform to current period classifications, including the reclassification of \$1.7 million of Interest income - Loans held for investment, for the quarter ended March 31, 2005, to Interest income - Investment securities and loans held in securitization trusts. In addition, there was a reclassification of \$1.1 million of Interest expense - Loans held for investment, for the quarter ended March 31, 2005, to Interest expense - Investment securities and loans held in securitization trusts. All intercompany transactions and balances have been eliminated.

Upon the closing of the Company's IPO, of the 2,750,000 shares exchanged for the equity interests of NYMC, 100,000 shares were held in escrow through December 31, 2004 and were available to satisfy any indemnification claims the Company may have had against the contributors of NYMC for losses incurred as a result of defaults on any residential mortgage loans originated by NYMC and closed prior to the completion of the IPO. As of December 31, 2004, the amount of escrowed shares was reduced by 47,680 shares, representing \$493,000 for estimated losses on loans closed prior to the Company's IPO. Furthermore, the contributors of NYMC entered into a new escrow agreement which extended the escrow period to December 31, 2005 for the remaining 52,320 shares. On or about December 31, 2005, the escrow period was extended for an additional year to December 31, 2006. There have been no additional losses with respect to the escrow agreement recorded during the three month period ended March 31, 2006.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's estimates and assumptions primarily arise from risks and uncertainties associated with interest rate volatility, prepayment volatility and credit exposure. Although management is not currently aware of any factors that would significantly change its estimates and assumptions in the near term, future changes in market conditions may occur which could cause actual results to differ materially.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand, amounts due from banks and overnight deposits. The Company maintains its cash and cash equivalents in highly rated financial institutions, and at times these balances exceed insurable amounts.

Restricted Cash - Restricted cash is held by counterparties as collateral for hedging instruments, a warehouse facility and two letters of credit related to the Company's lease of its corporate headquarters

Investment Securities Available for Sale - The Company's investment securities are residential mortgage-backed securities comprised of Ginnie Mae ("GNMA") and "AAA"- rated adjustable-rate securities, including adjustable-rate loans that have an initial fixed-rate period. Investment securities are classified as available for sale securities and are reported at fair value with unrealized gains and losses reported in other comprehensive income ("OCI"). Realized gains and losses recorded on the sale of investment securities available for sale are based on the specific identification method and included in gain on sale of securities and related hedges. Purchase premiums or discounts on investment securities are accreted or amortized to interest income over the estimated life of the investment securities using the interest method. Investment securities may be subject to interest rate, credit and/or prepayment risk.

When the fair value of an available for sale security is less than amortized cost, management considers whether there is an other-than-temporary impairment in the value of the security (e.g., whether the security will be sold prior to the recovery of fair value). Management considers at a minimum the following factors that, both individually or in combination, could indicate the decline is "other-than-temporary:" 1) the length of time and extent to which the market value has been less than book value; 2) the financial condition and near-term prospects of the issuer; or 3) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. If, in management's judgment, an other-than-temporary impairment exists, the cost basis of the security is written down to the then-current fair value, and the unrealized loss is transferred from accumulated other comprehensive income as an immediate reduction of current earnings (i.e., as if the loss had been realized in the period of impairment). Even though no credit concerns exist with respect to an available for sale security, an other-than-temporary impairment may be evident if management determines that the Company does not have the intent and ability to hold an investment until a forecasted recovery of the value of the investment.

As of December 31, 2005, management concluded that the decline in value of certain of the available for sale securities was other-than-temporary based on the intent of the Company to potentially sell such securities rather than retain them for a time sufficient to allow for anticipated recovery in market value. Accordingly, the cost basis of those securities of \$395.7 million was written down to fair value and an unrealized loss of \$7.4 million was transferred from accumulated other comprehensive income as an impairment loss on investment securities during the year ended December 31, 2005. During the quarter ended March 31, 2006 these securities were sold which resulted in an additional loss of approximately \$1.0 million, due to a decline in the value of such securities subsequent to the year end.

Due from Loan Purchasers and Escrow Deposits - Pending Loan Closings - Amounts due from loan purchasers are a receivable for the principal and premium due to us for loans sold and shipped but for which payment has not yet been received at period end. Escrow deposits pending loan closing are advance cash fundings by us to escrow agents to be used to close loans within the next one to three business days.

Mortgage Loans Held for Sale - Mortgage loans held for sale represent originated mortgage loans held for sale to third party investors. The loans are initially recorded at cost based on the principal amount outstanding net of deferred direct origination costs and fees. The loans are subsequently carried at the lower of cost or market value. Market value is determined by examining outstanding commitments from investors or current investor yield requirements, calculated on an aggregate loan basis, less an estimate of the costs to close the loan, and the deferral of fees and points received, plus the deferral of direct origination costs. Gains or losses on sales are recognized at the time title transfers to the investor which is typically concurrent with the transfer of the loan files and related documentation and are based upon the difference between the sales proceeds from the final investor and the adjusted book value of the loan sold.

Mortgage Loans Held in Securitization Trusts - Mortgage loans held in securitization trusts are certain ARM mortgage loans transferred to the NYMT 2005-1, the NYMT 2005-2 and the NYMT 2005-3 that have been securitized into sequentially rated classes of beneficial interests. Mortgage loans held in securitization trusts are recorded at amortized cost, using the same accounting principles as that used for mortgage loans held for investment.

Currently the Company has retained 100% of the securities issued by NYMT 2005-1 and the NYMT 2005-2 and the securities have been financed as a secured borrowing under repurchase agreements. For our third securitization, NYMT 2005-03, we sold investment grade securities to third parties, which are recorded as collateralized debt obligations on the accompanying consolidated balance sheet.

Mortgage Loans Held for Investment - The Company may retain the adjustable-rate mortgage loans originated that meet specific investment criteria and portfolio requirements. Loans originated and retained in the Company's portfolio are serviced through a servicer. Servicing is the function primarily consisting of collecting monthly payments from mortgage borrowers, and disbursing those funds to the appropriate loan investors.

Mortgage loans held for investment are recorded net of deferred loan origination fees and associated direct costs and are stated at amortized cost. Net loan origination fees and associated direct mortgage loan origination costs are deferred and amortized over the life of the loan as an adjustment to yield. This amortization includes the effect of projected prepayments.

Interest income is accrued and recognized as revenue when earned according to the terms of the mortgage loans and when, in the opinion of management, it is collectible. The accrual of interest on loans is discontinued when, in management's opinion, the interest is not collectible in the normal course of business, but in no case when payment becomes greater than 90 days delinquent. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Mortgage Servicing Rights - When the Company sells loans in securitizations of residential mortgage loans, it may, depending on the structure of the securitization, capitalize mortgage servicing rights ("MSRs") that are initially measured at fair value based on defined interest rate risk strata. When the Company sells certain loans and retains the servicing rights, it allocates the cost basis of the loans between the assets sold and the MSRs based on their relative fair values on the date of sale. Generally, MSRs a result from certain loan securitizations structured as real estate mortgage investment conduits ("REMIC").

The Company estimates the fair value of its MSRs based on the present value of future expected cash flows estimated using management's best estimates of key assumptions, including prepayment speeds, forward yield curves, and discount rates commensurate with the risk involved. Periodic changes in fair value are recorded to income or expense for the period.

For the period ended March 31, 2006, mortgage servicing rights were created as a result of our securitization of \$277.4 million of mortgage loans through New York Mortgage Trust 2006-1 on March 30, 2006. The value of these servicing rights is \$0.4 million at March 31, 2006 and is included as a component of "Other assets" on the Company's consolidated balance sheet.

Credit Risk and Allowance for Loan Losses - The Company limits its exposure to credit losses on its portfolio of residential adjustable-rate mortgage-backed securities by purchasing securities that are guaranteed by a government-sponsored or federally-chartered corporation (FNMA, FHLMC or GNMA) (collectively “Agency Securities”) or that have a “AAA” investment grade rating by at least one of two nationally recognized rating agencies, Standard & Poor’s, Inc. or Moody’s Investors Service, Inc. at the time of purchase.

The Company seeks to limit its exposure to credit losses on its portfolio of residential adjustable-rate mortgage loans held for investment (including mortgage loans held in the securitization trusts) by originating and investing in loans primarily to borrowers with strong credit profiles, which are evaluated by analyzing the borrower’s credit score (“FICO” is a credit score, ranging from 300 to 850, with 850 being the best score, based upon the credit evaluation methodology developed by Fair, Isaac and Company, a consulting firm specializing in creating credit evaluation models), employment, income and assets and related documentation, the amount of equity in and the value of the property securing the borrower’s loan, debt to income ratio, credit history, funds available for closing and post-closing liquidity.

The Company estimates an allowance for loan losses based on management's assessment of probable credit losses in the Company's investment portfolio of residential mortgage loans. Mortgage loans are collectively evaluated for impairment as the loans are homogeneous in nature. The allowance is based upon management's assessment of various credit-related factors, including current economic conditions, the credit diversification of the portfolio, loan-to-value ratios, delinquency status, historical credit losses, purchased mortgage insurance and other factors deemed to warrant consideration. If the credit performance of mortgage loans held for investment deviates from expectations, the allowance for loan losses is adjusted to a level deemed appropriate by management to provide for estimated probable losses in the portfolio.

The allowance will be maintained through ongoing provisions charged to operating income and will be reduced by loans that are charged off. As of March 31, 2006 the allowance for loan losses is insignificant. Determining the allowance for loan losses is subjective in nature due to the estimation required.

Property and Equipment, Net - Property and equipment have lives ranging from three to ten years, and are stated at cost less accumulated depreciation and amortization. Depreciation is determined in amounts sufficient to charge the cost of depreciable assets to operations over their estimated service lives using the straight-line method. Leasehold improvements are amortized over the lesser of the life of the lease or service lives of the improvements using the straight-line method.

Financing Arrangements, Portfolio Investments— Portfolio investments are typically financed with repurchase agreements, a form of collateralized borrowing which is secured by the Company's portfolio securities on the balance sheet. Such financings are recorded at their outstanding principal balance with any accrued interest due recorded as an accrued expense.

Financing Arrangements, Loans Held for Sale/for Investment— Loans held for sale or for investment are typically financed with warehouse lines that are collateralized by loans we originate or purchase from third parties. Such financings are recorded at their outstanding principal balance with any accrued interest due recorded as an accrued expense.

Collateralized Debt Obligations - CDOs are debt securities that are issued by the Company through an "on balance sheet" securitization and typically secured by ARM loans. For financial reporting purposes, the ARM loans and restricted cash held as collateral are recorded as assets of the Company and the CDO is recorded as the Company's debt. The transaction includes interest rate caps held by the securitization trust and recorded as an asset or liability of the Company.

Subordinated Debentures - Subordinated debentures are trust preferred securities that are fully guaranteed by the Company with respect to distributions and amounts payable upon liquidation, redemption or repayment. These securities are classified as subordinated debentures in the liability section of the Company's consolidated balance sheet.

Derivative Financial Instruments - The Company has developed risk management programs and processes, which include investments in derivative financial instruments designed to manage market risk associated with its mortgage banking and its mortgage-backed securities investment activities.

All derivative financial instruments are reported as either assets or liabilities in the consolidated balance sheet at fair value. The gains and losses associated with changes in the fair value of derivatives not designated as hedges are reported in current earnings. If the derivative is designated as a fair value hedge and is highly effective in achieving offsetting changes in the fair value of the asset or liability hedged, the recorded value of the hedged item is adjusted by its change in fair value attributable to the hedged risk. If the derivative is designated as a cash flow hedge, the effective portion of change in the fair value of the derivative is recorded in OCI and is recognized in the statement of operations when the hedged item affects earnings. The Company calculates the effectiveness of these hedges on an

ongoing basis, and, to date, has calculated effectiveness of approximately 100%. Ineffective portions, if any, of changes in the fair value or cash flow hedges are recognized in earnings. (See Note 16 below).

Risk Management - Derivative transactions are entered into by the Company solely for risk management purposes. The decision of whether or not an economic risk within a given transaction (or portion thereof) should be hedged for risk management purposes is made on a case-by-case basis, based on the risks involved and other factors as determined by senior management, including the financial impact on income, asset valuation and restrictions imposed by the Internal Revenue Code among others. In determining whether to hedge a risk, the Company may consider whether other assets, liabilities, firm commitments and anticipated transactions already offset or reduce the risk. All transactions undertaken to hedge certain market risks are entered into with a view towards minimizing the potential for economic losses that could be incurred by the Company. Under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), the Company is required to formally document its hedging strategy before it may elect to implement hedge accounting for qualifying derivatives. Accordingly, all qualifying derivatives are intended to qualify as fair value, or cash flow hedges, or free standing derivatives. To this end, terms of the hedges are matched closely to the terms of hedged items with the intention of minimizing ineffectiveness.

In the normal course of its mortgage loan origination business, the Company enters into contractual interest rate lock commitments to extend credit to finance residential mortgages. These commitments, which contain fixed expiration dates, become effective when eligible borrowers lock-in a specified interest rate within time frames established by the Company's origination, credit and underwriting practices. Interest rate risk arises if interest rates change between the time of the lock-in of the rate by the borrower and the sale of the loan. Under SFAS No. 133, the IRLCs are considered undesignated or free-standing derivatives. Accordingly, such IRLCs are recorded at fair value with changes in fair value recorded to current earnings. Mark to market adjustments on IRLCs are recorded from the inception of the interest rate lock through the date the underlying loan is funded. The fair value of the IRLCs is determined by the interest rate differential between the contracted loan rate and the currently available market rates as of the reporting date.

To mitigate the effect of the interest rate risk inherent in providing IRLCs from the lock-in date to the funding date of a loan, the Company generally enters into forward sale loan contracts ("FSLC"). The FSLCs in place prior to the funding of a loan are undesignated derivatives under SFAS No. 133 and are marked to market through current earnings.

Derivative instruments contain an element of risk in the event that the counterparties may be unable to meet the terms of such agreements. The Company minimizes its risk exposure by limiting the counterparties with which it enters into contracts to banks, investment banks and certain private investors who meet established credit and capital guidelines. Management does not expect any counterparty to default on its obligations and, therefore, does not expect to incur any loss due to counterparty default. These commitments and option contracts are considered in conjunction with the Company's lower of cost or market valuation of its mortgage loans held for sale.

The Company uses other derivative instruments, including treasury, agency or mortgage-backed securities forward sale contracts which are also classified as free-standing, undesignated derivatives and thus are recorded at fair value with the changes in fair value recognized in current earnings.

Once a loan has been funded, the Company's primary risk objective for its mortgage loans held for sale is to protect earnings from an unexpected charge due to a decline in value. The Company's strategy is to engage in a risk management program involving the designation of FSLCs (the same FSLCs entered into at the time of rate lock) to hedge most of its mortgage loans held for sale. The FSLCs have been designated as qualifying hedges for the funded loans and the notional amount of the forward delivery contracts, along with the underlying rate and critical terms of the contracts, are equivalent to the unpaid principal amount of the mortgage loan being hedged. The FSLCs effectively fix the forward sales price and thereby offset interest rate and price risk to the Company. Accordingly, the Company evaluates this relationship quarterly and, at the time the loan is funded, classifies and accounts for the FSLCs as cash flow hedges.

Interest Rate Risk - The Company hedges the aggregate risk of interest rate fluctuations with respect to its borrowings, regardless of the form of such borrowings, which require payments based on a variable interest rate index. The Company generally intends to hedge only the risk related to changes in the benchmark interest rate (London Interbank Offered Rate ("LIBOR") or a Treasury rate).

In order to reduce such risks, the Company enters into swap agreements whereby the Company receives floating rate payments in exchange for fixed rate payments, effectively converting the borrowing to a fixed rate. The Company also enters into cap agreements whereby, in exchange for a fee, the Company is reimbursed for interest paid in excess of a certain capped rate.

To qualify for cash flow hedge accounting, interest rate swaps and caps must meet certain criteria, including:

- the items to be hedged expose the Company to interest rate risk; and
- the interest rate swaps or caps are expected to be and continue to be highly effective in reducing the Company's exposure to interest rate risk.

The fair values of the Company's interest rate swap agreements and interest rate cap agreements are based on market values provided by dealers who are familiar with the terms of these instruments. Correlation and effectiveness are periodically assessed at least quarterly based upon a comparison of the relative changes in the fair values or cash flows of the interest rate swaps and caps and the items being hedged.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instruments are reported as a component of OCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instruments in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change.

With respect to interest rate swaps and caps that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such swaps and caps, will be recognized in current earnings.

Termination of Hedging Relationships - The Company employs a number of risk management monitoring procedures to ensure that the designated hedging relationships are demonstrating, and are expected to continue to demonstrate, a high level of effectiveness. Hedge accounting is discontinued on a prospective basis if it is determined that the hedging relationship is no longer highly effective or expected to be highly effective in offsetting changes in fair value of the hedged item.

Additionally, the Company may elect to undesignate a hedge relationship during an interim period and re-designate upon the rebalancing of a hedge profile and the corresponding hedge relationship. When hedge accounting is discontinued, the Company continues to carry the derivative instruments at fair value with changes recorded in current earnings.

Other Comprehensive Income - Other comprehensive income is comprised primarily of net income (loss) from changes in value of the Company's available for sale securities, and the impact of deferred gains or losses on changes in the fair value of derivative contracts hedging future cash flows.

Gain on Sale of Mortgage Loans - The Company recognizes gain on sale of loans sold to third parties as the difference between the sales price and the adjusted cost basis of the loans when title transfers. The adjusted cost basis of the loans includes the original principal amount adjusted for deferrals of origination and commitment fees received, net of direct loan origination costs paid.

Loan Origination Fees and Direct Origination Cost - The Company records loan fees, discount points and certain incremental direct origination costs as an adjustment of the cost of the loan and such amounts are included in gain on sales of loans when the loan is sold. Accordingly, salaries, compensation, benefits and commission costs have been reduced by \$6.4 million and \$9.6 million for the three months periods ended March 31, 2006 and 2005, respectively, because such amounts are considered incremental direct loan origination costs.

Brokered Loan Fees and Expenses - The Company records commissions associated with brokered loans when such loans are closed with the borrower. Costs associated with brokered loans are expensed when incurred.

Loan Commitment Fees - Mortgage loans held for sale: fees received for the funding of mortgage loans to borrowers at pre-set conditions are deferred and recognized at the date at which the loan is sold. Mortgage loans held for investment: such fees are deferred and recognized into interest income over the life of the loan based on the effective yield method.

Employee Benefit Plans - The Company sponsors a defined contribution plan (the "Plan") for all eligible domestic employees. The Plan qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Plan, participating employees may defer up to 15% of their pre-tax earnings, subject to the annual Internal Revenue Code contribution limit. The Company matches contributions up to a maximum of 25% of the first 5% of eligible compensation. Employees vest immediately in their contribution and vest in the Company's contribution at a rate of 25% after two full years and then an incremental 25% per full year of service until fully vested at 100% after five full years of service. The Company's total contributions to the Plan were \$0.1 million for each three month period ended March 31, 2006 and 2005.

Stock Based Compensation - Until January 1, 2006, the Company followed the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure" ("SFAS No. 148"). The provisions of SFAS No. 123 allow companies either to expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and disclose the pro forma effects on net income (loss) had the fair value of the options been expensed. The Company, since its inception, has elected not to apply APB No. 25 in accounting for its stock option incentive plans and has expensed stock based compensation in accordance with SFAS No. 123.

In December, 2004 the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R, "Share-Based Payment," ("SFAS No. 123R") which will require all companies to measure compensation costs for all share-based payments, including employee stock options, at fair value. This statement became effective for the Company on January 1, 2006. The adoption of SFAS No. 123R did not have a material impact on the Company's financial statements.

Marketing and Promotion - The Company charges the costs of marketing, promotion and advertising to expense in the period incurred.

Income Taxes - The Company operates so as to qualify as a REIT under the requirements of the Internal Revenue Code. Requirements for qualification as a REIT include various restrictions on ownership of the Company's stock, requirements concerning distribution of taxable income and certain restrictions on the nature of assets and sources of income. A REIT must distribute at least 90% of its taxable income to its stockholders of which 85% plus any undistributed amounts from the prior year must be distributed within the taxable year in order to avoid the imposition of an excise tax. The remaining balance may extend until timely filing of the Company's tax return in the subsequent taxable year. Qualifying distributions of taxable income are deductible by a REIT in computing taxable income.

The Company's QRS is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base upon the change in tax status. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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

New Accounting Pronouncements - In March 2006, the FASB issued SFAS 156, "Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140." Effective at the beginning of the first quarter of 2006, the Company adopted the newly issued statement and elected the fair value option to subsequently measure its mortgage servicing rights ("MSRs"). Under the fair value option, all changes in the fair value of MSRs are reported in the statement of operations. The initial implementation of SFAS 156 did not have a material impact on the Company's financial statements.

In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections." SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previous guidance required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the

period-specific effects or the cumulative effect of the change. Management believes SFAS 154 will have no impact on the Company's financial statements.

In February 2006, the FASB issued SFAS 155, "Accounting for Certain Hybrid Financial Instruments". Key provisions of SFAS 155 include: (1) a broad fair value measurement option for certain hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation; (2) clarification that only the simplest separations of interest payments and principal payments qualify for the exception afforded to interest-only strips and principal-only strips from derivative accounting under paragraph 14 of FAS 133 (thereby narrowing such exception); (3) a requirement that beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or whether they are hybrid instruments that contain embedded derivatives requiring bifurcation; (4) clarification that concentrations of credit risk in the form of subordination are not embedded derivatives; and (5) elimination of the prohibition on a QSPE holding passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions, including interest-only strips and principal-only strips, required to be accounted for in accordance with FAS 133. Management does not believe that SFAS 155 will have a material effect on the financial condition, results of operations, or liquidity of the Company.

2. Investment Securities Available For Sale

Investment securities available for sale consist of the following as of March 31, 2006 and December 31, 2005 (dollar amounts in thousands):

	March 31, 2006	December 31, 2005
Amortized cost	\$ 493,045	\$ 720,583
Gross unrealized gains	19	1
Gross unrealized losses	(7,581)	(4,102)
Fair value	\$ 485,483	\$ 716,482

The amortized cost balance at December 31, 2005 included approximately \$388.3 million of certain lower-yielding mortgage (with rate resets of less than two years) agency securities that the Company had concluded it no longer had the intent to hold until their values recovered. Upon such determination, the Company recorded an unrealized impairment loss of \$7.4 million for the three months ended December 31, 2005. For the three months ended March 31, 2006, all of such designated securities were sold at an additional loss of \$1.0 million.

None of the remaining securities with unrealized losses have been deemed to be other-than-temporarily impaired. The Company has the intent and believes it has the ability to hold such investment securities until recovery of their amortized cost. Substantially all of the Company's investment securities available for sale are pledged as collateral for borrowings under financing arrangements (Note 9).

The following table sets forth the stated reset periods and weighted average yields of our investment securities at March 31, 2006 (dollar amounts in thousands):

	Less than 6 Months		More than 6 Months To 24 Months		More than 24 Months To 60 Months		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Agency REMIC								
CMO Floating Rate	\$ 125,928	6.14%	\$ —	—	\$ —	—	\$ 125,928	6.14%
Private Label ARMs	3,981	5.67%	58,513	5.91%	297,061	5.87%	359,555	5.88%
Total	\$ 129,909	6.12%	\$ 58,513	5.91%	\$ 297,061	5.87%	\$ 485,483	5.94%

The following table sets forth the stated reset periods and weighted average yields of our investment securities at December 31, 2005 (dollar amounts in thousands):

	Less than 6 Months		More than 6 Months To 24 Months		More than 24 Months To 60 Months		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Agency REMIC								
CMO Floating Rate	\$ 13,535	5.45%	\$ —	—	\$ —	—	\$ 13,535	5.45%

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FHLMC Agency ARMs	—	—	91,217	3.82%	—	—	91,217	3.82%
FNMA Agency ARMs	—	—	297,048	3.91%	—	—	297,048	3.91%
Private Label ARMs	—	—	57,605	4.22%	257,077	4.57%	314,682	4.51%
Total	\$ 13,535	5.45%	\$ 445,870	3.93%	\$ 257,077	4.57%	\$ 716,482	4.19%

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The following table presents the Company's investment securities available for sale in an unrealized loss position, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2006 and December 31, 2005:

	Less than 12 Months		March 31, 2006 12 Months or More		Total	
	Fair	Gross	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized	Value	Unrealized
		Losses		Losses		Losses
Agency REMIC CMO						
Floating Rate	\$ 56,987	\$ 115	\$ 2,040	\$ 5	\$ 59,027	\$ 120
Private Label ARMs	82,899	880	255,715	6,581	338,614	7,461
Total	\$ 139,886	\$ 995	\$ 257,755	\$ 6,586	\$ 397,641	\$ 7,581

	Less than 12 Months		December 31, 2005 12 Months or More		Total	
	Fair	Gross	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized	Value	Unrealized
		Losses		Losses		Losses
Agency REMIC CMO						
Floating Rate	\$ 11,761	\$ 19	\$ —	\$ —	\$ 11,761	\$ 19
Private Label ARMs	48,642	203	270,124	3,880	318,766	4,083
Total	\$ 60,403	\$ 222	\$ 270,124	\$ 3,880	\$ 330,527	\$ 4,102

3. Mortgage Loans Held For Sale

Mortgage loans held for sale consist of the following as of March 31, 2006 and December 31, 2005 (dollar amounts in thousands):

	March 31, 2006	December 31, 2005
Mortgage loans principal amount	\$ 114,064	\$ 108,244
Deferred origination costs - net	190	27
Mortgage loans held for sale	\$ 114,254	\$ 108,271

Substantially all of the Company's mortgage loans held for sale are pledged as collateral for borrowings under financing arrangements (Note 10).

4. Mortgage Loans Held in Securitization Trusts

Mortgage loans held in securitization trusts consist of the following as of March 31, 2006 and December 31, 2005 (dollar amounts in thousands):

	March 31, 2006	December 31, 2005
Mortgage loans principal amount	\$ 735,625	\$ 771,451

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Deferred origination costs - net		4,921		5,159
Total mortgage loans held in securitization trusts	\$	740,546	\$	776,610

Substantially all of the Company's mortgage loans held in securitization trusts are pledged as collateral for borrowings under financing arrangements (Note 9) or for the collateralized debt obligation (Note 11).

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As of March 31, 2006, we had seven delinquent loans totaling \$3.6 million categorized as mortgage loans held in securitization trusts. The table below shows delinquencies in our loan portfolio as of March 31, 2006 (dollar amounts in thousands):

Days Late	Number of Delinquent Loans	Total Dollar Amount	% of Loan Portfolio
30-60	3	\$ 1,774.8	0.24%
61-90	1	74.3	0.01%
90+	3	\$ 1,771.0	0.24%

As of December 31, 2005, we had four delinquent loans totaling \$2.0 million categorized as Mortgage loans held in securitization trusts. The table below shows delinquencies in our loan portfolio as of December 31, 2005 (dollar amounts in thousands):

Days Late	Number of Delinquent Loans	Total Dollar Amount	% of Loan Portfolio
30-60	1	\$ 193.1	0.02%
61-90	—	—	—
90+	3	\$ 1,771.0	0.23%

5. Mortgage Loans Held For Investment

The Company had no mortgage loans held for investment at March 31, 2006 and at December 31, 2005 mortgage loans held for investment consist of the following (dollar amounts in thousands):

	December 31, 2005
Mortgage loans principal amount	\$ 4,054
Deferred origination costs - net	6
Total mortgage loans held for investment	\$ 4,060

All of the Company's mortgage loans held for investment at December 31, 2005 were sold during the first quarter of 2006, with a loss of \$0.8 million recognized at the time of sale.

Substantially all of the Company's mortgage loans held for investment were pledged as collateral for borrowings under financing arrangements at December 31, 2005 (Note 9).

6. Sale of Mortgage Loans Through Securitization

On March 30, 2006, the Company sold residential mortgage loans to the Trust in a securitization transaction structured as a sale under SFAS 140. In this securitization, the Company retained servicing responsibilities and subordinated interests. The Company receives annual servicing fees of approximately 0.21% of the outstanding balance of mortgage loans and rights to future cash flows arising after the senior investors in the securitization trust have received their stated return. The investors and the securitization trust have no recourse to the Company's other assets. The interests that continue to be held by the Company are subordinate to investor's interests. Their value is subject to credit, prepayment and interest rate risks on the transferred financial assets. The Company recognized a pre-tax loss of \$0.8 million on this securitization of residential mortgage loans.

7. Property and Equipment - Net

Property and equipment consist of the following as of March 31, 2006 and December 31, 2005 (dollar amounts in thousands):

	March 31, 2006	December 31, 2005
Office and computer equipment	\$ 6,795	\$ 6,292
Furniture and fixtures	2,296	2,306
Leasehold improvements	1,531	1,429
Total premises and equipment	10,622	10,027
Less: accumulated depreciation and amortization	(3,612)	(3,145)
Property and equipment - net	\$ 7,010	\$ 6,882

8. Derivative Instruments and Hedging Activities

The Company enters into derivatives to manage its interest rate and market risk exposure associated with its mortgage banking and its mortgage-backed securities investment activities. In the normal course of its mortgage loan origination business, the Company enters into contractual IRLCs to extend credit to finance residential mortgages. To mitigate the effect of the interest rate risk inherent in providing IRLCs from the lock-in date to the funding date of a loan, the Company generally enters into FSLCs. With regard to the Company's mortgage-backed securities investment activities, the Company uses interest rate swaps and caps to mitigate the effects of major interest rate changes on net investment spread.

The following table summarizes the estimated fair value of derivative assets and liabilities as of March 31, 2006 and December 31, 2005 (dollar amounts in thousands):

	March 31, 2006	December 31, 2005
Derivative Assets:		
Interest rate caps	\$ 4,162	\$ 3,340
Interest rate swaps	6,043	6,383
Interest rate lock commitments - loan commitments	—	123
Forward loan sale contracts - loan commitments	108	—
Forward loan sale contracts - mortgage loans held for sale	93	—
Forward loan sale contracts - TBA securities	335	—
Total derivative assets	\$ 10,741	\$ 9,846
Derivative Liabilities:		
Forward loan sale contracts - loan commitments	—	(38)
Forward loan sale contracts - mortgage loans held for sale	—	(18)
Forward loan sale contracts - TBA securities	—	(324)