NEW CENTURY FINANCIAL CORP
Form 10-K
March 16, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2005

OR

o **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 001-32314

NEW CENTURY FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	**56-2451736**
(State or other jurisdiction incorporation or organization)	*(I. R. S. Employer Identification Number)*
18400 Von Karman, Suite 1000, Irvine, California	**92612**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(949) 440-7030

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	New York Stock Exchange
9.125% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act). Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of common stock held by non-affiliates, based on the closing price of the common stock of the registrant on the last business day of the most recently completed second fiscal quarter as reported on the New York Stock Exchange, was $2.3 billion. All executive officers and directors of the registrant and all persons filing a Schedule 13D with the Securities and Exchange Commission in respect to registrant s common stock have been deemed, solely for the purpose of the foregoing calculations, to be affiliates of the registrant.

As of March 1, 2006, the Registrant had 55,984,299 shares of common stock outstanding.

Certain information required for Part III of this report is incorporated herein by reference to the proxy statement for the 2006 annual meeting of the Company s stockholders.

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PART I

Item 1. *Business*

General

New Century Financial Corporation is a real estate investment trust, or REIT, that, through its taxable REIT subsidiaries, operates one of the nation s largest mortgage finance companies. We began originating and purchasing loans in 1996, and, in the fourth quarter of 2004, we began operating our business as a REIT. We originate and purchase primarily first mortgage loans nationwide. Historically, we have focused on lending to individuals whose borrowing needs are generally not fulfilled by traditional financial institutions because they do not satisfy the credit, documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers. In September 2005, we acquired a mortgage origination platform from RBC Mortgage Company, or RBC Mortgage, that expands our offerings to include conventional mortgage loans, including Alt-A mortgage loans, loans insured by the Federal Housing Administration, or FHA, and loans guaranteed by the Veterans Administration, or VA. A significant portion of the conventional loans, which are generally referred to as conforming loans, we produce qualify for inclusion in guaranteed mortgage securities backed by the Federal National Mortgage Association, or Fannie Mae, or the Federal Home Loan Mortgage Corp., or Freddie Mac. At the same time, some of the conventional loans we produce either have an original loan amount in excess of the Fannie Mae and Freddie Mac loan limit for single-family loans or otherwise do not meet Fannie Mae or Freddie Mac guidelines.

We have historically sold our loans through both whole loan sales and securitizations structured as sales. Since 2003, we have also retained a portion of our loan production for investment on our balance sheet through securitizations structured as financings rather than sales. Our decisions regarding secondary marketing transactions in 2006 will be based on market conditions and our ability to access external sources of capital. We do not currently intend to structure any securitizations as sales in 2006.

On April 5, 2004, the board of directors of New Century TRS Holdings, Inc., or New Century TRS, formerly known as New Century Financial Corporation, approved a plan to change its capital structure to enable it to qualify as a REIT for U.S. federal income tax purposes. On April 12, 2004, New Century TRS formed New Century Financial Corporation, or New Century, a Maryland corporation formerly known as New Century REIT, Inc.

Pursuant to the merger that implemented the restructuring of New Century TRS in order for it to qualify as a REIT, New Century became the publicly-traded parent listed on the New York Stock Exchange, or NYSE, that succeeded to and continued to operate substantially all of the existing businesses of New Century TRS and its subsidiaries.

In this annual report on Form 10-K, unless the context suggests otherwise, for time periods before October 1, 2004, the terms the company, our company, we, our and us refer to New Century TRS and its subsidiaries, and f time periods on and after October 1, 2004, the terms the company, our company, we, our and us refer to New Ce and its subsidiaries, including New Century TRS.

Business Strategy

Our business objective is to deliver an attractive return to our stockholders, including a stable dividend. Our strategies to achieve this objective are:

Delivering consistently strong operating performance, including taxable REIT subsidiary (TRS) and mortgage loan portfolio earnings. We intend to maintain, if not increase, our mortgage loan portfolio by executing securitizations of loans originated through our TRS, and structuring those securitizations as financings. As we increase our mortgage loan portfolio, our interest income will increase and, in turn, we will have a larger pool of earnings that can be distributed to our stockholders. Alternatively, if we structure such securitizations in our TRS, the resulting earnings can be retained to strengthen our TRS origination franchise. We expect that our capacity to originate loans at our TRS will enable us to grow our mortgage loan portfolio by providing us with a significant volume of loans at a lower cost and with greater reliability than if we purchased our mortgage loan portfolio from a third party.

Broadening the mortgage products and services available through each of our delivery channels. We plan to grow our production franchise by expanding our product and service offerings through each of our delivery channels, as discussed below. As a result of our acquisition of the loan origination platform of RBC Mortgage, we now offer non-prime mortgage loan products through all of our delivery channels and intend to offer prime and Alt-A products through all of our delivery channels by mid-2006. By expanding the product lines available through each of our delivery channels, we believe we can profitably gain market share despite the projected contraction of overall mortgage industry volume in 2006.

Increasing productivity while reducing costs to enhance our competitive position in the industry. In the fourth quarter of 2005, the costs to originate our loans, which we refer to as loan acquisition costs, reached a record low as a result of our concerted efforts to improve our profitability. In addition, our 2005 loan production volume was $56.1 billion, our tenth consecutive record year of loan production. Our strong and scalable origination platform and low loan acquisition costs enable us to react to market conditions and allow us the opportunity to earn substantial income and build retained earnings and liquidity, enhancing our competitive position in the industry.

Actively managing our mortgage loan portfolio. We seek to actively manage the composition, as well as interest rate and credit risks relating to our mortgage loan portfolio, in an effort to generate an attractive risk-adjusted return to stockholders. We continue to use hedge instruments to attempt to reduce the interest rate exposure that results from financing fixed-rate assets with floating-rate liabilities. We also actively monitor our mortgage loan portfolio through early detection and management of probable delinquencies.

Maintaining a strong capital and liquidity base. We continue to prudently manage our capital and liquidity levels and may increase our capital and liquidity by accessing the capital markets, when appropriate. We also seek to maintain available capacity under our credit facilities and may enhance our capital and liquidity positions by retaining some or all of our earnings in our TRS.

Competitive Advantages

We believe the following competitive strengths distinguish our business model from those of other mortgage REITs and residential mortgage lenders and enable us to implement our business strategy:

One of the largest mortgage REIT portfolios. We have one of the largest portfolios of residential mortgage loans of any REIT. In 2005, our mortgage portfolio provided a significant portion of our earnings.

Leading mortgage loan origination franchise. New Century Mortgage Corporation and Home123 Corporation, our operating taxable REIT subsidiaries, together represent one of the nation s largest mortgage finance companies when measured by loan production volume for the year ended December 31, 2005. We are authorized to lend in all 50 states and have a leading market presence through a wholesale network of more than 47,000 approved independent mortgage brokers and our retail network of 222 branch offices, housing our consumer-direct channel and our builder/realtor channel. Our taxable REIT subsidiaries have the potential to generate significant earnings through our mortgage loan origination franchise.

Low-cost producer. Our ability to originate mortgage loans at a low cost allows us to achieve greater profitability than many of our competitors. In addition, we are able to build our portfolio by retaining self-originated loans, rather than engaging in large bulk secondary market purchases, providing us with a competitive advantage over REITs without origination capabilities.

Operational flexibility. Our structure and business strategy provide us with the flexibility to both securitize a portion of our loan originations for our portfolio and sell the balance for cash. We believe

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that this flexibility allows us to provide a broader product offering, better manage our cash flows and respond to changing conditions in the secondary market environment, thus enhancing returns to our stockholders.

Long-standing institutional relationships. We have developed long-standing relationships with a variety of institutional loan buyers, including Credit Suisse First Boston (DLJ Mortgage Capital, Inc.), Goldman Sachs, JPMorgan Chase, Lehman Brothers, Morgan Stanley, Residential Funding Corporation and UBS Real Estate Securities Inc. These loan buyers regularly bid on and purchase large loan pools from us, and we frequently enter into committed forward loan sale agreements with them. In addition, we have developed relationships with a variety of institutional lenders who provide reliable and stable sources of warehouse financing, including Bank of America NA, Barclays Bank PLC, Bear Stearns Mortgage Capital Inc., Citigroup Global Markets Realty Corp., Credit Suisse First Boston Mortgage Capital LLC, Deutsche Bank Securities Inc., IXIS Real Estate Capital Inc. (formerly known as CDC Mortgage Capital Inc.), Morgan Stanley Mortgage Capital Inc. and UBS Real Estate Securities.

Automated credit grading capability. We have created a proprietary automated credit grading and pricing methodology that we believe gives us the ability to more effectively evaluate credit risk and more efficiently price our products, as validated by our historical loan performance.

Reputation for high quality customer service. We believe our origination process is easier for our borrowers and brokers to use than the origination processes of most of our competitors because of our ability to provide quick responses and consistent and clear procedures, with an emphasis on ease of use through technology, including our FastQual® system, a Web-based underwriting engine.

Management experience and depth. The members of our senior management team have many years of experience in the mortgage finance sector, with substantial experience addressing the challenges posed by a variety of interest rate environments, including growing an origination franchise, managing credit risk and developing strong capital market relationships.

Investment and Operational Policies

Portfolio Strategy

One of our strategies is to maintain a portfolio of mortgage loans through securitizations structured as financings. Our securitizations are typically structured as collateralized mortgage obligations, or CMOs, rather than real estate mortgage investment conduits, or REMICs. Securitizations structured as financings remain on our consolidated balance sheet as an asset and the underlying bonds are reported as a liability. Consequently, we record interest income generated by the mortgage loans and recognize interest expense on the related financings over the life of the mortgage loan pool, rather than generate a gain or loss at the time of the securitization. Our expected securitization activity for 2006 will be based primarily on secondary market conditions and our ability to access external sources of capital.

A substantial portion of the net interest income generated by our securitized loans is based upon the difference between the weighted average interest earned on the mortgage loans and the interest paid to holders of the bonds collateralized by our loans. The net interest income we receive from the securitizations structured as financings is affected by the current level of the London Inter-Bank Offered Rate, or LIBOR, because the holders of the applicable securities are generally paid based on an adjustable LIBOR-based yield. Therefore, an increase in LIBOR reduces the net interest income we receive from, and the value of, these mortgage loans. In addition, the net interest income we receive from securitizations will be reduced if there are a significant number of defaults on repayments or prepayments of loans with interest rates that are high relative to the rest of the asset pool. We attempt to mitigate at least a portion of this net interest margin variability through various hedging activities described below.

We use leverage to increase our mortgage loan portfolio by financing the portfolio through securitizations structured as financings. We generally target our outstanding borrowings, including these financings, at roughly 12 to 14 times the amount of our consolidated equity capital, although our actual leverage ratio may

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vary from time to time depending on market conditions and other factors deemed relevant by our management and board of directors.

Hedging policy

We intend to use a variety of risk management strategies to monitor and address interest rate risk. We believe that these strategies will allow us to monitor and evaluate our exposure to interest rates and to manage the risk profile of our mortgage loans held for investment, mortgage loans held for sale and our residual interests in securitizations in response to changes in market conditions. As part of our interest rate risk management process, we may continue to use derivative financial instruments such as Euro Dollar futures contracts, interest rate cap agreements and interest rate swap agreements and may start using Treasury futures and options on interest rates. We may also use other hedging instruments including mortgage derivative securities, as necessary. These derivative instruments currently have an active secondary market, and are intended to offset potential reduced income and cash flow under certain interest rate environments. Hedging strategies involve transaction and other costs. We engage in hedging for the sole purpose of protecting against interest rate risk and not for the purpose of speculating on changes in interest rates.

Financing Policy

If our board of directors determines that additional financing is required, we may raise the funds through additional equity offerings, debt financings, retention of cash flow (subject to provisions in the Internal Revenue Code of 1986, as amended, or the Code, concerning distribution requirements and taxability of undistributed REIT taxable income) or a combination of these methods. In the event that our board of directors determines to raise additional equity capital, it has the authority, without stockholder approval, subject to applicable law and NYSE regulations, to issue additional common stock or preferred stock in any manner and on terms and for consideration it deems appropriate up to the amount of authorized stock set forth in our charter.

Borrowings may be in the form of bank borrowings, secured or unsecured, and publicly or privately placed debt instruments, purchase money obligations to the sellers of assets, long-term, tax-exempt bonds or other publicly or privately placed debt instruments, financing from banks, institutional investors or other lenders, and securitizations, including collateralized debt obligations, any of which indebtedness may be unsecured or may be secured by mortgages or other interests in the assets. Such indebtedness may entail recourse to all or any part of our assets or may be limited to the particular assets to which the indebtedness relates. We will enter into collateralized borrowings only with institutions we believe are financially sound and that are rated investment grade by at least one nationally recognized rating agency. We have authority to offer New Century common stock or other equity or debt securities in exchange for property and to repurchase or otherwise reacquire our securities or any other securities and may engage in any of these activities in the future, subject to applicable law.

Our Mortgage Loan Origination Franchise

We originate and purchase mortgage loans through two divisions our Wholesale Division and our Retail Division. Our Wholesale Division originates and purchases loans through a network of independent mortgage brokers and correspondent lenders solicited by our account executives. Our account executives provide on-site customer service to brokers to facilitate the funding of loans. The Wholesale Division operates under the name New Century Mortgage Corporation and originates mortgage loans through its FastQual Web site at *www.newcentury.com,* where a broker can upload a loan request and receive a response generally within 12 seconds. Our Retail Division operates under the name Home123 Corporation and originates loans through a consumer-direct channel and a builder/realtor channel. The Retail Division is supported by 222 branch offices and a central telemarketing unit. Leads for the consumer-direct channel are generated through radio, direct mail, telemarketing, television advertising and the Internet. Our builder/realtor channel is based on relationships that are either referred or solicited.

Most of our loan production consists of subprime mortgage loans originated through our Wholesale Division. Subprime mortgage loans are made to individuals whose borrowing needs are generally not fulfilled by traditional financial institutions because they do not satisfy the credit, documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers. Our acquisition of the mortgage origination platform of RBC Mortgage has expanded our product offerings to include conventional mortgage loans, including Alt-A mortgage loans, loans insured by the FHA and loans guaranteed by the VA.

For 2005, our Wholesale Division originated $49.2 billion in mortgage loans, or 87.7% of the total mortgage loans we originated, and our Retail Division originated $6.9 billion in mortgage loans, or 12.3% of the total mortgage loans we originated.

Our Wholesale Division

As of December 31, 2005, our Wholesale Division operated through 35 regional operating centers located in 18 states and employed 989 account executives. As of December 31, 2005, we had approved more than 47,000 mortgage brokers to submit loan applications to us. During this period, our 10 largest producing brokers originated 5.6% of our wholesale production.

We have designed and implemented a procedure for qualifying, approving and monitoring our network of approved mortgage brokers. We require the brokers to complete an application that requests general business information and to provide copies of all required licenses. Upon receipt of the application and supporting documentation, our Broker Services Department examines the materials for completeness and accuracy. Our Broker Services Department then independently verifies the information contained in the application through (i) a public records Web site to verify the validity and status of licenses, and (ii) the Mortgage Asset Research Institute, or MARI, which provides background information from both the public and private sectors.

To be approved, a broker must enter into a standard broker agreement with us pursuant to which the broker agrees to abide by the provisions of our Policy on Fair Lending and our Broker Code of Conduct. Each broker also agrees to comply with applicable state and federal lending laws and agrees to submit true and accurate disclosures with regard to loan applications and loans. In addition, we employ a risk management team that regularly reviews and monitors the loans submitted by our brokers.

In wholesale loan originations, the broker s role is to identify the applicant, assist in completing the loan application form, gather necessary information and documents and serve as our liaison with the borrower through our lending process. We review and underwrite the application submitted by the broker, approve or deny the application, set the interest rate and other terms of the loan and, upon acceptance by the borrower and satisfaction of all conditions imposed by us, fund the loan. Because brokers conduct their own marketing and employ their own personnel to complete loan applications and maintain contact with borrowers, originating loans through our Wholesale Division allows us to increase loan volume without incurring the higher marketing, labor and other overhead costs associated with increased retail originations.

Mortgage brokers can submit loan applications through an account executive or through FastQual, our Web-based loan underwriting engine, at *www.newcentury.com.*

In either case, the mortgage broker will forward the original loan package to the closest regional operating center where the loan is logged in for regulatory compliance purposes and approved or denied within 24 hours of receipt in most cases. If approved, we issue a conditional approval to the broker with a list of specific conditions that have to be met (for example, credit verifications and independent third-party appraisals) and additional documents to be supplied prior to the funding of the loan. An account manager and account executive work directly with the submitting mortgage broker who originated the loan to collect the requested information and to meet the underwriting conditions and other requirements. In most cases, we fund loans within 30 days from the date of our approval of an application.

FastQual generally provides the broker with a response in less than 12 seconds. Loan information from the brokers own loan operating systems can be automatically uploaded to FastQual. The system provides all loan products for which the borrower qualifies, enabling brokers to offer their customers many options. Our

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FastQual Web site enables mortgage brokers to evaluate loan scenarios for borrowers, submit loan applications, order credit reports, automatically credit grade the loan, obtain pricing and track the progress of the loan through funding.

Our Wholesale Division also purchases funded loans on an individual or flow basis from independent mortgage bankers and financial institutions known as correspondent lenders. We review an application for approval from each lender that seeks to sell us a funded loan. We also review their financial condition and licenses. We require each mortgage banker to enter into a purchase and sale agreement with us containing customary representations and warranties regarding the loans the mortgage banker will sell to us. These representations and warranties are comparable to those given by us to the purchasers of our loans. Once the correspondent lender is approved, we re-underwrite each loan we purchase from them.

The following table sets forth selected information relating to loan originations and purchases through our Wholesale Division during the periods shown:

	For the Quarters Ended			
	March 31, 2005	**June 30, 2005**	**September 30, 2005**	**December 31, 2005**
Principal balance of originations and purchases (in thousands)	$ 9,073,489	12,131,216	14,859,085	13,160,531
Average principal balance of loans originated and purchased (in thousands)	$ 185	184	185	187
Combined weighted average initial loan-to-value ratio(1)	81.3%	81.8%	81.4%	80.8%
Percent of loans secured by first mortgages	94.9%	93.3%	93.0%	92.9%
Property securing mortgage loans:				
Owner occupied	92.7%	93.9%	94.4%	93.7%
Non-owner occupied	7.3%	6.1%	5.6%	6.3%

(1) Weighted average LTV is the LTV of the first lien mortgages and combined LTV of the second lien mortgages.

Our Retail Division

In May 2004, we acquired the rights to Home123, a new brand identity and customer value proposition for our Retail Division. In the acquisition, we purchased the rights to the name Home123 and other brand assets including a loan origination center in Morris Plains, New Jersey, the Home123.com Web site address and the 1-800-HOME123 phone number. In order to facilitate a simple loan origination process, Home123 provides customers with the following tools to inform them about what they can expect throughout the loan process: (i) A Home123 Loan Tool Kit[SM], which contains information that assists a customer though the loan process, including mortgage calculators, available through Home123.com or on CD-ROM; (ii) a Loan Blueprint Calendar[SM], which is an automated online calendar that tracks the loan application allowing the customer and the loan advisor to understand the status of the loan application throughout the process; and (iii) a loan advisor that acts as the single point of contact for the borrower to help make the loan process as seamless as possible.

In connection with our acquisition of the mortgage loan origination platform from RBC Mortgage, we launched a builder/realtor channel as part of our Retail Division and expanded our product offerings to include conventional mortgage loans, loans insured by the FHA and loans guaranteed by the VA. Through the loan origination platform, prime credit quality first-lien mortgage loans, both conforming and nonconforming, are secured by one-to-four family residences. Conforming conventional loans qualify for inclusion in guaranteed mortgage securities backed by Fannie Mae or Freddie Mac. Nonconforming conventional loans

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either have an original loan amount in excess of the Fannie Mae and Freddie Mac loan limit for single-family loans or otherwise do not meet Fannie Mae or Freddie Mac underwriting guidelines. As a subset of nonconforming conventional loans, we offer an Alt-A adjustable-rate mortgage loan product with a reduced documentation feature to borrowers who satisfy prescribed FICO, LTV and loan purpose criteria. In addition to first-lien mortgage loans, we offer prime credit quality loans secured by second liens on one-to-four family residences, including home equity lines of credit.

We expect to grow our Retail Division through the value proposition of the Home123 brand, supported by our other retail marketing efforts. By creating a direct relationship with the borrower, retail lending provides greater potential for repeat business and greater control over the lending process. Loan origination fees we collect contribute to profitability and cash flow and partially offset the higher costs of retail lending.

As of December 31, 2005, our Retail Division, including our central retail telemarketing unit, employed approximately 1,747 retail loan officers located in two regional processing centers and 222 sales offices.

The following table sets forth selected information relating to loan originations through our Retail Division during the periods shown:

	For the Quarters Ended			
	March 31, 2005	**June 30, 2005**	**September 30, 2005**	**December 31, 2005**
Principal balance of originations and purchases (in thousands)	$ 1,178,078	1,312,954	1,852,513	2,540,375
Average principal balance of loans originated and purchased (in thousands)	$ 147	151	154	159
Combined weighted average initial loan-to-value ratio(1)	78.5%	78.9%	78.8%	78.7%
Percent of loans secured by first mortgages	98.8%	98.2%	96.7%	94.7%
Property securing mortgage loans:				
Owner occupied	96.6%	96.9%	95.9%	94.8%
Non-owner occupied	3.4%	3.1%	4.1%	5.2%

(1) Weighted average LTV is the LTV of the first lien mortgages and combined LTV of the second lien mortgages.

Wholesale Marketing

Our Wholesale Division s marketing strategy focuses on the sales efforts of its account executives and on providing prompt, consistent service to mortgage brokers and other customers. Our Wholesale Division supplements its strategy with direct mail, e-mail and fax programs to brokers, advertisements in trade publications, in-house production of collateral sales material, seminar sponsorships, tradeshow attendance, periodic sales contests and its Web site, *www.newcentury.com.*

Retail Marketing

Our retail consumer-direct channel solicits prospective borrowers through a variety of direct response advertising methods, such as purchased leads from aggregators, radio advertising, direct mail, search engine placement, banner ads, e-mail campaigns and links to related Web sites. The channel relies primarily on Internet lead acquisition, targeted direct mail, outbound telemarketing, television, radio and Internet advertisements to attract borrowers. Our television and radio advertisements are handled by an outside advertising agency that creates our advertisements and buys our television and radio time. Our direct mail and lead acquisition programs are managed by a centralized staff who create a targeted lead list for each branch

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market and oversee the completion of mailings by a third-party mailing vendor. All calls or written inquiries from potential borrowers are tracked centrally and then forwarded to a branch location and handled by branch loan officers.

The direct mail program uses the Retail Division s Web site, www.Home123.com, to provide information to prospective borrowers and to allow them to complete a brief or mini application online. Under the Central Telemarketing Program, the telemarketing staff solicits prospective borrowers, makes a preliminary evaluation of the value and type of property, and then refers qualified leads to loan officers in the retail branch closest to the customer. Our builder/realtor channel is based on relationships that are either referred or solicited.

Underwriting Standards

Our loan origination standards and procedures are designed to produce high quality loans. These standards and procedures encompass underwriter qualifications and authority levels, appraisal review requirements, fraud prevention, funds disbursement controls, training of our employees and ongoing review of our employees work. We help to ensure that our origination standards are met by employing accomplished and seasoned managers, underwriters and processors and through the extensive use of technology. We also have a comprehensive training program for the continuing development of both our existing staff and new hires. In addition, we employ proprietary underwriting systems in our loan origination process that improve the consistency of underwriting standards, assess collateral adequacy and help to prevent fraud, while at the same time increasing productivity.

A qualified independent appraiser inspects and appraises each mortgage property and gives an opinion of value and condition. Following each appraisal, the appraiser prepares a report that includes a market value analysis based on recent sales of comparable homes in the area and, when appropriate, replacement cost analysis based on the current cost of constructing a similar home. All appraisals must conform to the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Foundation s Appraisal Standards Board and are generally on forms acceptable to Fannie Mae and Freddie Mac. Our underwriting guidelines require a review of the appraisal by one of our qualified employees or by a qualified review appraiser that we have retained. Our underwriting guidelines then require our underwriters to be satisfied that the value of the property being financed, as indicated by the appraisal, would support the requested loan amount.

Most of our conventional loans conform to Fannie Mae, Freddie Mac, FHA, or VA standards, and our other non-conforming prime grade loans meet overall industry standards for loan documentation and borrower characteristics. The underwriting guidelines for conventional conforming loans comply with the guidelines established by Fannie Mae or Freddie Mac. Our underwriting guidelines for FHA-insured or VA-guaranteed mortgage loans comply with guidelines established by the U.S. Department of Housing and Urban Development, or HUD, and the VA, as applicable. Non-conforming prime grade mortgage loans originated through our mortgage loan origination platform acquired from RBC Mortgage must also meet overall industry standards for loan documentation and borrower characteristics so that these loans are saleable in the secondary market.

We periodically evaluate and modify our underwriting guidelines. We also adopt new underwriting guidelines appropriate to new loan products we may offer.

Income Documentation

Our underwriting guidelines include three levels of income documentation requirements, referred to as the full documentation, limited documentation and stated income documentation programs.

Under the full documentation program, we generally require applicants to submit two written forms of verification, or 12 or more consecutive monthly bank statements on their individual or business bank accounts, showing stable income for at least 12 months.

Under the limited documentation program, we generally require applicants to submit six consecutive monthly bank statements on their individual bank accounts.

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Under the stated income documentation program, an applicant may be qualified based upon monthly income as stated on the mortgage loan application if the applicant meets certain criteria.

All of these documentation programs require that, with respect to any salaried employee, the applicant s employment be verified by telephone. In the case of a purchase money loan, we require verification of the source of funds, if any, to be deposited by the applicant into escrow. Under each of these programs, we review the applicant s source of income, calculate the amount of income from sources indicated on the loan application or similar documentation, review the applicant s credit history, and calculate the debt service-to-income ratio to determine the applicant s ability to repay the loan. We also review the type, use and condition of the property being financed. We use a qualifying interest rate that is equal to the initial interest rate on the loan to determine the applicant s ability to repay an adjustable-rate loan. For our interest-only adjustable rate mortgage, or ARM, loans we generally use the initial interest-only payment for determining the borrower s repayment ability.

For the year ended December 31, 2005, full documentation loans as a percentage of total originations totaled $30.4 billion, or 54.2%, limited documentation loans totaled $1.5 billion, or 2.7%, and stated documentation loans totaled $24.2 billion, or 43.1%.

Credit History

Our underwriting guidelines require us to obtain a credit report on each applicant from a credit reporting company. In evaluating an applicant s credit history, we utilize credit bureau risk scores, generally known as FICO scores, which are statistical rankings of likely future credit performance reported by the three national credit data repositories Equifax, TransUnion and Experian. We also review all prior mortgage payment histories and public records in addition to the credit report.

The following table reflects the credit grades and FICO scores of our borrowers for the years ended December 31 (dollars in thousands):

	2005				2004			
Risk Grades	**Amount**	**%**	**Wtd. Avg. LTV(1) Ratio**	**FICO**	**Amount**	**%**	**Wtd. Avg. LTV(1) Ratio**	**FICO**
AA	$ 42,194,519	75.2	82.5	641	$ 31,990,160	75.8	82.7	642
A +	4,919,909	8.8	79.2	597	4,225,339	10.0	79.6	598
A -	2,626,138	4.7	76.3	574	2,734,814	6.5	76.4	577
B	1,529,765	2.7	73.7	561	1,760,102	4.2	73.9	565
C/ C -	1,291,206	2.3	67.2	556	1,336,108	3.2	68.1	555
Subtotal	52,561,537	93.7	81.3	629	42,046,523	99.7	81.1	627
Commercial Lending	162,912	0.3			135,538	0.3		
Prime and Alt-A	3,383,792	6.0	76.7	713	17,579			
Total	$ 56,108,241	100.0	81.0	634	$ 42,199,640	100.0	81.1	627

(1) Weighted average LTV is the LTV of the first lien mortgages and the combined LTV of the second lien mortgages.

Geographic Distribution

The following table sets forth by state the aggregate dollar amounts (in thousands) and the percentage of loans we originated or purchased for the periods shown:

	For the Years Ended December 31,					
	2005		2004		2003	
California	$ 20,956,373	37.35%	17,356,938	41.13	11,228,322	41.01
Florida	4,863,876	8.67	2,673,481	6.33	1,653,316	6.04
New York	3,179,280	5.67	2,630,074	6.23	1,632,744	5.96
Arizona	2,228,800	3.97	810,231	1.92	326,349	1.19
New Jersey	2,203,526	3.93	1,484,548	3.52	885,513	3.23
Texas	2,145,907	3.82	1,552,140	3.68	1,135,005	4.15
Illinois	1,841,152	3.28	1,314,726	3.11	1,230,530	4.49
Massachusetts	1,738,268	3.10	1,303,383	3.09	943,160	3.45
Nevada	1,444,757	2.58	1,053,166	2.50	315,799	1.15
Maryland	1,315,028	2.34	843,577	2.00	488,052	1.78
Other	14,191,274	25.29	11,177,376	26.49	7,544,048	27.55
Total	$ 56,108,241	100.00%	42,199,640	100.00	27,382,838	100.00

Financing Loan Originations

We require access to credit facilities in order to originate and purchase mortgage loans and to hold them pending their sale or securitization.

As of December 31, 2005, we used our credit facilities totaling $14.1 billion provided by Bank of America, Barclays Bank, Bear Stearns, Citigroup Global Markets Realty, Credit Suisse First Boston, Deutsche Bank, IXIS Real Estate Capital, Morgan Stanley and UBS Real Estate Securities to finance the funding of our loan originations and purchases. We also fund loans through our $2.0 billion asset-backed commercial paper note facility. We then sell the loans through whole loan sales or securitizations, generally within one to three months, and pay down the financing facilities with the proceeds.

Loan Sales and Securitizations

A majority of the mortgage loans that we originate and sell into the secondary mortgage market are sold through whole loan sales, with a lesser amount sold in the form of securities. For the loans that we retain on our balance sheet, our qualified REIT subsidiaries purchase those loans from New Century Mortgage or Home123, initially using short-term credit facilities. Our qualified REIT subsidiaries then complete CMO securitizations to finance the loans over the long term.

Whole Loan Sales

We sell whole loans on a non-recourse basis pursuant to a purchase agreement in which we give customary representations and warranties regarding the loan characteristics and the origination process. We may be required to repurchase or substitute loans in the event of a breach of these representations and warranties. In addition, we generally commit to repurchase or substitute a loan if a payment default occurs within the first month or two following the date the loan is funded, unless we make other arrangements with the purchaser. The majority of our whole loan sales are sold on a servicing-released basis.

Securitizations

Securitizations Structured as Financings During the year ended December 31, 2005, we completed four securitizations totaling $11.0 billion, which were structured as financings for accounting purposes under Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial

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Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125, or SFAS 140. During 2004, we completed five securitizations totaling $10.1 billion, all of which were structured as on-balance sheet securitizations for financial reporting purposes under generally accepted accounting principles. The portfolio-based accounting treatment for securitizations structured as financings and recorded on-balance sheet is designed to more closely match the recognition of income with the receipt of cash payments. Because we do not record gain on sale revenue in the period in which the securitization structured as a financing occurs, the use of such portfolio-based accounting structures results in lower income in the period in which the securitization occurs than would a securitization structured as a sale. However, the recognition of income as interest payments are received on the underlying mortgage loans is expected to result in higher income recognition in future periods than would a securitization structured as a sale.

Securitizations Structured as Sales In a securitization structured as a sale, or off-balance sheet, we sell a pool of loans to a trust for a cash purchase price and a certificate evidencing our residual interest ownership in the trust and the transaction is accounted for as a sale under SFAS 140. The trust raises the cash portion of the purchase price by selling senior certificates representing senior interests in the loans in the trust. Following the securitization, purchasers of senior certificates receive the principal collected, including prepayments, on the loans in the trust. In addition, they receive a portion of the interest on the loans in the trust equal to the specified investor pass-through interest rate on the principal balance. We receive the cash flows from the residual interests after payment of servicing fees, guarantor fees and other trust expenses if the specified over-collateralization requirements are met. Over-collateralization requirements are generally based on a percentage of the original or current unpaid principal balance of the loans and may be increased during the life of the transaction depending upon actual delinquency or loss experience. A net interest margin security, or NIMS, transaction, through which certificates are sold that represent a portion of the spread between the coupon rate on the loans and the investor pass-through rate, may also occur concurrently with or shortly after a securitization. A NIMS transaction allows us to receive a substantial portion of the gain in cash at the closing of the NIMS transaction, rather than over the actual life of the loans.

During 2005, we completed four securitizations structured as sales totaling $6.4 billion. The gain on sale recorded for the four securitizations was $141.5 million and our retained interests totaled $97.5 million. We did not complete any off-balance sheet securitization transactions structured as sales during 2004 or 2003.

In the first quarter of 2004, we invested $2 million in Carrington Capital Management, LLC, or the LLC, and $25 million in Carrington Mortgage Credit Fund I, LP, or Carrington, which is sponsored by the LLC. Carrington acquires individual and pooled single-family residential subprime loans and securitizes them in transactions structured as sales. We were originally the majority investor in Carrington, requiring us to consolidate Carrington s results in our financial statements for financial reporting purposes through September 30, 2004. In the fourth quarter of 2004, Carrington raised additional capital, reducing our ownership position to approximately 38%. Since that time, we have included Carrington in our financial statements under the equity method of accounting. As a result of Carrington s capital raising activities, our ownership position is approximately 7% as of December 31, 2005 and the carrying value of our equity investment in Carrington and the LLC is $39.7 million.

Our Mortgage Loan Portfolio

Our mortgage loan portfolio is comprised of loans originated by us and sold through securitizations structured as financings. Our securitization structure results in ownership interests we retain in what are commonly known as asset-backed securities.

The investment characteristics of our portfolio of asset-backed securities differ from those of traditional fixed-income securities. The major differences include the payment of interest and principal on the asset-backed securities on a more frequent schedule and the possibility that principal may be prepaid at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities.

Various factors affect the rate at which mortgage prepayments occur, including changes in interest rates, general economic conditions, the age of the mortgage loan, the location of the property and other social and

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demographic conditions. Generally, prepayments on asset-backed securities increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. As a result, we may replenish the portfolio at a yield that is higher or lower than the yield on the existing portfolio, thus affecting the weighted average yield of our investments.

During 2003, most of our securitizations structured as financings were structured as REMICs as opposed to CMOs. In 2004, most of our securitizations structured as financings were structured as CMOs and in 2005, all of our securitizations structured as financings were structured as CMOs. The CMO structure provides tax efficiencies not available under the REMIC structure.

The following table provides certain information on the mortgage loan portfolio as of December 31, 2005 (dollars in thousands):

	2003 Vintage		2004 Vintage		2005 Vintage	
	REMIC	CMO	REMIC	CMO	REMIC	CMO
Initial collateral pool	$ 3,808,887	1,137,894	1,679,397	8,431,735		10,961,957
Current collateral pool	$ 1,177,971	332,200	1,105,902	4,621,687		8,946,473
Delinquency (60+ days)	5.61%	9.49%	2.41%	4.67%	%	2.42%
Cumulative losses-to-date	0.29%	0.35%	0.02%	0.10%	%	0.01%
Projected cumulative losses over life	1.24%	1.93%	1.52%	2.40%	%	3.05%
Weighted avg. life in years	2.58	2.01	3.25	1.98		2.14

Loan Servicing and Delinquencies

Servicing

Loan servicing activities are designed and implemented to ensure that each loan in a mortgage servicing portfolio is repaid in accordance with its terms. Such activities are generally performed pursuant to servicing contracts we enter into with investors or their agents in connection with whole loan sales or securitizations. The servicing functions performed typically include: collecting and remitting loan payments; making required advances; accounting for principal and interest; customer service; holding escrow or impound funds for payment of taxes and insurance; and, if applicable, contacting delinquent borrowers and supervising foreclosures and property dispositions in the event of un-remedied defaults. For performing these functions for third parties we generally receive a servicing fee of 0.50% annually of the outstanding principal balance of each loan in the mortgage servicing portfolio. The servicing fees are collected from the monthly payments made by the mortgagors. In addition, we generally receive other remuneration consisting of float benefits derived from collecting and remitting mortgage payments, as well as mortgagor-contracted fees such as late fees and, in some cases, prepayment penalties. We use MortgageServ as our main servicing system to perform our servicing activities.

As of December 31, 2005, the balance of our loan servicing portfolio was $39.6 billion, consisting of $15.2 billion in mortgage loans held for investment, $6.7 billion in mortgage loans held for sale, $10.0 billion in mortgage loans sold on a servicing-retained basis, and $7.7 billion in loans serviced on a temporary basis for the purchasers thereof. These loans are serviced through one of our taxable REIT subsidiaries. Approximately $1.0 billion of our mortgage loans held for investment and approximately $1.2 billion of our mortgage loans held for sale are serviced by a third party. Mortgage loans originated through our mortgage loan origination platform acquired from RBC Mortgage through January 2006 were serviced by a third party. We began servicing the majority of these mortgage loans in February 2006.

Servicing Operations

After we originate or purchase a mortgage loan we begin the process of servicing the loan. We originated $56.1 billion in mortgage loans during the year ended December 31, 2005. With the exception of the mortgage loans originated by our mortgage loan origination platform acquired from RBC Mortgage, these loans were serviced by us on an interim servicing basis prior to sale or were included in one of our securitizations. During the year ended December 31, 2005, we boarded an average of approximately 24,000 new loans per month to our servicing platform and transferred an average of 14,000 loans per month to other unaffiliated servicers pursuant to mortgage loan sales transactions. We expect to continue to retain the servicing rights on a portion of the mortgage loan sold to third parties in whole mortgage loan sales transactions and on all of the mortgage loans that we hold in our portfolio in the future.

During the past two years, we have completed several key servicing platform initiatives. These completed technology initiatives include the deployment of a customer accessible interactive Web site, enhancements to that Web site including payment acceptance, bill presentment and access to key information on payment history, enhancements to the Web site s main servicing system, the implementation of a lockbox payment processing system and deployment of software that improves our loss mitigation activities. In addition, we moved our servicing platform to a new larger facility to allow for increased servicing capacity and growth of our servicing activity.

In the event a borrower becomes delinquent, our loan counselors and mortgage assistant advisors assist the borrower in addressing the reasons for the delinquency, achieving a resolution and bringing the loan current. We will issue a breach of contract notice upon a mortgage loan becoming more than 32 days delinquent unless the applicable state law requires a greater number of actual days of delinquency before permitting the issuance of a breach of contract notice. A breach of contract notice permits the mortgage loan borrower the opportunity to cure the delinquency within the following 30 days before we will initiate a foreclosure action.

Accounts that are referred to our foreclosure department are simultaneously referred to our loss mitigation department. We review and consider a variety of loss mitigation opportunities with the borrower, including the possibility of forbearance agreements, listing the property for sale, using a deed in lieu of foreclosure and full reinstatement of the loan. Loss mitigation strategies are designed to decrease the loss to both the borrower and investor and the resolution of loss mitigation activities are structured to insure, if at all possible, that the loan borrower performs his or her payment obligation in a manner that decreases the prospect of a foreclosure sale, while at the same time minimizing related fees and costs.

In the event that foreclosure is the only resolution available, we engage a local attorney to assure satisfaction of all appropriate legal processes and steps mandated by applicable state and local statutes. Foreclosure timelines are state and locality specific and have been programmed in our primary timeline management software and our loan servicing system. Servicing management responsibility for a mortgage loan property for which the foreclosure sale has been completed and the applicable state redemption period has been exceeded is transferred to our real estate owned department. Our in-house asset managers manage the ultimate disposition of these real estate owned properties with the assistance of local real estate agents. Once a real estate owned property has been vacated and is available for sale, it is listed and marketed for sale. We closely monitor the resulting sales price and overall recovery in order to decrease the loss incurred.

In addition to our written policies and procedures designed to assist our employees in the conduct of servicing activities, we have also adopted servicing best practices that are designed to prevent any unfair or abusive servicing practices. We regularly evaluate our policies and practices to ensure they remain effective and are properly observed.

We intend to continue to retain servicing rights on certain of the loans we sell in future periods. In the second quarter of 2004, we received a rating of RPS3+, or average with noted strengths, from Fitch Ratings for our subprime servicing platform. In 2005, we received a rating of SQ3+, or average, from Moody s Credit Rating Service and, in January 2006, Standard and Poor s upgraded its rating for our subprime servicing platform to above average from average.

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Delinquency Reporting

The following table sets forth loan performance data of the loans on our mortgage loan servicing platform at December 31, 2005 (dollars in thousands):

				Delinquency			
Pool Type	**Balance**	**Weighted Average Coupon**	**FICO**	**<90 days**	**90+**	**Real Estate Owned (REO)**	**Total**
Mortgage loans held for investment(1)	$ 15,150,133	7.04%	629	2.58%	3.29%	0.29%	6.16%
Mortgage loans held for sale(1)	6,670,715	7.97	626	0.74	0.87	0.13	1.74
Interim servicing	7,750,137	7.66	626	0.53	0.25	0.01	0.79
Servicing rights owned	10,039,803	7.22	629	1.44	1.07	0.05	2.56
Total	$ 39,610,788	7.36%	628	1.58%	1.72%	0.15%	3.45%

(1) At December 31, 2005, approximately $1.0 billion of our loans held for investment and $1.2 billion of our mortgage loans held for sale were serviced by a third party.

The following table sets forth loan performance data of the loans on our mortgage loan servicing platform at December 31, 2004 (dollars in thousands):

				Delinquency			
Pool Type	**Balance**	**Weighted Average Coupon**	**FICO**	**<90 days**	**90+**	**Real Estate Owned (REO)**	**Total**
Mortgage loans held for investment(1)	$ 11,573,630	6.92%	631	1.22%	1.04%	0.12%	2.39%
Mortgage loans held for sale	3,884,192	7.01	630	0.20	0.52	0.03	0.75
Interim servicing	7,705,367	7.35	628	0.40	0.01		0.41
Servicing rights owned	1,216,325	7.30	621	1.42	1.44	0.22	3.07
Total	$ 24,379,514	7.09%	629	0.81%	0.65%	0.07%	1.54%

(1) At December 31, 2004, approximately $1.6 billion of our mortgage loans held for investment were serviced by a third party.

Competition

We continue to face intense competition in the business of originating, purchasing and selling mortgage loans. Our competitors include other mortgage banking companies, consumer finance companies, commercial banks, credit unions, thrift institutions, credit card issuers, insurance finance companies, Internet-based lending companies and other large financial institutions. Large financial institutions may have greater access to capital at a cost lower than our cost of capital under our credit facilities. Federally chartered banks and thrifts have a competitive advantage over us because the federal laws applicable to their operations can preempt some of the state and local lending laws applicable to our operations. Fannie Mae and Freddie Mac presently do not have the legal authority to originate mortgage loans, including subprime loans, but they do have the authority to buy loans. These government-sponsored entities have a size and cost-of-funds advantage that allows them to purchase loans with lower rates or fees than we are willing to offer. Many of these competitors have considerably greater technical and marketing resources than we have. The intense competition in the mortgage industry has led to rapid technological developments, evolving industry standards and frequent releases of new products and enhancements.

Competition among industry participants can take many forms, including convenience in obtaining a loan, customer service, marketing and distribution channels, amount and term of the loan, loan origination fees and interest rates. Additional competition may lower the rates we can charge borrowers, thereby potentially reducing gain on future loan sales and securitizations. Since the majority of our core origination business is conducted through our Wholesale Division, in 2004 and 2005, the most significant form of competition was pricing pressure among wholesale mortgage originators. Some of our competitors lowered rates and fees to preserve or expand their market share. Competition typically becomes increasingly intense in a rising interest rate environment, when mortgage lenders do not necessarily increase their coupon rates as quickly as short-term interest rates are increasing. During these periods, profit margins generally decline.

Our results of operations, financial condition and business prospects could be harmed if competition intensifies or if any of our competitors significantly expands its activities in our markets.

Regulation

Our mortgage banking business is subject to the rules, regulations or guidelines of, and/or examination by, the following entities with respect to the processing, originating, selling and servicing of mortgage loans:

- State regulatory authorities;
- The Department of Housing and Urban Development, or HUD;
- The Federal Housing Administration, or the FHA;
- The Department of Veteran Affairs, or the VA;
- Fannie Mae, Freddie Mac and Ginnie Mae; and
- The Federal Home Loan Bank, or the FHLB.

The rules, regulations and requirements of these entities, among other things, impose licensing obligations on us and our subsidiaries, establish standards for processing, underwriting and servicing mortgage loans, prohibit discrimination, restrict certain loan features in some cases, and fix maximum interest rates and fees.

Our business activities are also subject to examination by the Federal Housing Commissioner to assure compliance with FHA regulations, policies and procedures. As an FHA lender, we are required to submit to the FHA Commissioner on an annual basis audited financial statements. In addition, Ginnie Mae, HUD, Fannie Mae and Freddie Mac require the maintenance of specified net worth levels (which vary among the entities).

We are subject to judicial and administrative decisions that impose requirements and restrictions on our business. Mortgage origination activities are regulated by federal, state and local government authorities and are subject to extensive federal, state and local laws, rules and regulations. At the federal-level, these laws and regulations include the:

- Equal Credit Opportunity Act;
- Federal Truth in Lending Act and Regulation Z;
- Home Ownership and Equity Protection Act;
- Real Estate Settlement Procedures Act and Regulation X;
- Fair Credit Reporting Act;
- Fair Debt Collection Practices Act;
- Home Mortgage Disclosure Act;
- Fair Housing Act;

Telephone Consumer Protection Act;

Gramm-Leach-Bliley Act;

Fair and Accurate Credit Transactions Act;

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- CAN-SPAM Act;
- Sarbanes-Oxley Act; and
- USA PATRIOT Act.

These laws, rules and regulations, among other things:

- impose licensing obligations and financial requirements on us;
- limit the interest rates, finance charges and other fees that we may charge;
- prohibit discrimination;
- impose underwriting requirements;
- mandate disclosures and notices to consumers;
- mandate the collection and reporting of statistical data regarding our customers;
- regulate our marketing techniques and practices;
- require us to safeguard non-public personal information about our customers;
- regulate our collection practices;
- require us to prevent money-laundering or the conduct of business with suspected terrorists; and
- impose corporate governance, internal control and financial reporting obligations and standards.

Our failure to comply with these laws can lead to:

- civil and criminal liability;
- loss of approved status;
- demands for indemnification or loan repurchases from buyers of our loans;
- class action lawsuits; and
- administrative enforcement actions.

Compliance, Quality Control and Quality Assurance

We regularly monitor the laws, rules and regulations that apply to our business and analyze any changes to them. We integrate many legal and regulatory requirements into our automated loan origination system to reduce the prospect of inadvertent non-compliance due to human error. We also maintain policies and procedures, summaries and checklists to help our origination personnel comply with these laws.

Our training programs are designed to teach our personnel about the significant laws, rules and regulations that affect their job responsibilities. We also maintain a variety of pre-funding quality control procedures designed to detect compliance errors prior to funding.

In addition, we also subject a statistically valid sampling of our loans to post-funding quality assurance reviews and analysis. We track the results of the quality assurance reviews and report them back to the responsible origination units. To the extent refunds or other corrective actions are appropriate, we deduct those amounts from the internal profit and loss calculation for that origination unit.

Our loans and practices are also reviewed regularly in connection with the due diligence that our loan buyers and lenders perform. Our state regulators also review our practices and loan files regularly and report the results back to us. Since our inception, we have undergone over 140 state examinations, which have never resulted in findings of material violations or penalties.

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Licensing

As of December 31, 2005, two of our taxable REIT subsidiaries were licensed or exempt from licensing requirements by the relevant state banking or consumer credit agencies to originate first and second mortgages in all 50 states and the District of Columbia. As of December 31, 2005, one of our qualified REIT subsidiaries was authorized to originate mortgage loans in 45 states and we are seeking to license that qualified REIT subsidiary in the states in which it is not currently authorized to originate mortgages.

Regulatory Developments

During 2005, federal and state legislators and regulators adopted a variety of new or expanded regulations, particularly in the areas of privacy and consumer protection. These regulations are summarized below.

Privacy and Data Security

The federal Gramm-Leach-Bliley financial reform legislation imposes additional obligations on us to safeguard the information we maintain on our borrowers. Regulations have been promulgated and continue to be proposed by several agencies that may affect our obligations to safeguard information. In addition, several federal agencies are considering regulations that could affect the content of our notices. Also, several states are considering even more stringent privacy legislation. California has passed two pieces of legislation known as the California Financial Information Privacy Act and the California On-Line Privacy Protection Act. Both pieces of legislation became effective July 1, 2004, and impose additional notification obligations on us that are not pre-empted by existing federal law. In addition, California s Shine the Light Law, effective January 1, 2005, imposes additional requirements on businesses to disclose to customers how their personal information is shared, and the California Information Safeguard Law AB1950 imposes the obligation on businesses to establish procedural and electronic safeguards to protect customer personal information. If other states choose to follow California and adopt a variety of inconsistent state privacy legislation, our compliance costs could substantially increase.

In 2005, in response to the many well publicized incidents involving the breach of consumer personal confidential data, a number of states enacted laws that govern our duty to notify customers and consumers in the event there is a breach of their personal confidential information as defined in those laws. Failure to provide proper and timely notification following a breach could result in fines and penalties being imposed, which, in some cases, can be criminal in nature as well as potentially subject us to legal actions for damages both compensatory and punitive. Also, there are currently pending in Congress, 23 proposed bills dealing with data security and data breach notification. Some of these new laws would pre-empt state law if enacted and create a uniform national standard, but others would create a federal standard that could be superseded by stricter state laws. These laws have and will continue to impose regulatory and compliance costs on us.

Fair Credit Reporting Act

The Fair Credit Reporting Act provides federal preemption for lenders to share information with affiliates and certain third parties and to provide pre-approved offers of credit to consumers. Changes to the Fair Credit Reporting Act were made in December 2003, and some provisions will not become effective until the federal regulatory agencies issue final regulations. These new provisions impose additional regulatory and compliance costs on us and reduce the effectiveness of our marketing programs.

Home Mortgage Disclosure Act

In 2002, the Federal Reserve Board adopted changes to Regulation C promulgated under the Home Mortgage Disclosure Act. Among other things, the new regulations require lenders to report pricing data on loans with annual percentage rates that exceed the yield on treasury bills with comparable maturities by 3%. The expanded reporting took effect in 2004 for reports filed in 2005. As anticipated, a significant portion of our loans were subject to the expanded reporting requirements.

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The expanded reporting does not provide for additional loan information such as credit risk, debt-to-income ratio, LTV, documentation-level or other salient loan features. As a result, lenders are concerned that the reported information may lead to increased litigation as the information could be misinterpreted by third parties.

Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003

The CAN-SPAM Act of 2003 took effect on January 1, 2004 and applies to businesses, such as ours, that use electronic mail for advertising and solicitation. This law, generally administered by the Federal Trade Commission, preempts state laws to the contrary, and establishes, among other things, a national uniform standard that gives recipients of e-mail messages principally promoting a good or service the right to stop unwanted emails. New requirements include: truthful and accurate header captions in emails as well as return email addresses; specifying a valid physical postal address of the sender; notifying consumers of the right to opt out from receiving further emails from the sender and providing an opt out mechanism and timely honoring an opt out request. Effective March 28, 2005, new rules apply to dual-purpose e-mails where a commercial message is included with transactional or relationship e-mail. These new and existing provisions impose additional regulatory and compliance costs on us and potentially reduce the effectiveness of our marketing programs.

Telephone Consumer Protection Act and Telemarketing Consumer Fraud and Abuse Prevention Act

The Telephone Consumer Protection Act and the Telemarketing Consumer Fraud and Abuse Prevention Act, enacted in 1991 and 1994, respectively, are designed to restrict unsolicited advertising using the telephone and facsimile machine. Since they were enacted, however, telemarketing practices have changed significantly due to new technologies that make it easier to target potential customers while at the same time making it more cost effective to do so. The Federal Communications Commission, or the FCC, and the Federal Trade Commission, or the FTC, have responsibility for regulating various aspects of these laws, such as regulating unwanted telephone solicitations and the use of automated telephone dialing systems, prerecorded or artificial voice messages and telephone facsimile machines. In 2003, both agencies adopted a national do-not-call registry requirement, which, in part, mandated that companies such as us (i) cross reference our prospective telemarketing lists against the national do-not-call registry to avoid contacting enrolled customers unless established exceptions apply, (ii) regularly check the do-not-call registry for updates at least every 31 days, and (iii) maintain and regularly update an internal company list comprised of consumers who have chosen not to be called or receive facsimile advertising specifically from us. Over 25 states have also adopted similar laws, with which we also comply. As with other regulatory requirements, these provisions impose additional regulatory and compliance costs on us and reduce the effectiveness of our marketing programs.

Predatory Lending Legislation

The Home Ownership and Equity Protection Act of 1994, or HOEPA, identifies a category of mortgage loans and subjects them to more stringent restrictions and disclosure requirements. In addition, liability for violations of applicable law for loans covered by HOEPA extends not only to the originator but also to the purchaser of the loans. HOEPA generally covers loans with either (i) total points and fees upon origination in excess of the greater of eight percent of the loan amount or $528 (an annually adjusted dollar amount), or (ii) an APR of more than eight percentage points higher than United States Treasury securities, or Treasuries, of comparable maturity on first mortgage loans and 10 percentage points above Treasuries of comparable maturity for junior mortgage loans.

We do not originate loans covered by HOEPA because of the higher legal risks as well as the potential negative perception of originating loans that are considered to be high cost under federal law. Several federal, state and local laws and regulations have been adopted or are under consideration that are intended to eliminate so-called predatory lending practices. Many of these laws and regulations go beyond targeting abusive practices by imposing broad restrictions on certain commonly accepted lending practices, including some of our practices. In addition, some of these laws impose liability on assignees of mortgage loans such as loan buyers, lenders and securitization trusts. Such provisions deter loan buyers from purchasing loans covered by the applicable law.

In 2005, we continued to be subject to adverse state legislation. For example, Illinois enacted House Bill 4050 (HB 4050) in 2005, which will subject certain zip codes in Cook County, Illinois to a pilot program that potentially may have larger statewide implications for our subprime business. Under the terms of HB 4050, the law requires brokers, lenders, title companies, closing agents and credit counselors to report detailed borrower loan information for loans being made to borrowers within the designated zip codes in Cook County. Pursuant to regulations promulgated by the Department of Financial and Professional Regulation, or the DFPR, the DFPR determines which borrowers must receive loan counseling in an effort to avoid abusive or predatory loan terms. The brokers or lenders are required to pay for the loan counseling and the loan may not be closed until the borrower completes loan counseling. The law was to become effective January 1, 2006, but its effective date has been postponed until a secure database for the borrower information being gathered can be created and the logistics of how loan counseling will be handled can be worked out. It is anticipated that the law will become effective in the spring of 2006, unless a legal challenge is mounted. Further clarifying regulations are to be issued and we will be studying them to see what impact the law and the regulations will have on our ability to do business in these zip codes.

Additionally, we await judicial decisions in two court cases, either one of which may have significant impact on our lending operations. In Ohio, the issue awaiting decision by the Ohio Supreme Court in the case of *American Financial Services Association vs. The City of Cleveland* is whether or not cities and counties in Ohio have the right to enact predatory lending ordinances even though state legislation specifically preempts their ability to do so. An adverse decision will subject us to a myriad of local lending laws. In Montgomery County, Maryland, in the case of *American Financial Services Association, et al vs. Montgomery County, Maryland,* a trial court has enjoined a local predatory lending/discrimination ordinance from taking effect, pending a full hearing as to whether or not it is preempted by Maryland state law.

These decisions and new laws impose additional regulatory and compliance costs on us and reduce the effectiveness of our marketing programs. There can be no assurance that other similar laws, rules or regulations will not be adopted in the future. Adoption of these laws and regulations could have a material adverse impact on our business by substantially increasing the costs of compliance with a variety of inconsistent federal, state and local rules, or by restricting our ability to charge rates and fees adequate to compensate us for the risk associated with certain loans. Adoption of these laws could also have a material adverse effect on our loan origination volume, especially if our lenders and secondary market buyers elect not to finance or purchase loans covered by the new laws. We remain in favor of strong uniform national standards and are supporting legislative initiatives consistent with this principle.

Efforts to Avoid Abusive Lending Practices

In an effort to prevent the origination of loans containing unfair terms or involving predatory practices, we have adopted many policies and procedures, including the following.

Product Policies

We do not fund or purchase high cost loans as defined by HOEPA.

We do not make or purchase loans containing single premium credit life, disability or accident insurance.

We do not make or purchase loans containing mandatory arbitration clauses or interest rate increases triggered by borrower default. None of the subprime loans we make or purchase allow for negative amortization of the loan.

We offer loans with and without prepayment penalties. When a borrower opts for a loan with a prepayment charge, the borrower benefits from a lower interest rate and/or pays lower upfront fees.

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Our prepayment penalties do not extend beyond three years from the origination date. On fixed rate loans, the maximum prepayment penalty term is three years. Prepayment penalties on adjustable rate subprime loans do not extend beyond the first adjustment date.

We do not originate loans that pay off zero interest rate mortgages provided by charitable organizations or the government without borrower third-party counseling.

Loan Processing Policies

We only approve subprime loan applications that evidence a borrower s ability to repay the loan.

We consider whether a subprime borrower s loan terms are in the borrower s best interests and document our belief that the loan represents a tangible benefit to the borrower. We are currently working to set up a similar system for loans originated through our mortgage origination platform acquired from RBC Mortgage.

We do not resolicit our borrowers within 12 months of loan origination.

We price loans commensurate with risk.

We use an electronic credit grading system for our subprime loans to help ensure consistency of grading.

We do not ask appraisers to report a predetermined value or withhold disclosure of adverse features.

We employ electronic and manual systems to protect against adverse practices like property flipping. Loan origination systems are designed to detect red flags such as inflated appraisal values, unusual multiple borrower activity or rapid loan turnover.

Customer Interaction and Education

We market our loans with a view to encouraging a wide range of applicants strongly representative of racial, ethnic and economic diversity in the markets we serve throughout the nation.

We provide a helpful, easy-to-follow brochure to all our loan applicants to educate them on the loan origination process, explain basic loan terms, help them obtain a loan that suits their needs and advise them on how to find a U.S Department of Housing and Urban Development, or HUD-approved loan counselor.

We distribute our Fair Lending Policy to all newly hired employees and hold them accountable for treating borrowers fairly and equally.

We provide fair lending training to employees having direct contact with borrowers or loan decision-making authority.

We require brokers to sign an agreement indicating that they are knowledgeable about and will abide by fair lending laws and our Broker Code of Conduct.

We monitor broker performance and strive to hold brokers accountable for fair and equal treatment of borrowers.

Our Retail Division conducts regular customer satisfaction surveys of all newly funded loans.

We also conduct periodic randomly selected satisfaction surveys of customers who receive loans through a mortgage broker.

Each division is supported by well-trained consumer relations staff dedicated to resolving consumer complaints in a timely and fair manner.

Our Loan Servicing Department contacts each borrower prior to the first payment to confirm that the borrower understands the loan payment terms.

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When appropriate, we also offer loss mitigation counseling to borrowers in default and provide opportunities to enter into mutually acceptable reasonable repayment plans.

We report borrower monthly payment performance to major credit repositories.

Evaluation and Compliance

We subject a significant statistical sampling of our loans to a quality assurance review of borrower qualification, validity of information and verified property value determination.

Our Fair Lending Officer provides an independent means of reporting or discussing fair lending concerns through consumer and employee hotlines.

Our Fair Lending Officer monitors production of fair lending performance, including loan file analysis and reporting, and coordinates community outreach programs.

We periodically engage independent firms to review internal controls and operations to help ensure compliance with accepted federal and state lending regulations and practices.

We adhere to high origination standards in order to sell our loan products in the secondary mortgage market.

We treat all customer information as confidential and consider it to be nonpublic information. We maintain systems and procedures designed to ensure that access to nonpublic consumer information is granted only to legitimate and valid users.

We use sophisticated fraud prevention and detection applications and techniques that allow us to better protect our customers from fraud and identity theft.

We believe that our commitment to responsible lending is good business.

We strive to promote highly ethical standards throughout our industry.

We plan to continue to review, revise and improve our practices to enhance our fair lending efforts and support the goal of eliminating predatory lending practices in the industry. Our policies and procedures are subject to change from time to time and without notice.

Environmental

In the course of our business, we may acquire properties securing loans that are in default. There is a risk that hazardous or toxic waste could be found on such properties. If this occurs, we could be held responsible under applicable law for the cost of cleaning up or removing the hazardous waste. This cost could exceed the value of the underlying properties.

Employees

As of December 31, 2005, we employed approximately 7,200 employees. None of our employees are subject to a collective bargaining agreement. We believe that our relations with our employees are satisfactory.

Available Information

We make available, free of charge, on the Investor Relations Section of our Web site (http://investorrelations.ncen.com/), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 reports and any amendments to those reports as soon as reasonably practicable after such reports or amendments are electronically filed with or furnished to the SEC.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

Introduction

The following general discussion summarizes the material U.S. federal income tax considerations regarding our qualification and taxation as a REIT. This discussion is based on interpretations of the Code, regulations issued thereunder, and rulings and decisions currently in effect (or in some cases proposed), all of which are subject to change. Any such change may be applied retroactively and may adversely affect the federal income tax consequences described herein. This summary does not discuss all of the tax consequences that may be relevant to particular stockholders or stockholders subject to special treatment under the federal income tax laws. Accordingly, you should consult your own tax advisor regarding the federal, state, local, foreign, and other tax consequences of your ownership and our REIT election, and regarding potential changes in applicable tax laws.

In general, the Code does not differentiate between preferred and common stockholders when applying the tax laws to stockholders. Unless specifically indicated otherwise, all references to stockholders shall include both our common and preferred classes of stock.

Taxation as a REIT

Generally. We have elected to be taxed as a REIT under Sections 856 through 859 of the Code commencing with our taxable year ended December 31, 2004. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we distribute currently to our stockholders at least 90% of our REIT taxable income. As a REIT, we generally are not subject to federal corporate income tax on that portion of our REIT taxable income that we distribute currently to our stockholders. Even if we qualify as a REIT, however, we may be subject to tax in certain situations. In addition, any taxable REIT subsidiary or TRS in which we own an interest, including New Century TRS Holdings, Inc. and its subsidiaries, is subject to federal corporate income tax on its taxable income at the highest applicable state and federal corporate tax rates.

There are no differences in the taxation of our common and preferred shares. All stockholders will generally be taxed on the dividends they receive at ordinary income rates unless such dividends are designated by us as a capital gain dividend or as qualified dividend income. Since our conversion to a REIT, all dividends paid are taxed at ordinary income rates. We urge all investors to consult their own independent tax advisors regarding the effect of all tax matters, including federal, state, local and in the case of non U.S. investors, international tax laws, for their investment in New Century common or preferred stock.

Many of the requirements for qualification as a REIT are highly technical and complex and require an analysis of factual matters and an application of the legal requirements to such factual matters in situations where there is only limited judicial and administrative guidance. Therefore, no assurance can be given that we have qualified or will qualify as a REIT for any particular year. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax at regular corporate rates and may not be able to qualify as a REIT for four subsequent tax years. Failure to qualify as a REIT would adversely affect our net income, our dividend distributions and could adversely affect the value of our stock.

Taxable Income. We use the calendar year for both tax and financial reporting purposes. However, there may be differences between taxable income, taxable REIT income, and income computed in accordance with accounting principles generally accepted in the United States of America (GAAP). These differences primarily arise from permanent differences created by taxable intercompany transactions between TRS and REIT level companies or to the timing and character differences in the recognition of revenue and expense and gains and losses for tax and GAAP purposes. Additionally, taxable REIT income does not include the taxable income of our taxable REIT subsidiaries, although the TRS operating results are included in our GAAP results.

Taxable mortgage pools and REMICs. We will make investments or enter into financing and securitization transactions that give rise to our being considered to be, or to own an interest in, one or more

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taxable mortgage pools or REMICs, although we do not intend to engage in REMIC securitization transactions other than through one of our Taxable REIT Subsidiaries.

Under the REIT rules, any portion of our income from a REMIC residual interest or taxable mortgage pool, including non-cash accrued income, or phantom taxable income that is owned by the REIT, will be treated as excess inclusion income and the character of that income will be passed along to our stockholders via the dividend each quarter.

The amount of excess inclusion income in any given year from these activities, transactions and investments by the REIT could be significant. Generally, individuals and taxable corporations investing in New Century and receiving our dividends will not be required to report or consider excess inclusion income when they file their annual tax return unless they fall into one of the three special tax circumstances listed below.

1. That portion of our dividend represented by excess inclusion income may not be offset by any net operating losses otherwise available to the stockholder.

2. Stockholders otherwise generally exempt from federal income tax as a non-profit organization will, for that portion of our dividend represented by excess inclusion income, be subject to tax for unrelated business taxable income or UBTI.

3. For most types of foreign stockholders that portion of our dividend represented by excess inclusion income will result in the application of U.S. federal income tax withholding at the maximum rate (i.e., 30%), without reduction for any otherwise applicable income tax treaty.

The Treasury Department has yet to issue regulations governing the exact computation of excess inclusion income, its reporting and finally the tax treatment of the stockholders of a REIT that owns an interest in a taxable mortgage pool. Accordingly, the manner in which excess inclusion income is to be allocated among shares of different classes of our stock or how such income is to be reported to our stockholders is not clear under current law. Tax-exempt investors, foreign investors, and taxpayers with net operating losses should carefully consider the tax consequences described above and are urged to consult their tax advisors in connection with their decision to invest in our stock.

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EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information about our executive officers as of March 1, 2006:

Name	Age	Position
Executive Officers:		
Robert K. Cole	59	Chairman of the Board of Directors and Chief Executive Officer of New Century
Brad A. Morrice	49	Vice Chairman of the Board of Directors, President and Chief Operating Officer of New Century; Chief Executive Officer and Director of New Century Mortgage(1); Chairman of the Board of Directors and Chief Executive Officer of NC Capital(2); Chairman of the Board of Directors and Chief Executive Officer of Home123(3)
Edward F. Gotschall	51	Vice Chairman-Finance of the Board of Directors of New Century; Chief Financial Officer and Director of NC Capital
Patrick J. Flanagan	40	Executive Vice President of New Century
Kevin M. Cloyd	35	Executive Vice President of New Century and Home123; Executive Vice President and Director of New Century Mortgage; President and Director of NC Capital
Patti M. Dodge	45	Executive Vice President and Chief Financial Officer of New Century and New Century Mortgage; Chief Financial Officer and Director of Home123
Stergios Theologides	39	Executive Vice President-Corporate Affairs and General Counsel of New Century; Executive Vice President-Corporate Affairs, Senior Legal Counsel and Secretary of New Century Mortgage; Executive Vice President and Director of NC Capital; Corporate Secretary of Home123
Joseph F. Eckroth, Jr.	47	Executive Vice President of New Century and Executive Vice President, Chief Information Officer and Chief Operating Officer of New Century Mortgage

(1) New Century Mortgage is a wholly owned direct subsidiary of New Century TRS.

(2) NC Capital is a wholly owned direct subsidiary of New Century Mortgage.

(3) Home123 is a wholly owned indirect subsidiary of New Century TRS.

Robert K. Cole, one of our co-founders, has been the Chairman of our board of directors and Chief Executive Officer since December 1995 and one of our directors since November 1995. Mr. Cole also served as a director of New Century Mortgage from November 1995 to April 2005. From February 1994 to March 1995, he was the President and Chief Operating Officer-Finance of Plaza Home Mortgage Corporation, a publicly-traded savings and loan holding company specializing in the origination and servicing of residential mortgage loans. In addition, Mr. Cole served as a director of Option One Mortgage Corporation, a subsidiary of Plaza Home Mortgage specializing in the origination, sale and servicing of non-prime mortgage loans. Previously, Mr. Cole was the President of operating subsidiaries of NBD Bancorp and Public Storage, Inc. Mr. Cole received a Masters of Business Administration degree from Wayne State University.

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Brad A. Morrice, one of our co-founders, has been a Vice Chairman of our board of directors since December 1996, our President and one of our directors since 1995, and our Chief Operating Officer since January 2001. Mr. Morrice also served as our General Counsel from December 1995 to December 1997 and our Secretary from December 1995 to May 1999. In addition, Mr. Morrice serves as Chief Executive Officer and a director of New Century Mortgage and Chairman of the board of directors and Chief Executive Officer of NC Capital and Home123. From February 1994 to March 1995, he was the President and Chief Operating Officer-Administration of Plaza Home Mortgage, after serving as its Executive Vice President, Chief Administrative Officer since February 1993. In addition, Mr. Morrice served as General Counsel and a director of Option One. From August 1990 to January 1993, Mr. Morrice was a partner in the law firm of King, Purtich & Morrice, where he specialized in the legal representation of mortgage banking companies. Mr. Morrice previously practiced law at the firms of Fried, King, Holmes & August and Manatt, Phelps & Phillips. He received his law degree from the University of California, Berkeley (Boalt Hall) and a Masters of Business Administration degree from Stanford University.

Edward F. Gotschall, one of our co-founders, has been the Vice Chairman-Finance of our board of directors since July 2004, a Vice Chairman of our board of directors since December 1996 and one of our directors since November 1995. Prior to being appointed Vice Chairman-Finance, Mr. Gotschall served as our Chief Financial Officer from August 1998 to July 2004 and our Chief Operating Officer Finance/ Administration from December 1995 to August 1998. Mr. Gotschall also served as a director of New Century Mortgage from August 1995 to April 2005 and was its Executive Vice President from December 1995 to March 2004 and its Chief Financial Officer from August 1995 to February 2002. Mr. Gotschall is also Chief Financial Officer and a director of NC Capital. From April 1994 to July 1995, he was the Executive Vice President/ Chief Financial Officer of Plaza Home Mortgage and a director of Option One. Mr. Gotschall was one of the co-founders of Option One and from December 1992 to April 1994, Mr. Gotschall served as its Executive Vice President/ Chief Financial Officer. From January 1991 to July 1992, he was the Executive Vice President/ Chief Financial Officer of The Mortgage Network, Inc., a retail mortgage banking company. Mr. Gotschall received his Bachelors of Science in Business Administration degree from Arizona State University.

Patrick J. Flanagan has been our Executive Vice President since August 1998. Mr. Flanagan entered into an employment agreement with us on December 27, 2005 whereby he commenced a leave of absence January 1, 2006 and his term as our Executive Vice President will expire as of the earlier to occur of June 30, 2006 or Mr. Flanagan s termination of employment with us. Upon expiration of Mr. Flanagan s term as Executive Vice President on July 1, 2006, the consulting agreement he enter