ECC CAPITAL CORPORATION
AND SUBSIDIARIES

A Maryland Corporation

2040 Main Street, Suite 800
Irvine, California 92614

CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Nine Months Ended September 30, 2007

Date of report
December 4, 2007

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
September 30, 2007
(in thousands)
"Unaudited/Unreviewed"

Cash and cash equivalents	$	18,186
Restricted cash		2,615
Mortgage loans held for sale, net		4,093
Mortgage loans held for investment, net		1,444,169
Accrued mortgage loan interest		18,461
Residual interests in securitizations		1,988
Real estate owned		57,850
Prepaid expenses and other assets		17,950
Derivative instruments		12,578
Assets of discontinued operations		5,481
Total assets	$	1,583,371
LIABILITIES AND STOCKHOLDERS' EQUITY		
Long-term debt	$	1,504,982
Accounts payable and accrued expenses		35,940
Liabilities of discontinued operations		8,215
Total liabilities		1,549,137
Stockholders' equity:		
Common stock authorized, 200,000,000 shares of $0.001 par value, 101,013,410 shares issued and 97,073,300 outstanding		101
Additional paid-in capital		373,760
Accumulated deficit		(339,627)
Total stockholders' equity		34,234
Total liabilities and stockholders' equity	$	1,583,371

The accompanying notes are an integral part of these statements.

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands)
"Unaudited/Unreviewed"

	For the three months ended September 30, 2007	For the nine months ended September 30, 2007
Revenue		
Interest income	$ 30,178	$ 111,771
Interest expense	(26,468)	(91,964)
Net interest income	3,710	19,807
Provision for loan losses - loans held for investment	10,746	76,006
Deficiency in interest income, after provision for loan losses	(7,036)	(56,199)
Change in market value of residuals	258	(10,000)
Loss on derivative instruments, net	(8,458)	(2,889)
Total deficiency in revenues	(15,236)	(69,088)
Expenses		
Operating expenses	3,863	18,679
Servicing fees	894	3,367
Total expenses	4,757	22,046
Loss from continuing operations before income taxes	(19,993)	(91,134)
Income tax (provision)benefit from continuing operations	(8)	69
Loss from continuing operations	(20,001)	(91,065)
Discontinued operations		
(Loss) income from discontinued operations before income taxes	(2,308)	6,625
Income tax provision	(33)	(221)
(Loss) income from discontinued operations	(2,341)	6,404
NET LOSS	$ (22,342)	$ (84,661)

The accompanying notes are an integral part of these statements.

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Nine months ended September 30, 2007
(in thousands)
"Unaudited/Unreviewed"

Cash flows from operating activities:	
Net loss	$ (84,661)
Adjustments to reconcile net loss to cash provided by operating activities:	
Depreciation and amortization	13,949
Provision for loan losses	75,707
Change in mortgage loans	1,132,864
Gain on sale of mortgage origination operations	(21,461)
Fair value adjustment of residual interest	10,000
Accretion of residual interest	(4,533)
Compensation charge from stock options and warrants	820
Net increase in fair value of derivative instruments	24,017
Loss on disposal/impairment of equipment	(288)
Net change in:	
Other receivables	8,887
Accrued mortgage loan interest	11,161
Accrued bond interest payable	(637)
Prepaid expenses and other assets	(21,255)
Accounts payable and accrued expenses	(27,224)
Net cash provided by operating activities	1,117,346
Cash flows from investing activities:	
Purchases of property, equipment and leasehold improvements	235
Principal payments received on loans held for investment	875,044
Proceeds from sale of loan origination operations	26,061
Cash received from residual interest	37,725
Net cash provided by investing activities	939,065
Cash flows from financing activities:	
Net decrease in warehouse lines of credit	(1,169,580)
Principal payments on long-term debt	(880,807)
Payments of capital lease obligations	(867)
Repurchase of common stock	(1,340)
Net decrease in restricted cash	885
Dividends paid	(31,301)
Net cash used in financing activities	(2,083,010)
Net decrease in cash and cash equivalents	(26,599)
Cash and cash equivalents at beginning of the period	44,785
Cash and cash equivalents at end of the period	$ 18,186
Supplemental cash flow information:	
Cash used to pay interest	$ 109,019
Cash used to pay income taxes	$ 142

The accompanying notes are an integral part of these statements.

NOTE A—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ECC Capital Corporation (the "Company") deregistered all of its shares of common stock from registration under the Securities Act of 1934 and is no longer required to issue periodic reports in accordance with SEC regulations. These unaudited/unreviewed consolidated financial statements do not include comparative analysis and other information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. These consolidated financial statements have been prepared on the same basis as the annual financial statements. In the opinion of management, the accompanying notes to the consolidated financial statements are intended to include all material disclosures for the period represented. Therefore, these consolidated financial statements should be read in conjunction with the Company's audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and financial statements included in the Company's interim quarterly reports. The results for the three and nine months ended September 30, 2007 are not necessarily indicative of the expected results for the year ending December 31, 2007.

Organization

The Company is a mortgage real estate investment trust ("REIT") that owns and manages interests in securitization trusts which issued securities collateralized by mortgages on residential real estate.

The Company originated nonconforming mortgage loans through its taxable REIT subsidiary, Performance Credit Corporation (formerly known as Encore Credit Corp.), principally using its network of brokers throughout the United States. The Company either sold loans to third parties, through Performance Credit, or it transferred loans to a wholly-owned bankruptcy remote subsidiary which financed such loans through the issuance of asset-backed securities in securitization transactions accounted for as financings or sales. The Company's loan origination operations comprised the majority of its business activities within its mortgage banking operations. On February 9, 2007, the Company closed the sale of its mortgage banking operations to Bear Stearns and effectively exited the wholesale mortgage origination business. As Bear Stearns also acquired use of the Encore Credit name, the Company changed the name of Encore Credit Corp. to Performance Credit Corporation ("Performance"), which remains the Company's wholly-owned subsidiary.

Principles of Consolidation

The consolidated financial statements of the Company include the financial position and results of operations of ECC Capital Corporation and its wholly-owned subsidiaries. All material intercompany balances and transactions are eliminated in consolidation. The Company is the primary beneficiary in a variable interest entity ("VIE"), as defined by Financial Accountings Standard Board ("FASB") Interpretation No. 46 Revised ("FIN 46R"), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*, involved in a retail lending business. The Company has consolidated the financial statements of this VIE. The financial statements of this VIE are not material to the Company's operations or financial position. The Company's current maximum exposure to loss with respect to this VIE is approximately $3.7 million as of September 30, 2007.

The Company securitized its loans held for investment by transferring loans to trusts that issued long-term debt. The Company retained certain servicing rights and the excess interest spread between the rate paid by the borrowers and the rate paid to the noteholders. The structure of the trusts limits its activities to holding the transferred assets and transferring cash collected to the trusts' beneficial interest holders. Certain trusts utilized by the Company do not meet the definition of a qualified special purpose entity as defined by Statement of Financial Accounting Standards No. 140 ("SFAS 140"), *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as: (i) the Company retains certain discretionary rights as servicer of the mortgage loans transferred to the trust, (ii) the Company holds a right to repurchase any of the loans in the trust aggregating up to 1% of the initial principal balance of the transferred loans, and (iii) the trust may, with the approval of the beneficial interest holders, acquire derivative financial instruments. Such trusts are considered VIEs. The Company is considered the primary beneficiary of the trust because, as the recipient of the excess cash flows from the trust, the Company's interests in the trust are exposed to the majority of the variability in the trust's cash flows. As the primary beneficiary of the trust, the Company has consolidated the assets and liabilities of the trust in the accompanying consolidated financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, and contingencies at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant balance sheet items which could be materially affected by such estimates include the residual interests in securitizations, deferred and prepaid taxes, repurchase allowance, the carrying value of loans held for sale, deferred fees, deferred bond issuance costs and allowance for loan losses on loans held for investment.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Cash equivalents include funds invested in interest bearing accounts such as money market funds and similar accounts.

Restricted Cash

At September 30, 2007, restricted cash represented collateral for letters of credit provided in connection with surety bonding requirements.

Mortgage Loans and Loan Origination Fees and Costs

Mortgage loans held for investment are stated at amortized cost, including the outstanding principal balance, less the allowance for loan losses. Deferred origination fees and costs, net of discounts are amortized as an adjustment of yield over the life of the portfolio using the effective yield method in a manner that anticipates prepayments.

Repurchase Obligations

The Company did not repurchase any loans during the third quarter of 2007. However, the Company did enter into two agreements to settle outstanding claims in the third quarter of 2007. Since September 30, 2007, the Company entered into one agreement to settle certain loan repurchase claims. As of September 30, 2007, $1.8 million was reserved for potential losses that may be realized on the settlement of these and other incurred but unknown loan repurchase claims. Although management believes the amount reserved is adequate to provide for losses on the settlement of repurchase claims, the timing and amount of any remaining repurchase claims is highly uncertain and it is reasonably possible that losses ultimately realized may be greater than amounts provided for.

Allowance for Loan Losses on Mortgage Loans Held for Investment

In connection with its mortgage loans held for investment, the Company establishes an allowance for loan losses based on its estimate of losses inherent and probable as of the balance sheet date. The Company charges off uncollectible loans at the time of liquidation. The Company evaluates the adequacy of this allowance each reporting period, giving consideration to factors such as the current performance of the loans, characteristics of the portfolio, the value of the underlying collateral and the general economic environment. Although the Company believes the allowance for loan losses is adequate for known and inherent losses in the portfolio of mortgage loans held for investment, several factors including, but not limited to, the adverse real estate market conditions, the expiration of the initial fixed interest rate period for the loans it originated resulting in increased loan payments for borrowers and the limited ability for borrowers to refinance, has caused the Company to significantly increase its allowance in the second quarter. Until the debt and real estate markets stabilize, the Company cannot be confident that such inherent losses will not exceed existing reserves. Provision for losses is charged to the Company's consolidated statement of operations and losses incurred are charged to the allowance.

Residual Interests in Securitization

Residual interests in securitizations represent interests retained from the sale of loans through securitizations that the Company structures as sales rather than financings, referred to as "off-balance sheet securitizations". The Company may also sell residual interests in securitizations through, what are sometimes referred to as, net interest margin securities, or NIMS.

In an off-balance sheet securitization, the Company transfers mortgage loans to a Real Estate Mortgage Investment Conduit (the "REMIC" or "Trust"), which is a Qualified Special Purpose Entity ("QSPE"), as defined by SFAS 140 and accounts for the transfer as a sale of loans. The Trust, in turn, issues interest bearing asset-backed securities (the "Certificates"). The Certificates are sold without recourse except that the Company provides representations and warranties customary to the mortgage banking industry with respect to loans transferred to the Trust. The Trust uses the cash proceeds from the sale of the Certificates to pay the Company the purchase price for the mortgage loans. The Trust also issues certificates representing interests in the excess interest spread and other residuals. The excess interest spread represents the present value of estimated

cash flows that the holder of such Certificates will receive as a result of the interest collected from borrowers exceeding the interest paid to security holders by the Trust. The Company retained the Certificates from securitizations in 2003, 2004, and 2006 representing the excess interest spread and other residuals, collectively referred to as residual interests.

In such transactions, the Company allocates its basis in the mortgage loans and residual interests between the portion of the assets sold through the Certificates and the portion of retained interests based on the relative fair values of those portions on the date of sale. The Company recognizes gains or losses attributable to the change in the fair value of the residual interests, which are recorded at estimated fair value and accounted for as either available-for-sale or trading securities. At September 30, 2007, the Company had $905,000 in residual interests classified as available-for-sale and $1,082,000 in residual interests classified as trading securities. The Company determines the estimated fair value of the residual interests by discounting the expected cash flows released from the Trust (the cash out method) using a discount rate commensurate with the risks involved. The values at September 30, 2007 reflect a change in the estimated timing of cash flows. Through March 31, 2007, the Company estimated that all three of its residual interests would be called at a date prior to maturity. Due to reduced liquidity in the securitization markets, the Company has changed its estimate of cash flows to reflect that the residual interests will not be called and that the resulting cash flows will be received as the loans mature and prepay. In accordance with Emerging Issues Task Force Issue No. 99-20 ("EITF 99-20"), *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets*, increases to the fair value of available-for-sale residual interests are recorded as unrealized gains, net of tax, as a component of other comprehensive income, with the yield being adjusted on a prospective basis. Decreases to the fair value, that are considered to be other than temporary, are recorded as a loss against earnings in the period of the change. Changes to the fair value of trading residual interests are recorded through earnings as a component of the gain or loss on trading securities and derivative instruments.

There is no active market which would provide market quotes for the Company's residual interests in securitizations. While management believes the estimated value of its residual interests in securitizations to be reasonable, these estimates are based upon various assumptions including, but not limited to, the performance of the loans within the securitizations, interest rates and changes in real estate values. The Company's actual experience may be different than management's assumptions and, as a result, the values ultimately realized may be materially different than the values recorded at September 30, 2007.

The Trusts have no recourse against the Company for failure of mortgage loan borrowers to pay when due. Purchasers of securitization bonds and certificates have no recourse against the other assets of the Company, other than the assets of the Trust. The Company's residual interests are subordinated to the Certificates until the Certificate holders are fully paid. The value of the Company's residual interests is subject to credit, prepayment and interest rate risk on the transferred financial assets.

Real Estate Owned

Real estate owned ("REO") results from the Company foreclosing on delinquent borrowers. These properties are held for sale and carried at the lesser of the carrying value or fair value less estimated selling costs. Individual properties are periodically evaluated and additional impairments are recorded, if necessary. At September 30, 2007, the Company had REO properties valued at $57,850,000 resulting from foreclosing on loans held for investment. At September 30, 2007, there are additional REO properties valued at $1,869,000 which are included with assets of discontinued operations.

Derivative Instruments

In connection with the Company's strategy to mitigate interest rate risk on its residual assets, mortgage loans held for sale and the repricing of long-term debt issued in securitization transactions, the Company uses derivative financial instruments such as Eurodollar futures contracts, interest rate caps, and interest rate swaps. These derivative instruments are intended to provide income and cash flow to partially offset changes in interest income and cash flows as interest rates change. However, unlike interest rate caps that will only provide cash flow to the Trusts as interest rates increase, interest rate swaps can provide both the right to receive cash flow as interest rates increase as well as the obligation to remit cash as interest rates decrease. The derivative financial instruments and any related margin accounts are included in derivative instruments in the consolidated balance sheet and are carried at their fair value. Changes in the fair value of derivative instruments are reported as gain or loss on derivative instruments within the consolidated statements of operations. Currently the Company does not use derivatives to speculate on interest rates. However, the Company may consider using derivatives as an investment instrument.

The Company held the following positions in derivatives (in thousands) at September 30, 2007:

Contract	**Notional amount**	**Fair value**
Interest rate swaps	$ 682,913	$ 5,241
Interest rate cap	703,090	7,337
Derivative instruments	$ 1,386,003	$ 12,578

During the three and nine months ended September 30, 2007, the Company recorded a loss of $8,458,000 and $2,889,000 respectively related to the Company's interest rate swaps and caps. This is comprised of a loss of $14,189,000 in fair value adjustments and settlement receipts of $5,731,000 for the three months ended September 30, 2007 and loss of $22,945,000 in fair value adjustments and settlement receipts of $20,056,000 for the nine months ended September 30, 2007 on the swaps and caps. The values of derivatives are volatile and may not be realized.

Income Taxes

The Company is not subject to tax on the earnings of the REIT it distributes to its stockholders as long as it distributes at least 90% of its taxable REIT earnings to its stockholders each taxable year and satisfies other qualifying tests. The Company has elected to have its wholly-owned subsidiary, Performance Credit Corporation, treated as a taxable REIT subsidiary ("TRS"). As a TRS, Performance Credit is subject to federal and state taxes on its income. Accordingly, the Company reports a provision for taxes based upon the earnings of Performance Credit using the asset and liability method of accounting for income taxes.

Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates for the periods in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company records a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized, as required by Statement of Financial Accounting Standards No. 109 ("SFAS 109"), *Accounting for Income Taxes.* In determining the possible realization of deferred tax assets, the Company considers future taxable income from the following sources: (i) the reversal of taxable temporary differences, (ii) taxable income from future operations and (iii) tax planning strategies that, if necessary, would be implemented to accelerate taxable income into periods in which net operating losses might otherwise expire.

The Company adopted FASB Interpretation 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No.109* on January 1, 2007. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The adoption of FIN 48 has resulted in a transition adjustment reducing beginning retained earnings by $751,000; $475,000 in taxes and $276,000 in interest. If recognized, the tax portion of the adjustment would affect the effective tax rate. Open tax return years are subject to future examination by tax authorities. Federal tax returns are open for years 2003 and after and some material state tax returns are open for years 2002 and after. For the three and nine months ended September 30, 2007, the Company has recorded tax expense related to accounting for these uncertainties of $0 and $190,000 respectively. For the three and nine months ended September 30, 2007, the Company has recorded interest expense on taxes related to accounting for these uncertainties of $26,000 and $82,000, respectively. At September 30, 2007, $665,000 and $358,000 respectively, were reserved for tax and interest related to uncertain tax positions.

Stock-Based Compensation

The Company accounts for its employee stock-based compensation under the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment*, ("SFAS No. 123(R)"). SFAS No. 123(R) requires an entity to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period.

SFAS No. 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statements of operations.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

SFAS No. 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash flows. Due to the Company's loss position, there were no such tax benefits during the three and nine months ended September 30, 2007.

In connection with the sale of the mortgage banking operations to Bear Stearns, the Company accelerated the vesting of 279,208 stock options with an exercise price less than $1.50 for those employees that were terminated in connection with the termination of their employment by Performance Credit. On May 9 and 10, 2007, approximately 1,000,000 options expired unexercised leaving approximately 789,000 options outstanding. No options were granted during the nine months ended September 30, 2007.

Under the provisions of SFAS 123(R), the Company calculates the expected term of option grants as the average of the vesting term and the contractual term. The risk free interest rate is based on the U.S. Treasury rate at the date of grant with the maturity date approximately equal to the expected life of the option. Volatility is calculated based on historical stock price volatility of the Company and similar entities over a period that approximates the expected term. The dividend rate is based upon historical dividend distributions and is adjusted based on the dividend yield of similar entities to reduce volatility in calculating this assumption.

During the three and nine months ended September 30, 2007, the Company included $0 and $20,095 respectively, in stock-based compensation expense in the consolidated statements of operations. The Company has no remaining unamortized option expense as of September 30, 2007.

Compensation related to restricted stock for the three and nine months ended September 30, 2007 was $139,000 and $778,000 respectively. The remaining unamortized restricted stock expense at September 30, 2007 was $234,000.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 155 ("SFAS 155"), *Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140.* SFAS 155 permits fair value measurement for certain hybrid instruments, clarifies which interest-only and principal-only strips are subject to Statement of Financial Accounting Standards No. 133 ("SFAS 133"), *Accounting for Derivative Instruments and Hedging Activities*, clarifies and establishes requirements related to derivatives embedded in beneficial interests issued in securitizations, and amends SFAS 140 to eliminate the prohibition on QSPEs holding certain derivative financial instruments. SFAS 155 is effective for fiscal years beginning after September 15, 2006. The Company's adoption of SFAS 155 has not had a material effect on its financial statements.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 ("SFAS 156"), *Accounting for Servicing of Financial Assets* — an amendment of FASB Statement No. 140. SFAS 156 requires companies to record a servicing asset or servicing liability each time they undertake an obligation to service a financial asset from (i) the transfer of financial assets that meet the requirements for sale accounting, (ii) a transfer of financial assets to a QSPE in a guaranteed mortgage securitization in which the transferor retains the securities and accounts for them as available-for-sale or trading, or (iii) an acquisition or assumption of an obligation to service financial assets that does not relate to financial assets of the servicer or its affiliates. In addition, SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The Company's adoption of SFAS 156 has not had a material effect on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS 157”), *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (“GAAP”), and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is presently evaluating the impact of the adoption of SFAS 157 on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (“SFAS 159”), *Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is presently evaluating the impact of the adoption of SFAS 159 on its financial statements.

NOTE B—DISCONTINUED OPERATIONS

In accordance with Statement of Financial Accounting Standards No. 144 (“SFAS 144”), *Accounting for the Impairment of Disposal of Long Lived Assets*, the assets and liabilities related to this transaction were segregated as follows in the accompanying consolidated balance sheet. In addition, operations associated with these assets and liabilities and the loss on the sale have been classified as loss from discontinued operations in the accompanying consolidated statements of operations.

Discontinued operations results were as follows:

	Balance at September 30, 2007
Assets of discontinued operations	(in thousands)
Mortgage loans held for sale	$ 185
Other assets	5,296
Total assets of discontinued operations	$ 5,481
Liabilities of discontinued operations	
Warehouse and repurchase facilities	$ 7
Other liabilities	8,208
Total liabilities of discontinued operations	$ 8,215

	For the three months ended September 30, 2007	For the nine months ended September 30, 2007
	(in thousands)	
Net interest income	$ 52	$ (1,005)
Gain on sale of loans	575	1,492
Gain on derivative instruments, net	-	350
Net revenues	627	837
Operating expenses	2,801	15,423
Servicing fees	134	250
Income tax provision	33	221
Net expenses	2,968	15,894
Net loss before other income	(2,341)	(15,057)
Other income	-	21,461
Net (loss) income	$ (2,341)	$ 6,404

Discontinued operations for the three and nine months ended September 30, 2007 reflects the activity and related costs of managing the remaining liabilities and obligations related to the post sale wholesale mortgage origination operations to Bear Stearns.

NOTE C—LOANS HELD FOR INVESTMENT

The components of mortgage loans held for investment at September 30, 2007 were as follows:

	September 30, 2007	Weighted Average Coupon
	(in thousands)	
Unpaid principal balance of mortgage loans	$ 1,509,959	8.36%
Net deferred origination costs and discount	16,268	
Allowance for loan losses	(82,058)	
	$ 1,444,169	

The following table presents a summary of the activity for the allowance for losses on mortgage loans held for investment for the three and nine months ended September 30, 2007:

	For the three and nine months ended September 30, 2007	
	Three months	Nine months
	(in thousands)	
Beginning balance	$ 85,382	$ 43,425
Additions	10,746	75,707
Charge-offs, net	(14,070)	(37,074)
Ending balance	$ 82,058	$ 82,058

NOTE D—RESIDUAL INTERESTS IN SECURITIZATIONS

The following table summarizes activity in residual interests:

	For the three and nine months ended September 30, 2007	
	Three months	Nine months
	(in thousands)	
Beginning balance	$ 2,163	$ 45,920
Residual interests	-	-
Mark-to-market adjustment	258	(10,740)
Accretion of residual interests	118	4,533
Cash received from residual interests	(551)	(37,725)
Ending balance	$ 1,988	$ 1,988

The Company uses certain assumptions and estimates to determine the fair value allocated to the residual interests at the time of initial sale and each subsequent reporting date in accordance with SFAS 140. These assumptions and estimates include projections concerning the various rate indices applicable to the Company's loans and the pass-through rate paid to bondholders, credit loss experience, prepayments rates, and a discount rate commensurate with the risks involved. These assumptions are reviewed periodically by management. If these assumptions change, the related asset and income would be affected.

Unpaid loan principal balances underlying the Company's residual interests in securitizations aggregate $159,977,000 as of September 30, 2007. A total of 15.73% of unpaid principal balances are delinquent 60 or more days, in bankruptcy or foreclosure or are real estate owned at September 30, 2007.

NOTE E—LONG-TERM DEBT

Long-term debt consists of mortgage-backed securities secured solely by mortgages transferred to the related securitization trust and are non-recourse to the Company. The principal and interest payments on the mortgages provide the funds to pay debt service on the securities. The interest rate on the securities resets monthly and is based upon one-month LIBOR. The weighted-average interest rate payable on the Company's long-term debt at September 30, 2007 was 6.09%. As principal payments on the underlying mortgages are paid through to reduce principal on the bonds, the term of the bonds is ultimately a function of the rate at which principal is paid on the mortgages. The Company cannot estimate when the bonds will be fully repaid. The bonds will mature in 2035. The bonds have a "clean-up call" provision which allows the Company to dissolve the Trust and repay outstanding bonds when the remaining principal balance of the underlying loans is 10% or less of their original balance. The timing of when the Company may be able to exercise the call provision may be delayed based upon the tightening of credit standards for subprime borrowers and the continued deterioration of the mortgage and real estate markets.

As of September 30, 2007, the balance of long-term debt consists of the following:

	September 30, 2007
	(in thousands)
Securitized bonds	$ 1,508,417
Discount on bonds	(4,710)
Accrued interest on securitized bonds	1,275
Total financing on mortgage loans held for investment	$ 1,504,982

Costs associated with issuing long-term debt were capitalized and are being amortized as a component of interest expense over the estimated term of the debt, expecting that the debt will be paid fully from the cash flows from the underlying collateral. Through September 30, 2007, total deferred bond issue costs of $16,168,000 were capitalized. The balance of deferred bond issue costs at September 30, 2007, net of accumulated amortization, was $2,823,000 and is included in prepaid expenses and other assets.

The discount on bonds reflects the difference between the proceeds received from the sale of the bonds and the face amount to be repaid over the life of the bonds. The discount is being amortized as an adjustment to interest expense over the estimated life of the bonds.

NOTE F—SETTLEMENT AGREEMENT

On June 29, 2007, the Company entered into a Settlement Agreement and Release with Friedman, Billings, Ramsey Group, Inc. ("FBR"), whereby FBR agreed to terminate the Company's obligations under the Registration Rights Agreement, dated as of February 14, 2005 (the "Registration Rights Agreement"). The Registration Rights Agreement required, among other things, that the Company file a registration statement with the U.S. Securities and Exchange Commission relating to the offer and sale of FBR's 3,940,110 shares of the Company's common stock within a year after the Company's initial public offering and keep the registration statement effective for a certain period of time. If the Company was not able to satisfy its obligations under the Registration Rights Agreement, the Company could be liable for monetary damages. Due to its inability to timely file its periodic reports with the SEC, the Company was not able to maintain the effectiveness of its registration statement on Form S-3 filed in accordance with the terms of the Registration Rights Agreement.

On July 5, 2007, under the terms of the Settlement Agreement and Release with FBR, the Company paid FBR a total of approximately $2.3 million in exchange for (1) a complete release of the Company's obligations to FBR under the Registration Rights Agreement and (2) the purchase of 3,940,110 shares of the Company's common stock owned by FBR. The purchase price of the common stock was $0.34 per share, based upon the closing price reported on the Over-the-Counter Bulletin Board on July 3, 2007. The purchase of the 3,940,110 shares of the company's common stock was accounted for

and treated as a reduction of outstanding shares in the third quarter 2007. The expense of $964,000 related to the release of the Registration Rights Agreements was accrued through the second quarter 2007.

NOTE G—COMMITMENTS AND CONTINGENCIES

On April 4, 2007, Performance filed suit in the Central District of California, Southern Division, against EMC Mortgage Corporation ("EMC"), a subsidiary of Bear Stearns, seeking damages of more than $20 million for alleged breach of contract in connection with EMC's purchases of Performance's residential mortgage loan portfolio during the period from and after October 10, 2006 and related matters (as amended, the "Complaint"). The Complaint alleges that EMC agreed to purchase and securitize Performance's entire loan production monthly and assume responsibility for any early payment defaults by mortgage loan borrowers. The Complaint also alleges that EMC breached the agreement by, among other things, delaying the purchase of certain loans originated by Performance and failing to securitize monthly. As a result of these alleged breaches by EMC, the Complaint alleges that Performance suffered losses of more than $20 million when these mortgage loans declined in value from the date EMC agreed to purchase such loans until the date EMC ultimately did purchase them. EMC filed counterclaims against the Company alleging breaches by Performance in connection with EMC's purchases of Performance's residential mortgage loan portfolio, in connection with which EMC seeks damages of approximately $16 million. The Company believes the counterclaims are without merit and intends to vigorously defend against such claims. However, the Company cannot guarantee the outcome in this matter.

Performance has also asserted claims against EMC for breach of a Loan Servicing Agreement ("Servicing Agreement"). Performance originally asserted this claim in arbitration but, by agreement between Performance and EMC, this claim will be adjudicated as part of the Complaint. Performance alleges that EMC breached the Servicing Agreement by failing to act diligently to collect all payments due under each of the mortgage loans required to be serviced and otherwise to perform its obligations under the Servicing Agreement. Performance seeks damages of more than $5 million for EMC's breaches of the Servicing Agreement.

Although the Company believes that its claims are well-founded, as is true of all legal proceedings, it is impossible at an early stage to predict with accuracy the likely outcome or amount of recovery, if any, that may be obtained from these actions. The Company expects that there will be substantial costs associated with the prosecution of these claims, which may never be recouped and which may have a material effect on its results of operations. In addition, Bear Stearns has significantly more resources than the Company, which may lead to prolonged litigation and increased expenses related to the prosecution of these claims.

The Company has been involved, from time to time, in a variety of mortgage lending related claims and other matters in the ordinary course of its business. In the Company's opinion, the resolution of any of these pending matters is not currently expected to have a material adverse effect on its consolidated financial position and results of operations.

Management Overview

You should read this information with the Company's consolidated financial statements and related notes and the information provided in the Company's Form 10-K for the year ended December 31, 2006 and interim quarterly reports. The following information contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and are subject to risks, uncertainties and other factors that may cause the Company's actual results to differ materially from those expressed or implied. You are urged to carefully review and consider the various disclosures made herein as we attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and cash flows.

The Company is a REIT that invests in residential mortgage loans. The Company owns and manages interests in securitization trusts which issued securities collateralized by mortgages on residential real estate. Its principal sources of revenue are net interest income on its portfolio of loans held for investment and interest accretion on its investments in residual interests in its securitizations. As part of managing the Company's portfolio of loans held for investment, it may also originate mortgage loans as a broker to generate additional revenue from borrowers wishing to prepay their mortgage loans or to facilitate the workout or modification of a loan to mitigate losses. The Company refers to this as portfolio protection. Revenue generated from its portfolio protection activities is not material to its financial statements.

The Company intends to maintain the size and scope of its current operations for the foreseeable future in connection with trying to maximize the value of its loan portfolio. The Company is evaluating various operating alternatives which include, among other things, managing its existing investments in its securitizations, acquiring loan portfolios for securitization and making investments in other residual interests in securitizations. In addition, the Company may consider other opportunities if they appear to provide advantageous returns for shareholders. The Company intends to maintain its REIT status for the period of time during which it holds residual interests in its securitizations. As a REIT, earnings the Company distributes to

its stockholders are not subject to income tax for federal or state purposes as long as the Company distributes at least 90% of its taxable earnings and satisfies certain other qualifying tests.

The Company has cautioned on several occasions about the uncertainty of any distributions to shareholders due to the adverse, changing and unpredictable environment in which it operates, the continued deterioration of the subprime lending industry and the subsequent adverse effects these factors have on the Company's loan portfolio. The Company is unable to provide any dividend guidance at this time because the timing and amount of any distributions to shareholders remains uncertain and dependent upon many factors, such as the need to retain: (1) cash reserves for continued Company operations in case of further deterioration of the Company's cash flows; (2) capital required to maximize the value of its residuals investments through the potential purchase of non performing loans or foreclosed real estate; and (3) cash to fund distributions of REIT taxable income. In addition, the Company is continuing to explore opportunities to maximize shareholder value which may impact the timing and amount of any future distributions

For the three and nine months ended September 30, 2007, the Company reported a net loss of $22.3 million and $84.7 million, respectively. These losses have reduced total stockholders' equity to $34.2 million at September 30, 2007 from $128 million and $57.8 million at December 31, 2006 and June 30, 2007, respectively. The net loss is primarily attributed to the following factors:

- The Company continued to experience higher levels of delinquency and loss severity on mortgage loans held for investment. After realizing losses of $14.2 million for the three months ended September 30, 2007, the loan loss allowance was reduced to $82.1 million as compared to $85.4 million at June 30, 2007;
- The value of the Company's interest rate swaps and caps has decreased $14.2 million for the three months ended September 30, 2007. The decrease in value is attributable to the change in yield conditions as well as $5.7 million in swap and cap payments received in the same three month period;
- Net interest income from loans held for investment has declined reflecting (i) reversal of previously accrued interest and reduction in accrued interest due to a higher percentage of loans delinquent greater than 90 days, (ii) a reduction in prepayment penalty income due to the expiration of the prepayment penalty periods and a slower rate of prepayment, (iii) a significant decline in levels of interest earning assets as we have experienced prepayments through September 30, 2007 with no additions since the fourth quarter 2005, and (iv) higher borrowing costs, in particular with respect to the securitizations within the portfolio investment operations where borrowing costs adjust monthly and a portion of the adjustable rate mortgage loans have not reached scheduled interest rate reset dates; and
- The first quarter 2007 reflected both income and loss resulting from the operations of our wholesale loan origination business and the gain on sale of the operations to Bear Stearns. Whereas, the second and third quarter operations reflect only the cost related to winding up the related discontinued operations.

Mortgage Loans and Origination Costs and Fees

The Company's mortgage loans are classified as either held for sale or held for investment. Mortgage loans held for sale are carried at the lower of cost or market on an individual loan basis. Market value is determined by reference to prices obtained on prior bids, prior sales of similar loans, planned loan sale transactions, or through the expected resolution should the loan go to default, become a REO and be liquidated. The provision to reduce held for sale loan inventory to the lower of cost or market is charged against gain on sale of loans.

The Company capitalizes the fees received from borrowers at the time of loan origination, and various costs of originating loans, which consist of fees and premiums paid to brokers, as well as certain direct internal costs. Net capitalized origination costs and fees on loans held for sale are charged to expense at the time the related loans are sold and reduce the gain on sale recorded. Net capitalized origination costs and fees on loans held for investment are amortized as a component of interest income over the life of the portfolio using the effective yield method in a manner that anticipates prepayments.

Allowance for Losses on Mortgage Loans Held for Investment

For the Company's mortgage loans held for investment, it establishes an allowance for loan losses based on its estimate of losses inherent and probable as of the balance sheet date. To date, the Company has had increasing losses and as its portfolio continues to mature it expects more losses. The Company plans to compare actual loss performance to original loss assumptions and, if necessary, make adjustments to the allowance for losses. As its portfolio of loans held for investment ages, the Company expects its allowance for losses to increase accordingly.

The Company ceases accruing interest income on loans when any portion of principal or interest is 90 days past due, or earlier when any concern exists as to the ultimate collectibility of principal or interest. Interest income recognized prior to loans becoming 90 days past due is reversed.

Gain or Loss on Sale of Loans

The Company recognizes a gain or loss on the sale of its loans it sells through whole loan sales. Gains or losses resulting from these sales or securitizations of mortgage loans are recognized at the date of settlement and are based on the difference between the selling price for sales or securitizations and the carrying value of the related loans sold. As part of the sale of a mortgage loan, the Company sells the servicing rights. The purchasing company pays the Company a service release premium for that right. As the Company terminated this aspect of its business upon the sale to Bear Stearns, this premium is included in discontinued operations in the accompanying consolidated statements of operations. Retained interests in securitizations accounted for as sales are measured by allocating the previous carrying value between the loans sold and the interests retained, if any, based on their relative fair values at the date of transfer.

Allowance for Repurchase Losses

The terms of the Company's loan sale agreements generally require it to repurchase loans where it has been determined that representations and warranties made by the Company at the time of sale have been breached or loans for which the borrower has missed the first payment due to the purchaser of the loan. The Company establishes an allowance for such losses based upon its evaluation of historical experience with respect to the principal, premium, interest losses and other costs, if any, expected to occur in the fulfillment of its repurchase obligations. Losses incurred on mortgage loans that the Company has sold and subsequently repurchased are charged to the allowance for repurchase losses.

Fair Value of Residual Interests in Loan Securitizations

In securitizations completed during 2003, 2004 and 2006, the Company conveyed loans that it originated to a special purpose entity (such as a trust), or to a third party that subsequently sold the loans to a special purpose entity, in exchange for cash proceeds and a residual interest in the trust. The cash proceeds were raised through an offering of the pass-through certificates or bonds evidencing the right to receive principal payments and interest on the certificate balance or on the bonds. The Company recorded gain or loss on sales of loans, equal to the difference between the portion sold and any retained interests, herein referred to as residual interests, based on their relative fair values at the date of transfer and its basis in the loans. The residual interests represent, over the estimated life of the loans, the present value of the estimated cash flows. Each agreement that the Company has entered into in connection with these securitizations requires over-collateralization which may initially be funded by cash or an excess of loans deposited into the trust. The amount and timing of any over-collateralization released from the securitization trusts depends on, among other things, the applicable delinquency and credit loss limits specified in the securitization agreements.

The Company determined the present value of the cash flows at the time each securitization transaction closed using certain assumptions and estimates made by management at the time the loans were sold. These assumptions and estimates included:

- estimates of future interest rates based upon the forward London Interbank Offered Rate, or LIBOR, curve;
- future rates of principal prepayment on the loans;
- timing and magnitude of credit losses; and
- discount rate used to calculate present value.

The future cash flows represent management's best estimate. There can be no assurance of the accuracy of management's estimates. Most of the Company's residual interests are recorded at estimated fair value and are marked to market through a charge (or credit) to earnings. On a quarterly basis, the Company reviews the fair value of its residual interests by analyzing prepayment, credit loss, discount rate assumptions and other performance assumptions and estimates in relation to its actual experience and current rates of prepayment and credit loss prevalent in the industry. The Company may adjust the value of its residual interests or take a charge to earnings related to the residual interests, as appropriate, to reflect a valuation or write-down of the residual interests based upon the actual performance of the residual interests as compared to the Company's key assumptions and estimates used to determine fair value. Although management believes that the assumptions used to estimate the fair value of the residual interests are reasonable, there can be no assurance as to the accuracy of the assumptions or estimates. Estimated future cash flows in excess of the amortized cost of the investment in residual interests are recognized as income at a constant rate of interest (level-yield) over the estimated period of time that the cash flows will be received.

Deferred Bond Issuance Costs

Direct costs associated with the issuance of long-term collateralized debt are capitalized and amortized as a component of interest expense in a manner that produces a constant rate of interest over the estimated term of the debt, expecting that the debt will be paid fully from the cash flows from the underlying collateral. Changes in the estimated amount and timing in cash flows of the collateral that pass through to the debt may cause the Company to amortize deferred bond issuance costs faster or slower than the Company anticipated upon issuance of the bonds.

Derivative Financial Instruments and Hedging Activities

Hedging is a critical aspect of the Company's business because the value of its assets is sensitive to the fluctuation of interest rates. From time to time, the Company has used, and will continue to use, various financial instruments to economically hedge its exposure to changes in interest rates. While the Company may change the classification of its derivative financial instruments in the future, the Company presently accounts for its derivative financial instruments as trading instruments.

To date, the Company has not entered into derivative instruments, except for hedging purposes. However, the Company may use derivatives as an investment instrument. It is unlikely that the Company can obtain hedging instruments that perfectly offset all of the risks of our assets and liabilities. No hedging strategy can completely insulate the Company from risk, and certain of the federal income tax requirements that it must satisfy to qualify as a REIT may limit the Company's ability to hedge. The Company intends to monitor and may have to limit its hedging strategies to ensure that it does not realize excessive hedging income or hold hedging assets having excess value in relation to its total assets.

During the fourth quarter of 2007, the Company purchased an interest rate cap for $651,000 that is intended to hedge a portion of the cost of long term debt that funded loans held for investment. Due to slowing prepayments, the Company believes that this hedge will help supplement residual cash flows that would be reduced if interest rates increase significantly in the future and the life of the mortgage pools are extended beyond the term of our existing hedges. This hedge will be accounted for as a trading instrument

Operating Results

Net Interest Income. The unpaid principal balances on the Company's portfolio of loans held for investment declined from $2.4 billion at December 31, 2006 to $1.5 billion at September 30, 2007 as a result of normal principal payments, loan prepayments and increasing foreclosures. Similarly, the outstanding bond balances secured by these mortgage loans declined from $2.4 billion at December 31, 2006 to $1.5 billion at September 30, 2007.

Interest income is earned on our portfolio of loans held for investment and investments in residual interests.

	Three months ended	
	September 30, 2007	June 30, 2007
	(in thousands)	
Loans held for investment		
Coupon interest	$ 30,833	$ 37,131
Premium amortization	(1,829)	(2,257)
Prepayment penalties	828	1,398
Total	29,832	36,272
Residual accretion	118	1,061
Investment interest income	228	164
Total interest income	$ 30,178	$ 37,497

Residual accretion decreased during the second quarter of 2007 reflecting a lower residual balance due to significant one-time cash receipt from off balance sheet securitizations completed in 2004 and 2003.

Premium amortization and prepayment penalties decreased due to slowing of prepayments and normal seasoning of the portfolio. As a result of aging of the portfolio, many of the remaining loans are outside of the prepayment penalty period.

Interest expense primarily relates to long-term debt, which consists of mortgage-backed bonds issued in connection with our securitizations. Components of interest expense are summarized as follows:

	Three months ended			
	September 30, 2007		June 30, 2007	
	(in thousands)			
Bond interest	$	25,011	$	29,193
Amortization of bond discount and deferred bond issuance costs		1,457		1,627
Total interest expense	$	26,468	$	30,820

Net interest income (difference between interest income and interest expense) is summarized as follows:

	Three months ended			
	September 30, 2007		June 30, 2007	
	(in thousands)			
Interest income	$	30,178	$	37,497
Interest expense		26,468		30,820
Net interest income	$	3,710		6,677

Provision for Loan Losses. The provision for loan losses is summarized as follows:

	For the three and nine months ended September 30, 2007			
	Three months		Nine months	
	(in thousands)			
Beginning balance	$	85,382	$	43,425
Additions		10,746		75,707
Charge-offs, net		(14,070)		(37,074)
Ending balance	$	82,058	$	82,058

The Company believes delinquency levels as of September 30, 2007 have increased due in part to seasoning of the loan portfolio, increasing interest rates, expiration of the initial fixed interest rate periods and present adverse market conditions. Although unpaid principal balances at September 30, 2007 have declined from the prior quarter by 15.4%, the allowance for loan losses has increased as a percentage of the outstanding portfolio balance from 4.8% as of June 30, 2007 to 5.4% as of September 30, 2007. The Company anticipates delinquencies and loss severity will continue to increase through the remainder of 2007.

As of September 30, 2007, the allowance for loan losses represents 17.3% of unpaid principal balances 60 days or more delinquent. Through September 30, 2007, average loss severity on all liquidated loans has been 32.28%. For the three and nine months ended September 30, 2007, average loss severity on liquidated loans during these periods was 42.41% and 38.15%, respectively. The Company believes average loss severity on liquidated loans may continue to increase.

In assessing the adequacy of the allowance for loan losses, management considers, among other things, current delinquency trends. Loan delinquency information is summarized as follows (amounts in thousands):

	September 30, 2007		December 31, 2006	
Aging	**Loan balance**	**Percentage of total**	**Loan balance**	**Percentage of total**
Current	1,159,363	76.8%	2,133,450	88.2%
30-59 days past due	86,233	5.7%	88,274	3.6%
60-89 days past due	49,099	3.3%	41,562	1.7%
90-119 days past due	38,309	2.5%	27,840	1.1%
120-149 days past due	33,618	2.2%	23,884	1.0%
150-179 days past due	32,639	2.2%	22,222	0.9%
180+ days past due	110,698	7.3%	84,985	3.5%
	$ 1,509,959		$ 2,422,217	
Bankruptcy/foreclosure	$ 210,631	13.9%	$ 159,239	6.6%

Gain (Loss) on Derivative Instruments and Trading Securities. The net gain on derivative instruments consists of the following:

	For the three months ended	
	September 30, 2007	June 30, 2007
	(in thousands)	
Residual market-to-market loss	$ 258	$ (8,268)
Derivative gains (losses):		
Interest rate agreements	(14,189)	665
Net receipts under interest rate agreements	5,731	6,584
	$ (8,200)	$ (1,019)

The Company completed a securitization of approximately $1.1 billion in assets in May 2006. The fair value assigned to the residual interests at the date of securitization was $50,185,000. In July 2006, the Company sold a portion of its residual interests in this securitization which reduced the fair value of its residual interests to approximately $33 million. In February 2007, the Company completed the sale of its remaining interests in this securitization for $20 million.

A summary of the fair values of our residual interests in securitizations is as follows:

	Values as of	
	September 30, 2007	December 31, 2006
	(in thousands)	
SASCO ECC 2003-1	$ 905	$ 3,525
CWABS ECC 2004-1	141	9,407
CWABS ECC 2004-2	942	12,988
Bravo Mortgage Asset Trust 2006-1	-	20,000
Total	$ 1,988	$ 45,920

The values of the securitizations the Company completed in 2003 and 2004 decreased for the following three reasons. First, the Company recorded cash flows from these residual interests during 2007. Second, through March 31, 2007, based on historic trends the Company estimated that all three of its residual interests would be called at a date prior to maturity. Due to reduced liquidity in the securitization markets, the Company has changed its estimate of cash flows to reflect that the residual interests will not be called and that the resulting cash flows will be received as the loans mature and prepay. Third, the

discount rates used to determine the value were updated from 33% for SASCO ECC 2003-1 to 23% and from 18% for CWABS ECC 2004-1 and CWABS ECC 2004-2 to 23%. Loan principal balances in the 2003 securitization have paid down to the point that the servicer may exercise their clean up call rights, upon which the balance of the overcollateralization account within the securitization will be released to the Company. The Company is unable to determine when or if such a clean up call will occur and as previously stated the Company does not believe that the call will be exercised in the near future.

Operating expenses. The decline in operating expenses is consistent with the sale of the Company's mortgage banking operations to Bear Stearns that occurred on February 9, 2007.

The Company shared personnel and services with its subsidiaries, principally Performance through the date of the sale of the mortgage origination business to Bear Stearns. Operating expenses for the three and nine months ended September 30, 2007 include the costs associated with these shared personnel and services. Many of the personnel providing such services became employees of Bear Stearns after February 9, 2007. Although the number of employees was significantly reduced following the completion of the sale of the mortgage origination business to Bear Stearns and while there can be no assurances as to the amount of operating expenses we incur in the future, we have seen a reduction in operating expenses for the three months ended September 30, 2007 as compared to March 31, 2007. The Company does not anticipate any material reductions in operating costs in the near future.

Servicing fees. Servicing fees are paid to third party loan servicers that service our portfolio of loans held for investment.

Off-Balance Sheet Arrangements

In connection with off-balance sheet securitization transactions, there were $160 million in loans remaining in off-balance sheet trusts as of September 30, 2007. The trusts have issued securities or bonds secured by these loans. The Company has no obligation to provide funding support to either the third party investors or the off-balance sheet trusts. The third party investors, or the trusts, generally have no recourse to the Company's assets or it.

Contractual Obligations and Commercial Commitments

Through August 31, 2007, the Company has entered into various agreements to terminate or sublease all of its material operating leases of office space and other real estate, with the exception of two leases. On September 6, 2007, the Company entered into a lease that provides space for the remaining work force through December 31, 2008. The Company holds a minority ownership interest in a small retail lending business which is consolidated in the financial statements. That business leases office space under another lease arrangement that has been guaranteed by the Company and there is no assurance that the subtenants will meet their obligations under the sublease agreements. The Company's remaining lease obligations at September 30, 2007 are $4.3 million.

The Company had no active warehouse and repurchase facilities at September 30, 2007.

Securitizations

The Company's principal source of liquidity is its cash currently held and the cash flow it receives from its securitizations. The Company created its securitizations through the transfer of loans to a trust that issued long-term debt or bonds collateralized by the loans. The trust collects the principal and interest on the loans and passes through all principal collected to the bondholders. Interest is paid to holders of the debt based upon the stated rate associated with the class of debt. The difference between the interest collected on the loans and interest paid to the bondholders and ongoing expenses of the trust is excess cash flow. The excess cash flow provides additional collateral to the bondholders as it is available to absorb losses realized on defaulted loans. To the extent excess cash flow exceeds losses on the loans, it is used to pay down principal on senior securities issued by the trust to create additional collateralization (over-collateralization or OC) until specified OC levels are maintained by the trust. Any excess cash flow not required to cover losses or build OC will be distributed to the Company. A release of the OC cash is allowed on step-down dates if a predetermined loss trigger or a dynamic delinquency trigger has not been exceeded. The delinquency trigger is a function of a senior enhancement percentage. Three month running delinquency levels at October 2007 for the Company's securitizations Encore Credit Receivables Trust 2005-1, 2005-2, 2005-3 and 2005-4 are 20.48%, 19.09%, 15.68% and 16.29%, respectively. If delinquencies continue to increase in these securitizations, management has no ability to predict if, or when, an OC release may occur. In addition to excess cash flow from the securitizations, the Company may receive servicing fees if it has retained ownership in the servicing rights on the loans included in the trust. The Company receives cash flows from securitizations as described regardless of whether the securitization is accounted for as a sale or a financing.

While management believes that cash flows from the Company's securitizations, including cash made available from the sale or financing of all or part of the Company's retained interests in securitizations as well as cash on hand, will be adequate to provide for operating needs through 2008 and make the minimum distributions to retain REIT status, there can be no assurances that this will occur. There have been significant adverse market conditions in the subprime mortgage industry because of increasing loan defaults and losses, slowing property appreciation and, in some cases, declines in housing prices. If loan delinquencies and losses continue to increase within the securitizations, cash flows the Company receives from its securitizations may be significantly reduced. Based on current market conditions, the Company's ability to sell and or satisfactorily finance certain assets may be adversely impacted. These market conditions as well as a possible decline in expected cash flows from the residual interests in securitizations may negatively impact the cash flow generated from the Company's securitizations and their value. Further, these market conditions may negatively impact the Company's ability to meet its obligations, including its ability to make additional dividend distributions.

The Company is in the process of transferring the servicing of its loan portfolio to Select Portfolio Services, Inc. ("SPS"). The Company believes that the services provided by SPS will benefit the Company's loan portfolio. As with any servicing transfer, there may be a short-term adverse impact on loan performance. However, the Company believes that any possible adverse impact should be offset by the long-term benefits of transferring the loan servicing to SPS.

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Through September 30, 2007, the Company had completed eight securitizations. A summary of the Company's seven remaining securitizations' initial and current balances and over collateralization requirements as of September 30, 2007 is as follows:

	As of September 30, 2007						
	Date of securitization	Scheduled loan principal balances		Bond balances	Over collateralization		
Securitization		Initial	Current		Currently required	Current balance	60+ days delinquencies (1)
		(in thousands)					
Retained interests							
SASCO ECC 2003-1	Apr-03	$ 278,718	$ 20,866	$ 17,125	$ 3,763	$ 3,741	22.3%
CWABS ECC 2004-1	Jul-04	530,000	67,000	63,961	3,082	3,082	15.4%
CWABS ECC 2004-2	Sep-04	549,464	72,111	68,235	4,038	3,876	14.1%
Financing transactions							
ECR 2005-1	Mar-05	1,600,004	325,293	304,492	20,800	20,800	22.1%
ECR 2005-2	May-05	1,400,000	394,941	378,420	16,800	16,520	21.8%
ECR 2005-3	Aug-05	1,029,348	363,435	334,099	29,336	29,336	18.7%
ECR 2005-4	Nov-05	1,000,002	499,294	491,405	8,000	7,889	16.6%
Total			$ 1,742,940	$ 1,657,737	$ 85,819	$ 85,244	

(1) 60+ days delinquencies also include bankruptcies, foreclosures and REO.

A summary of cash flows received by the Company from its retained interests in each securitization during the three and nine months ended September 30, 2007 are as follows (amounts in thousands)**:**

Securitization	**Three months ended September 30, 2007**	**Nine months ended September 30, 2007**
Retained interests		
SASCO ECC 2003-1	$ -	$ 30
CWABS ECC 2004-1	432	7,408
CWABS ECC 2004-2	119	10,289
Bravo Mortgage Asset Trust 2006-1	-	20,000
Financing transactions		
ECR 2005-1	1,070	5,557
ECR 2005-2	174	4,444
ECR 2005-3	2,759	8,547
ECR 2005-4	319	3,071
Total	$ 4,873	$ 59,345

As of September 30, 2007, the Company received distributions of cash flow from all of its securitizations except SASCO ECC 2003-1. The Company sold its interest in Bravo Mortgage Asset Trust ("BMAT") 2006-1 in February 2007 for $20 million. The Company is continuing to explore opportunities to maximize the value and liquidity of its remaining retained interests, including the sale or financing of all or part of its retained interests in securitizations.

Other Borrowings

From time to time the Company may also enter into repurchase borrowing arrangements, pledging securities it owns as collateral or may borrow against the cash surrender value of corporate owned life insurance ("COLI"). At September 30, 2007, the Company had no outstanding borrowings against the COLI. The total cash surrender value of the COLI, including amounts securing borrowings, was $14.4 million at September 30, 2007. On September 7, 2007, the Company terminated its deferred compensation plan which will result in payments of its related liability through January 2008. The Company's liability to the plan at September 30, 2007 was $2.0 million.

Interest Rate Risk

The Company is subject to interest rate exposure relating to its portfolio of mortgage loans held for investment. Changes in interest rates impact the Company's future earnings in various ways. The interest expense on the mortgage-backed securities is typically adjusted monthly relative to market interest rates, generally the one-month LIBOR. However, the interest on the underlying mortgage loans is based on fixed rates payable on the underlying loans, generally for the first two or three years from origination, while the holders of the applicable securities are generally paid based on an adjustable LIBOR-based yield. Further, the interest rates on hybrid/adjustable-rate mortgage loans may be capped for the first adjustment, per adjustment period and for the life of the loan (commonly referred to as the initial cap, the periodic cap and the lifetime cap, respectively), and the Company's borrowings may not have similar limitations. Finally, interest rates on hybrid/adjustable-rate mortgage loans typically change less frequently than the applicable interest rates on the Company's liabilities.

The rate of prepayment on mortgage loans may increase if interest rates decline or if the difference between long-term and short-term interest rates diminishes. Increased prepayments would cause the Company to amortize the premiums paid for its mortgage loans faster, resulting in a reduced yield on its mortgage loans. Increased prepayments would also reduce the length of time it receives excess cash flow from its securitizations, reducing the value of its retained interests in securitizations.

Conversely, the rate of prepayment on mortgage loans may decrease if interest rates rise or if the difference between long-term and short-term interest rates increases. Decreased prepayments would cause the Company to amortize the premiums paid for its hybrid/adjustable-rate mortgage loans over a longer time period, resulting in an increased yield on its mortgage loans. Decreased prepayments would also increase the length of time the Company receives excess cash flow from its securitizations, increasing the value of its retained interests in securitizations.

Interest rate changes may also impact the Company's equity as its residual interests and derivative instruments are held at fair value. In general, the Company would expect that over time, decreases in income from its loan portfolio attributable to interest rate changes will be offset to some degree by increases in cash flow received from its derivative instruments and vice versa. Changes in market interest rates affect the Company's estimates of the fair value of its mortgage loans held for investment and related derivatives.

Credit Risk

Loans the Company carries as held-for-investment are subject to the risk that a borrower will default, requiring foreclosure on and disposition of the collateral at an amount less than the principal and accrued interest. The Company's interests in its securitizations are subordinate to other interests and absorb the losses incurred on these loans, reducing the cash flows ultimately distributed to it. However, the Company is not obligated to fund losses beyond the interests it holds in the securitizations.

In recent years there have been a number of "non-traditional" mortgage loan products offered to borrowers such as hybrid loans (interest rate fixed for a period and then converts to adjustable), interest only loans, 80/20 loans (an 80% first mortgage "piggybacked" with a 20% second mortgage) and mortgages with terms in excess of the traditional 30 years (e.g., 40 years). These non-traditional mortgage loan products carry a higher credit risk principally due to the risk of "payment shock" (described below) and/or the limited equity a borrower may have in the collateral.

The Company generally qualifies its borrowers based upon the initial payment for the mortgage loan. If the payment is subject to adjustment at some future point in time and if interest rates increase, the borrower's income may not be able to support the monthly payment on the loan when the formerly fixed payment adjusts upward to reflect the increased interest rate (i.e., payment shock).

A summary of loan products in the Company's portfolio of loans held for investment at September 30, 2007 follows:

	As of September 30, 2007					
Product	**Loan Count**	**Loan Balance (in thousands)**	**Weighted Average Coupon**	**FICO Score (1)**	**Loan to Value (1)**	**Debt to Income (1)**
2/28 ARM	2,645	450,543	9.90%	594	81	40
30 YR Fixed	1,753	335,614	6.90%	645	76	40
Stated Income	631	139,183	8.80%	637	78	39
2 Yr Full Doc	586	102,147	8.27%	618	80	40
1 Yr Full Doc	474	87,940	8.31%	616	78	41
3/27 ARM	348	67,493	7.42%	619	82	39
2 YR I/O 2/28 ARM	243	65,967	9.67%	652	82	41
2/28 Dual	219	57,756	7.67%	594	78	41
5 YR I/O 2/28 ARM	196	53,225	7.06%	655	83	40
15 YR Fixed	102	11,196	7.17%	630	66	36
5 YR I/O 30 YR Fixed	100	28,697	6.57%	688	76	40
5 YR 5/25 ARM	95	20,458	6.72%	647	77	42
5 YR I/O 3/27 ARM	89	26,455	6.92%	669	83	39
20 YR Fixed	79	10,831	6.84%	653	73	41
1 YR 1/29 ARM	67	12,688	10.73%	613	83	40
3 YR I/O 3/27 ARM	61	16,692	6.62%	677	81	42
Full Doc - 12 Months Bank Statements	39	9,479	7.29%	663	82	34
1 Yr Limited Doc	31	7,141	8.84%	594	78	40
10 YR Fixed	12	1,113	7.07%	628	65	36
Full Doc - 24 Months Bank Statements	10	1,935	8.30%	618	77	42
25 YR Fixed	9	1,798	6.75%	654	74	36
6 Month LIBOR	5	1,177	11.34%	652	85	43
2 Yr Limited Doc	2	431	7.49%	574	80	33
Total/Average	7,796	$ 1,509,959	8.36%			

(1) Represents data as of date of origination.

Release of Future Information

The Company is no longer required to issue periodic reports in accordance with SEC regulations. However, the Company presently intends to provide quarterly and annual information regarding its performance to shareholders by posting information on its website (www.ecccapital.com) at least for periods ending through December 31, 2007. This information may be posted under the "Investor Relations" section of the Company's website. The Company cannot guarantee the frequency of updates after 2007 because of reduced staff and limited operations. Although the Company has issued press releases in the past, in an effort to reduce costs, ECC expects to limit its future use of press releases. Please periodically check the Company's website for information. You may also contact the Company using the toll free number of 866-338-8749 or via email at investorrelations@ecccapital.com. Additionally, copies of our previous SEC filings can be obtained at www.sec.gov.

The Company presently intends to post quarterly financial information about two months after the end of each of the first three fiscal quarters and annual financial information about three months after the end of the fiscal year. The Company anticipates that annual financial information will continue to be audited.

Quotation on the Pink Sheets and Stock Ownership Limitation

The Company's common stock is currently quoted on the Pink Sheets under the symbol "ECRO.PK". However, the Company does not control whether its stock is quoted on the Pink Sheets and therefore cannot guarantee there will be a market to trade the common stock. Further, the Company does not anticipate applying for listing on any stock exchange or quotation on any electronic trading system in the near future.

The Company's corporate charter prohibits non-founding stockholders from owning more than 5.6% of its common stock. The reason for this restriction is so the Company can comply with the ownership limitations imposed upon Real Estate Investment Trusts. The Company's charter provides that any ownership in excess of the 5.6% restriction may be automatically transferred to a charitable trust and sold. Please refer to the Company's charter for specific information regarding this restriction. Currently, there are 97,073,300 shares of ECC Capital common stock outstanding.

On January 7, 2008 the Company intends to reduce its ownership limitation to 2.5%. Shareholders whose ownership percentage of the Company's common stock exceeds the reduced ownership limit on January 6, 2008, but is less than or equal to the existing 5.6% ownership limit, will be grandfathered and therefore, permitted to continue owning the Company's stock at their current ownership percentage. However, if those shareholders subsequently reduce their ownership percentage of the Company's common stock, their maximum ownership limit will be reduced accordingly until their limit is equal to the new ownership limit.

The Company is providing advance notice of the intended ownership limit reduction so shareholders have time to respond to the change. The Company intends to reduce the ownership limit to provide greater flexibility should it decide to pursue different structuring options, although no structuring options are currently contemplated.

Risk Factors

In addition to this information, you should consider the risk factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 and the cautionary statements included therein. These risk factors, as well as other risks not presently known, could materially affect its business, financial condition or results of operations.