ANTHRACITE CAPITAL INC
Form 10-Q
November 14, 2001

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

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

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

For the quarterly period ended September 30, 2001

Commission File Number 001-13937

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

Maryland	13-3978906
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
345 Park Avenue, New York, New York	10154
(Address of principal executive offices)	(Zip Code)

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

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

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

(1) Yes X No__
(2) Yes X No__

As of November 13, 2001, 40,618,496 shares of voting common stock ($.001 par value) were outstanding.

ANTHRACITE CAPITAL, INC.,
FORM 10-Q

INDEX

PART I - FINANCIAL INFORMATION		Page
Item 1.	Interim Financial Statements	3
	Consolidated Statements of Financial Condition At September 30, 2001 (Unaudited) and December 31, 2000	3
	Consolidated Statements of Operations For the Three and Nine Months Ended September 30, 2001 and 2000 (Unaudited)	4
	Consolidated Statement of Changes in Stockholders' Equity For the Nine Months Ended September 30, 2001 (Unaudited)	5
	Consolidated Statements of Cash Flows For the Nine Months Ended September 30, 2001 and 2000 (Unaudited)	6
	Notes to Consolidated Financial Statements (Unaudited)	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	30
Part II - OTHER INFORMATION		
Item 1.	Legal Proceedings	34
Item 2.	Changes in Securities and Use of Proceeds	34
Item 3.	Defaults Upon Senior Securities	34
Item 4.	Submission of Matters to a Vote of Security Holders	34
Item 5.	Other Information	34
Item 6.	Exhibits and Reports on Form 8-K	34
SIGNATURES		35

Part I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

	September 30, 2001 (Unaudited)
ASSETS	

Cash and cash equivalents		$ 69,9
Restricted cash equivalents		29,6
Securities available for sale, at fair value		
Subordinated commercial mortgage-backed securities (CMBS)	$303,737	
Investment grade securities	738,223	
Total securities available for sale		1,041,9
Securities held for trading, at fair value		612,2
Mortgage loan pools available for sale, at fair value		
Commercial mortgage loans		100,1
Investments in real estate joint ventures		8,4
Receivable for investments sold		407,8
Other assets		18,1
Total Assets		$ 2,288,3
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Borrowings:		
Secured by pledge of subordinated CMBS	$162,554	
Secured by pledge of other securities available for sale and cash equivalents	673,784	
Secured by mortgage loan pools	-	
Secured by pledge of securities held for trading	591,506	
Secured by pledge of investments in real estate joint ventures	1,337	
Secured by pledge of commercial mortgage loans	43,006	
Total borrowings		$ 1,472,1
Payable for investments purchased		405,6
Distributions payable		13,6
Other liabilities		36,9
Total Liabilities		1,928,3
10.5% Series A preferred stock, redeemable convertible, liquidation preference $34,200		30,7
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value $0.001 per share; 400,000 shares authorized; 35,786 shares issued and outstanding in 2001; and 25,136 shares issued and outstanding in 2000		
10% Series B preferred stock, liquidation preference $55,317 in 2001, $56,525 in 2000		42,0
Additional paid-in capital		412,3
Distributions in excess of earnings		(10,5
Accumulated other comprehensive loss		(114,6
Total Stockholders' Equity		329,2
Total Liabilities and Stockholders' Equity		$2,288,3

The accompanying notes are an integral part of these financial statements

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

	For the Three Months Ended September 30, 2001	For the Three Months Ended September 30, 2000
Income:		
Securities available for sale	$ 20,546	$ 21,585
Commercial mortgage loans	2,941	3,573
Mortgage loan pools	-	1,555
Trading securities	11,054	-
Earnings from real estate joint ventures	634	-
Cash and cash equivalents	1,071	255
Total income	36,246	26,968
Expenses:		
Interest	10,752	14,765
Interest - trading securities	7,589	-
Management and incentive fees	3,303	2,060
Other expenses - net	78	(20)
Total expenses	21,722	16,805
Other gains (losses):		
Gain on sale of securities available for sale	175	994
Gain on securities held for trading	1,875	191
Foreign currency gain	(91)	29
Loss on impairment of asset	-	-
Total other gain	1,959	1,214
Income before cumulative transition adjustment	16,483	11,377
Cumulative transition adjustment - SFAS 133	-	-
Net Income	16,483	11,377
Dividends and accretion on preferred stock	2,290	2,307
Net Income available to Common Shareholders	$ 14,193	$ 9,070
Net income per common share, basic:		
Income before cumulative transition adjustment	$0.40	$0.36

Cumulative transition adjustment - SFAS 133	-	-
Net income	$0.40	$0.36
Net income per common share, diluted:		
Income before cumulative transition adjustment	$0.38	$0.34
Cumulative transition adjustment - SFAS 133	-	-
Net income	$0.38	$0.34
Weighted average number of shares outstanding:		
Basic	35,397	25,136
Diluted	39,595	29,218

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

Anthracite Capital, Inc. and Subsidiaries
Consolidated Statement of Changes in Stockholders' Equity (Unaudited)
For the Nine Months Ended September 30, 2001
(in thousands)

	Common Stock, Par Value	Series B Preferred Stock	Additional Paid-In Capital	Distributions In Excess Of Earnings	Accumul Othe Comprehe Los
Balance at January 1, 2001	$25	$43,004	$315,533	($13,437)	($102,
Issuance of common stock	10		95,734		
Net income				41,359	
Net charge associated with current period hedging transactions					(22,
Net amount reclassified into earnings due to amortization of de-designated hedges					
Cumulative transition adjustment - SFAS 133					1,
Change in net unrealized loss on securities available for sale, net of reclassification adjustment					8,
Other Comprehensive loss					
Comprehensive Income					
Dividends declared-common stock				(31,607)	

Dividends and accretion on Preferred stock				(6,866)	
Conversion of Series B preferred stock to common stock	1	(918)	917		
Compensation cost - stock options			132		
Balance at September 30, 2001	$36	$42,086	$412,316	($10,551)	($114

Disclosure of reclassification adjustment:

Unrealized holding gain

Less: reclassification for realized gains previously recorded as unrealized

Net charge associated with current period hedging transactions

Net amount reclassified into earnings due to amortization of de-designated hedges

Cumulative transition adjustment - SFAS 133

Net unrealized loss on securities

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

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

	For th
	September 30,
Cash flows from operating activities:	
Net income	$
Adjustments to reconcile net income to net cash provided by operating activities:	
Net (purchase) sale of trading securities	(4
Amortization on negative goodwill	
Cumulative transition adjustment - SFAS 133	
Premium amortization, net	
Compensation cost - stock options	
Loss on impairment of asset	
Non-cash portion of net foreign currency (gain) loss	
Net (gain) loss on sale of securities	

Distributions from real estate joint ventures in excess of earnings	
Decrease in other assets	
Increase (decrease) in other liabilities	
Net cash (used in) provided by operating activities	(4
Cash flows from investing activities:	
Purchase of securities available for sale	(1,7
Funding of commercial mortgage loans	(
Repayments received from commercial mortgage loans	
Increase in restricted cash equivalents	(
Principal payments received on securities available for sale	
Principal payments received on mortgage loan pools	
Proceeds from sales of securities available for sale and mortgage loan pools	1,2
Investment in real estate joint ventures	
Net payments under hedging securities	
Net cash (used in) provided by investing activities	(3
Cash flows from financing activities:	
Net increase (decrease) in borrowings	7
Proceeds from issuance of common stock, net of offering costs	
Distributions on common stock	(
Distributions on preferred stock	
Net proceeds from merger	
Acquisition costs against goodwill	
Purchase of common shares	
Net cash provided by (used in) financing activities	8
Net decrease in cash and cash equivalents	
Cash and cash equivalents, beginning of period	
Cash and cash equivalents, end of period	$
Supplemental disclosure of cash flow information:	
Interest paid	$
Investments purchased not settled	$ 4
Investments sold not settled	$ 4

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

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

Note 1 ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anthracite Capital, Inc. (the "Company"), a Maryland corporation, is a real estate finance company that generates income based on the spread between the interest income on its mortgage loans and securities investments and the interest expense from borrowings used to finance its investments. The

Company seeks to earn high returns on a risk-adjusted basis to support a consistent quarterly dividend. The Company has elected to be taxed as a Real Estate Investment Trust, therefore, its income, to the extent distributed, is largely exempt from corporate taxation. The Company commenced operations on March 24, 1998.

The Company's business focuses on (i) originating high yield commercial real estate loans, (ii) investing in below investment grade commercial mortgage backed securities ("CMBS") where the Company has the right to control the foreclosure/workout process on the underlying loans, and (iii) acquiring investment grade real estate related securities as a liquidity diversification.

The accompanying unaudited financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's annual report on Form 10-K for 2000 filed with the Securities and Exchange Commission.

In the opinion of management, the accompanying financial statements contain all adjustments, consisting of normal and recurring accruals (except for the cumulative transition adjustment for SFAS 133 in the first quarter 2001 - see note 2), necessary for a fair presentation of the results for the interim periods. Operating results for interim periods are not necessarily indicative of the results that may be expected for the entire year.

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

Note 2 DERIVATIVE FINANCIAL INSTRUMENTS

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

On January 1, 2001 the Company reclassified certain of its agency debt securities, with an amortized cost of $64,432 from available-for-sale to trading. An interest rate swap agreement with a $25,000 notional amount that had been designated as hedging these debt securities was similarly reclassified. The unrealized gain of $895 related to the agency debt securities and the unrealized loss of $2,830 related to the interest rate

swap as of January 1, 2001 were removed from OCI and recorded as the cumulative transition adjustment to earnings upon adoption of SFAS 133. The net cumulative effect of adopting SFAS 133 was ($1,903) and is reflected as "Cumulative Transition Adjustment - SFAS 133" on the consolidated statement of operations.

In addition, on January 1, 2001, the Company re-designated interest rate swap agreements with notional amounts aggregating $98,000 that had been hedging available-for-sale debt securities as cash flow hedges of its variable rate borrowings under reverse repurchase agreements. The fair value of these swap agreements on January 1, 2001, an unrealized loss of ($9,853), remained in OCI at the date of adoption of FAS 133, and therefore, did not result in a transition adjustment.

Because of the de-designation and re-designation of the $98,000 interest rate swaps, the Company is required to amortize the related $9,853 recorded in OCI. Amortization is on a straight-line basis over the shorter of the life of the swap or the previously hedged assets and is recognized as a reduction of interest income. For the three and nine months ended September 30, 2001, $248 and $745 was amortized as a reduction of interest income respectively, and $248 will be amortized as a reduction of interest income each quarter for the next 12 months.

In addition, on January 1, 2001 the Company re-designated interest rate swap agreements with notional amounts aggregating $57,744 that had been hedging available-for-sale debt securities to hedges of trading securities. These interest rate swap agreements were sold in January 2001; the loss of $795 is included in gain on securities held for trading. As of December 31, 2000 the accumulated loss for these interest rate swaps was $3,226. This accumulated loss is being amortized as a reduction of income from securities available for sale over the weighted average life of the securities these interest rate swaps were hedging on December 31, 2000. For the three and nine months ended September 30, 2001 $64 and $193 was amortized as a reduction of interest income.

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

The Company has entered into reverse repurchase agreements to finance securities available for sale that are not financed under its lines of credit. The reverse repurchase agreements bear interest at a LIBOR based variable rate. Increases in the LIBOR rate could negatively impact earnings. The interest rate swap agreements allow the Company to receive a variable rate cash flow based on LIBOR and pay a fixed rate cash flow, mitigating the impact of this exposure.

As of September 30, 2001, the Company had interest rate swaps with notional amounts aggregating $291,000 that were designated as cash flow hedges of borrowings under reverse repurchase agreements. Their aggregate fair value was a $22,887 liability included in other liabilities on the statement of financial condition. This liability was fully collateralized with cash listed as restricted cash on the Company's statement of financial condition. For the three months ended September 30, 2001, the net change in the fair value of the interest rate swaps was ($23,653) of which $1,574 of this change in value was deemed ineffective and is included as additional interest expense and ($25,227) was recorded in OCI. During the third quarter, the Company closed one of its interest rate swaps with a notional amount of $50,000, that was designated as a cash flow hedge of borrowings

under reverse repurchase agreements. The Company will amortize as an increase of interest expense the $1,671 loss in value incurred during the period from January 1, 2001, the date this swap was designated as a cash flow hedge of borrowings under reverse repurchase agreements, thru the sale date, over the remaing term of the swap.

As of September 30, 2001, the Company had interest rate swaps with notional amounts aggregating $25,000 designated as trading derivatives. Their aggregate fair value at September 30, 2001 was ($4,676), included in trading securities. For the three months ended September 30, 2001, the change in fair value for these trading derivatives was ($2,024) and is included as a reduction of gain on securities held for trading in the consolidated statement of operations.

The implementation of SFAS 133 did not change the manner in which the Company accounts for its forward currency exchange contracts; these contracts are carried at fair value, with changes in fair value included as a component of net foreign currency gain or loss in the consolidated statement of operations.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions. The Company assesses, both at the inception of the hedge and on an on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge, the Company discontinues hedge accounting prospectively.

Note 3 RECENT ACCOUNTING PRONOUNCMENTS

In July 2001, the Financial Accounting Standards Board issued Statement No. 141, "Business Combinations" (SFAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). These statements establish new standards for accounting and reporting for business combinations and for goodwill and intangible assets resulting from business combinations. SFAS 141 applies to all business combinations initiated after June 30, 2001; the Company is required to implement SFAS 142 on January 1, 2002. For the Company, this will result in the unamortized balance of negative goodwill being recognized in income during the first quarter of 2002 as the cumulative effect of implementing the new accounting standard. The Company estimates that the gain recognized upon implementation will be approximately $6,500.

In July of 2000, the FASB's Emerging Issues Task Force reached a consensus on Issue 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Interests." This issue provides guidance on the appropriate methodology to be used in recognizing changes in the estimated yield on asset-backed securities, and in determining whether impairment exists. This consensus was applied by the Company beginning in the second quarter of 2001, and did not have an impact on the Company's financial statements, but it may require earlier recognition of impairment of CMBS investments than under previous guidance, should the Company experience credit losses on the loans underlying a CMBS investment in amounts greater than anticipated at acquisition.

In August of 2001, the FASB issued SFAS No, 143, "Accounting for Asset Retirement Obligations" (effective January 1, 2003) and SFAS No. 144, "Accounting for the Impariment or Disposal of Long Lived Assets" (effective January 1, 2002). SFAS No. 143 requires the recording of the fair value of a liability for an asset retirement obligation in the period in which it is incurred. SFAS No. 144 supercedes existing accounting literature dealing

with impariment and disposal of long lived assets, including discontinued operations. It addresses financial accounting and reporting for the impariment of long-lived assets and for long-lived assets to be disposed of , and expands current reporting for discontinued operations to include disposals of a "component" of an entity that has been disposed of or is classified as held for sale. The Company is in the process of evaluating the financial statement impact of the adoption of these two standards.

Note 4 NET INCOME PER SHARE

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

	For the Three Months Ended September 30, 2001	2000	Fo
Numerator:			
Net Income available to common shareholders before cumulative transition adjustment	$14,193	$ 9,070	$
Cumulative transition adjustment - SFAS 133	-	-	
Numerator for basic earnings per share	14,193	9,070	
Effect of 10.5% series A senior cumulative redeemable preferred stock	907	893	
Numerator for diluted earnings per share	$15,100	$9,963	
Denominator:			
Denominator for basic earnings per share--weighted average common shares outstanding	35,397	25,136	
Effect of 10.5% series A senior cumulative redeemable preferred stock	4,121	4,082	
Dilutive effect of stock options	77	-	
Denominator for diluted earnings per share--weighted average common shares outstanding and common share equivalents outstanding	39,595	29,218	
Basic net income per weighted average common share:			
Income before cumulative transition adjustment	$0.40	$0.36	
Cumulative transition adjustment - SFAS 133	-	-	
Net income	$0.40	$0.36	
Diluted net income per weighted average common share and common share equivalents:			

Income before cumulative transition adjustment	$0.38	$0.34	
Cumulative transition adjustment - SFAS 133	-	-	
Net income	$0.38	$0.34	

Note 5 SECURITIES AVAILABLE FOR SALE

The Company's securities available for sale are carried at estimated fair value. The amortized cost and estimated fair value of securities available for sale as of September 30, 2001 are summarized as follows:

Security Description	Amortized Cost	Gross Unrealized Gain
Commercial mortgage-backed securities ("CMBS"):		
CMBS IO's	$ 80,281	$ 3,643
Investment grade CMBS	20,521	6
Non-investment grade rated subordinated securities	361,229	1,218
Non-rated subordinated securities	32,014	713
Total CMBS	494,045	5,580
Single-family residential mortgage-backed securities ("RMBS"):		
Fixed Rate Securities	60,839	880
Home Equity Loans	29,412	1,295
Hybrid adjustable rate mortgages	60,404	432
Agency adjustable rate securities	105,079	1,341
Agency fixed rate securities	369,658	9,429
Total RMBS	625,392	13,377
	$1,119,437	$18,957

As of September 30, 2001, an aggregate of $953,932 in estimated fair value of the Company's securities available for sale was pledged to secure its collateralized borrowings.

The following table sets forth certain information relating to the aggregate principal balance and payment status of delinquent mortgage loans underlying the subordinated CMBS held by the Company as of September 30, 2001:

	September 30, 2001		
	Principal	Number of Loans	% of Collateral

Past due 30 to 60 days	$25,845	6	0.29%
Past due 60 to 90 days	$57,291	7	0.63%
Past due 90 or more	$39,475	8	0.44%
Real Estate owned	$8,818	1	0.10%
Total Delinquent	$131,429	22	1.46%
Total Principal Balance	$9,023,664	1,753	

The Company's delinquency experience of 1.46% is compared to the 1.18% for directly comparable collateral experience shown in the Lehman Brothers CMBS 1998 vintage collateral delinquency index.

To the extent that realized losses, if any, or such resolutions differ significantly from the Company's original loss estimates, it may be necessary to reduce the projected GAAP yield on the applicable CMBS investment to better reflect such investment's expected earnings net of expected losses, from the date of purchase. While realized losses on individual assets may be higher or lower than original estimates, the Company currently believes its aggregate loss estimates and GAAP yields are appropriate.

As of September 30, 2001, the anticipated weighted average unleveraged yield to maturity based upon adjusted cost of the Company's subordinated CMBS was 10.10% per annum, and of the Company's other securities available for sale was 6.28% per annum. The Company's anticipated yields to maturity on its subordinated CMBS and other securities available for sale are based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples of these include, among other things, the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass-through or coupon rate and interest rate fluctuations. Additional factors that may affect the Company's anticipated yields to maturity on its subordinated CMBS include interest payment shortfalls due to delinquencies on the underlying mortgage loans, and the timing and magnitude of credit losses on the mortgage loans underlying the subordinated CMBS that are a result of the general condition of the real estate market (including competition for tenants and their related credit quality) and changes in market rental rates. As these uncertainties and contingencies are difficult to predict and are subject to future events, which may alter these assumptions, no assurance can be given that the anticipated yields to maturity, discussed above and elsewhere, will be achieved.

As part of the acquisition of CORE Cap, Inc. in May 2000 the Company inherited securities backed by franchise loans originated by Franchise Mortgage Acceptance Corporation ("FMAC 1998-BA trust"). The Company currently owns $16,366 of class B principal and $10,829 of class C principal. The trust is collateralized by loans on 365 properties to 75 borrowers. The properties are largely franchise restaurants and gas station convenience stores. Collateral performance has been poor. In March of 2001 the class B securities were downgraded to BBB and the class C securities were downgraded to BB. In July 2001 the class B was downgraded to BBB and class C was downgraded to B.

Although the class C bond is current on all payments, the Company concluded that due to poor collateral performance, future cash flows on the class C bond were not likely to be received as originally provided and,

accordingly, the bond was deemed to be impaired. The Company performed an analysis assuming 40% of the underlying collateral balance was nonrecoverable. Given the current level of credit enhancement to the class C securities the loss would amount to 51% of the current principal amount over time. Under this scenario a yield of approximately 14% results in a dollar price of 40. As a point of comparison the yield on the 10 year Treasury on June 30, 2001 was 5.41%. During the second quarter of 2001, the Company took a charge to income of $5,702 on the class C bond, to write this bond down to its estimated fair value. At September 30, 2001, the fair value of class C was marked at a dollar price of 35 representing a change in dollar price from the previous quarter of 5. The change in value is reflected in other comprehensive income. As of November 12, 2001, the class C was current on all payments.

Note 6 SECURITIES HELD FOR TRADING

The Company's securities held for trading are carried at estimated fair value. At September 30, 2001, the Company's securities held for trading consisted of FNMA and Federal Home Loan Corp. mortgage pools with an estimated fair value of $616,327 and a interest rate swap agreement which represented a notional amount of $25,000 and a fair value of $(4,067). The interest rate swap agreement was closed out in October 2001. The FNMA Mortgage Pools, and the underlying mortgages, bear interest at fixed rates for specified periods, generally three to seven years after which the rates are periodically reset to market. The Federal Home Loan Mortgage Pools and the underlying mortgages generally bear interest at fixed rates through maturities of fifteen to thirty years.

Some of the securities held for trading reflect short-term trading strategies, which the Company employs from time to time, designed to generate economic and taxable gains. As part of its trading strategies, the Company may acquire long or short positions in U.S. Treasury or agency securities, forward commitments to purchase such securities, financial futures contracts and other fixed income or fixed income derivative securities. Any taxable gains from such strategies will be applied as an offset against the tax basis capital loss carry forward that the Company incurred during 1998 as a result of the sale of a substantial portion of its securities available for sale.

Note 7 COMMON STOCK

On February 14, 2001 the Company completed a secondary offering of 4,000,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting underwriting fees and expenses) were approximately $33,200. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 600,000 additional shares of common stock to cover over-allotments. This option was exercised on March 13, 2001 and resulted in net proceeds to the Company of approximately $5,000.

On May 11, 2001, the Company completed a follow-on offering of 4,000,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting underwriting fees and expenses) were approximately $37,800. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 600,000 additional shares of common stock to cover over-allotments. This option was exercised on June 6, 2001 and resulted in net proceeds to the Company of approximately $5,675.

On November 7, 2001 the Company completed a follow-on offering of 4,400,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting estimated expenses)

were approximately $39.4 million. On November 13, 2001, the underwriters exercised an option to purchase an additional 90,000 shares of Company common stock available through an over-allotment granted to the underwriters. The aggregate net proceeds to the Company (before deducting expenses) were approximately $810.

On September 14, 2001, the Company declared distributions to its common shareholders of $0.32 per share, paid on October 31, 2001 to shareholders of record on September 30, 2001. For U.S. Federal income tax purposes, the dividends are expected to be ordinary income to the Company's shareholders.

For the three and nine months ended September 30, 2001, the Company issued 661,373 and 1,378,997 shares, respectively, of common stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $7,264 and $14,349, respectively. No shares were issued for the three and nine months ended September 30, 2000 under the Dividend Reinvestment Plan.

Note 8 TRANSACTIONS WITH AFFILIATES

The Company has a management agreement (the "Management Agreement") with BlackRock Financial Management, Inc. (the "Manager"), a majority owned indirect subsidiary of PNC Financial Services Group, Inc. ("PNC Bank") and the employer of certain directors and officers of the Company, under which the Manager manages the Company's day-to-day operations, subject to the direction and oversight of the Company's Board of Directors. The Management Agreement expires on March 20, 2002. The Company pays the Manager an annual base management fee equal to a percentage of the average invested assets of the Company as defined in the Management Agreement. The base management fee is equal to 1% per annum of the average invested assets rated less than BB- or not rated, 0.75% of average invested assets rated BB- to BB+, and 0.20% of average invested assets rated above BB+. In order to reflect the increased scale of the Company, effective July 1, 2001, the Manager reduced the base management fee to 0.20% of average invested assets rated above BB+ from 0.35%.

The Company incurred $1,842 and $5,805 in base management fees in accordance with the terms of the Management Agreement for the three and nine months ended September 30, 2001 and $1,681 and $4,585 in base management fees for the three and nine months ended September 30, 2000. In accordance with the provisions of the Management Agreement, the Company will reimburse the Manager for certain expenses incurred on behalf of the Company. No reimbursement of expenses were incurred during the three months ended September 30, 2001, and the nine months ended September 30, 2000. Reimbursement of expenses during the nine months ended September 30, 2001 was $82.

The Company will also pay the Manager, as incentive compensation, an amount equal to 25% of the funds from operations of the Company (as defined) plus gains (minus losses) from debt restructuring and sales of property, before incentive compensation, in excess of the amount that would produce an annualized return on equity equal to the greater of 3.5% over the ten-year U.S. Treasury Rate as defined in the Management Agreement or 9.5%. For purposes of the incentive compensation calculation, equity is generally defined as proceeds from issuance of Common Stock before underwriting discounts and commissions and other costs of issuance. The Company incurred $1,461 and $2,614 in incentive compensation for the three and nine months ended September 30, 2001 and $379 and $465 for the three and nine months ended September 30, 2000. Effective July 1, 2001, the Manager revised the hurdle rate applicable to the incentive fee from 3.5% over the ten-year U.S. Treasury Rate, to the greater of 3.5% over the ten-year U.S. Treasury Rate or 9.5% on the adjusted issue price of the common stock ($11.76 as of September 30, 2001).

Under the terms of an administration agreement, the Manager provides financial reporting, audit coordination and accounting oversight services. The Company pays the Manager a monthly administrative fee at an annual rate of 0.06% of the first $125 million of average net assets, 0.04% of the next $125 million of average net assets and 0.03% of average net assets in excess of $250 million subject to a minimum annual fee of $120. For the three and nine months ended September 30, 2001, the administration fee was $38 and $103. For the three and nine months ended September 30, 2000 the administration fee was $30 and $90.

On March 30, 2001, the Company purchased two certificates representing a 1% interest in PNC Loan Trust - III for an aggregate investment of $1,732. These certificates were purchased from PNC Bank, an affiliate of the Company. The assets of the Trusts consist of commercial mortgage loans originated or acquired by PNC. The Company has a committed line of credit for $4,500 from PNC Funding Corp., a wholly owned indirect subsidiary of PNC Bank, to borrow up to 90% of the fair market value of the Company's interest in such Trusts. Outstanding borrowings against this line of credit bear interest at a LIBOR based variable rate. As of September 30, 2001, there were no outstanding borrowings against this line of credit.

During the three months ended March 30, 2001, the Company purchased twelve certificates each representing a 1% interest in different classes of Owner Trust NS I Trust ("Owner Trusts") for an aggregate investment of $37,868. These certificates were purchased from PNC Bank. The assets of the Owner Trusts consist of commercial mortgage loans originated or acquired by an affiliate of PNC. The Company entered into a $50,000 committed line of credit from PNC Funding Corp. to borrow up to 95% of the fair market value of the Company's interest in the Owner Trusts. Outstanding borrowings against this line of credit bear interest at a LIBOR based variable rate. As of September 30, 2001, there was $19,966 borrowed under this line of credit. The Company earned $504 and $1,221 from the Owner Trusts and paid interest of approximately $214 and $745 to PNC Funding Corp. as interest on borrowings under a related line of credit for the three and nine months ended September 30, 2001. During the three months ended September 30, 2001, the Company sold two Owner Trusts. The gain on the sale of those Owner Trusts was $35.

Note 9 BORROWINGS

Certain information with respect to the Company's collateralized borrowings at September 30, 2001 is summarized as follows:

	Lines of Credit and Term Loans	Reverse Repurchase Agreements
Outstanding borrowings	$111,035	$1,361,152
Weighted average borrowing rate	4.09%	2.93%
Weighted average remaining maturity	165 days	19 days
Estimated fair value of assets pledged	$166,573	$1,468,803

As of September 30, 2001, $20,584 of borrowings outstanding under the lines of credit were denominated in pounds sterling and interest payable is based on sterling LIBOR.

As of September 30, 2001, the Company's collateralized borrowings had the

following remaining maturities:

	Lines of Credit and Term Loan	Reverse Repurchase Agreements	Total Collateralized Borrowings
Within 30 days	$ -	$1,361,152	$1,361,152
31 to 59 days	-	-	-
Over 60 days	111,035	-	111,035
	$111,035	$1,361,152	$1,472,187

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

Note 10 SUBSEQUENT EVENTS

On November 7, 2001 the Company completed a follow-on offering of 4,400,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting estimated expenses) were approximately $39,400. On November 13, 2001, the underwriters exercised an option to purchase an additional 90,000 shares of Company common stock available through an over-allotment granted to the underwriters. The aggregate net proceeds to the Company (before deducting expenses) were approximately $810.

On November 7, 2001 the Company received a capital call notice to fund a portion of its Carbon Capital, Inc. investment. The total amount of the capital call was $8,784 and is expected to be paid on November 19, 2001. The use of proceeds will be to acquire three commercial loans all of which are secured by office buildings. The remaining commitment is $41,216. Carbon Capital, Inc. is a private commercial real estate income opportunity fund managed by BlackRock Financial Management, Inc., who is also the Manager of the Company.

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

General: During the third quarter of 2001 the Company paid $0.32 per common share in dividends and GAAP book value rose from $7.92 to $8.03. This represents a 21.7% annualized total return. For the nine months ended September 30, 2001 the total return for the Company stock was 50.5%. This compares favorably to the total return of the Dow Jones industrial average of negative 18.2% and negative 15.4% total return of the Russell 2000 Index, a broad based small cap stock index which includes the Company.

The Company attributes this strong performance to its ability to raise capital accretively and invest in the asset classes of the real estate

capital markets that provides the best risk adjusted returns. The Company believes this multi asset class strategy will continue to create greater long-term earnings sustainability than focusing on a single asset class. Shareholders will benefit directly through a consistent dividend payout over the long-term. This should be compared with the earnings and dividend volatility of companies that operate in only one of these asset classes.

Through November 13, 2001, the Company raised over $135 million on an accretive basis through secondary stock offerings and the dividend reinvestment program. This is consistent with the Company's long stated strategy of increasing scale. The benefits of this strategy are to increase liquidity, increase diversification, increase financial flexibility and to take advantage of economies of scale through lower expense ratios.

The following table illustrates the book value accretion generated by the three capital raises closed by the Company this year, including the recently completed fourth quarter 2001 offering. Shareholders will also benefit from increased float and an increase in the number of research analysts covering the Company.

Issue Date	Shares Outstanding Before Issue	Shares Issued	Issue Price	% Increase in Comm Share GAAP Book Value aft Issue
Feb 20, 2001	25,135,986	4,600,000	$8.75	1.1%
May 15, 2001	29,792,017	4,600,000	9.75	2.8%
November 7, 2001	35,785,646	4,490,000	9.56	1.2%
Cumulative Effect		13,690,000	9.35	5.1%

The Company used virtually all of the proceeds of the equity offerings to invest in Government Agency-Backed residential mortgages. This investment strategy focused mainly on purchasing discounted fixed rate mortgages to provide additional protection in the event that falling interest rates cause prepayments to increase significantly. The Company used the same strategy to reinvest the net proceeds from over $65 million received from two commercial assets which paid-off early in the first half of the year. The Company has maintained a cautious approach to reinvestment of proceeds in commercial assets in light of the slowdown in the U.S. economy and the September 11, 2001 events. Reinvesting in liquid high credit quality residential mortgages on a hedged basis allows the Company to maintain significant liquidity yet still earn high returns on equity for shareholders on a risk-adjusted basis. This portfolio earned over 18% return on equity after hedging expenses compared to average overnight cash rates of 3.67% or the pay-down of debt which cost an average of 4.22% for the third quarter.

Despite this emphasis on maintaining a high degree of liquidity the Company still increased earnings per share. This is attributable to the steep yield curve and the Company's actions to adjust its hedges to increase exposure to both short and long-term interest rates. At September 30, 2001 the Company's exposure to a 100 basis point move in short-term rates was 11.4% of net interest income, as compared to September 30, 2000 when that same

sensitivity was 6.4%. This action created greater per share operating income net of commercial loan paydowns. Exposure to long rates was similarly increased to a duration of 6.1 on Net Market Value of invested assets as of September 30, 2001 from approximately 5.0 as of September 30, 2000. This action resulted in a 5.5% annualized increase in GAAP book value over the quarter as interest rates rallied throughout the third quarter of 2001, partially offsetting the effects of widening CMBS spreads that occurred in late September 2001.

Reportable earnings also benefited from economies of scale as the Company has grown. The Manager recently reduced the base management fee scale by over 42% on investment grade assets. This resulted in a reduction of quarterly base management fees on a per share basis from approximately $0.06 (diluted) per share for the quarter ended September 30, 2000 to $0.047 (diluted) per share for the quarter ended September 2001. The manager also raised the threshold of its participation in income of the Company from 350 basis points over the 10 year Treasury (8.48% for the quarter ended September 30, 2001) to the greater of that amount or 9.5%. This threshold continues to be based on the adjusted issue price of the stock. At September 30, 2001 the adjusted issue price of the Company's stock was $11.76 compared to the GAAP book value of $8.03. The increase to a 9.5% hurdle on adjusted issue price increases the per share earnings threshold from $1.00 to $1.12 or from 12.5% to 13.9% based upon September 30, 2001 GAAP book value. In aggregate the fee reductions adopted by the Manager increased return on equity by 100 basis points, or $0.02 per share (diluted), as of September 30, 2001.

The Company's business focuses on (i) originating high yield commercial real estate loans, which includes senior interests in partnerships that own real property and are reported as real estate or joint venture investments, (ii) investing in below investment grade CMBS where the Company has the right to control the foreclosure/workout process on the underlying loans, and (iii) acquiring investment grade real estate related securities.

The Company's management believes that this represents an integrated strategy where each asset class supports the others and creates additional value for shareholders over and above operating each in isolation. The commercial real estate loans provide high risk adjusted returns for shorter periods of time, the CMBS portfolio provides diversification and high loss adjusted returns over a weighted average life of approximately 10 years, and the investment grade securities investments are an actively managed portfolio that supports the liquidity needs of the Company while earning attractive returns.

These strategies are pursued within an aggregate risk management framework that seeks to limit the exposure of the Company's equity and earnings to changes in interest rates and other factors beyond the Company's control.

The principal risks that the Company faces are (i) credit risk on the high yield real estate loans and securities it underwrites, (ii) interest rate risk on the spread between the rates (typically one month LIBOR) at which the Company borrows and the generally longer term rates (as represented by the U.S. Ten Year Treasury) at which the Company lends, and (iii) funding risk in the amount and cost of debt financing employed by the Company over time versus the level of such funding that is sustainable by the financing markets. These risks are discussed in more detail below, under the heading, "Quantitative and Qualitative Disclosures About Market Risk" and under "Capital Resources and Liquidity".

The following discussion should be read in conjunction with the financial statements and related notes. Dollar amounts are expressed in thousands, other than per share amounts.

Market Conditions and their Effect on Company Performance:

Two of the most significant factors that affect the Company's earnings are credit experience and the relationship of long-term interest rates to short-term interest rates. The Company's interest income from credit sensitive securities is based on a loss-adjusted yield. The Company establishes loss assumptions on the pools of loans underlying its CMBS portfolios. It then computes a loss adjusted yield based on the assumed cash flows that are projected after applying the loss assumptions. To the extent that actual losses are substantially similar to the loss assumptions the loss adjusted yield would stay constant. If actual losses are greater or lower than expectations the loss adjusted yields would be decreased or increased respectively.

The relationship of long-term rates to short-term rates is important because the Company's interest income is generally based on long-term rates and its interest expense is based on short-term rates. When long-term rates exceed short-term rates (i.e. the yield curve is steep) the Company will generally report higher earnings. When short-term rates are higher than long-term rates (an inverted yield curve) the Company will generally report lower earnings.

Credit Experience: The Company considers delinquency information from the Lehman Brothers Conduit Guide for 1998 transactions to be the most relevant measure of market conditions applicable to its below investment grade CMBS holdings. Pursuant to these statistics as of September 30, 2001, 40 securitizations were included and 1.18% of principal balances were delinquent, compared to 0.95% as of June 30, 2001. The broader measure of all transactions issued since 1994 and tracked in the Conduit Guide also provides relevant comparable information. As of September 30, 2001, 200 securitizations were being monitored among the larger universe and 0.98% of the outstanding balances were delinquent, compared to an overall delinquency rate of 0.93% across 190 transactions as of June 30, 2001.

Morgan Stanley Dean Witter (MSDW) also tracks CMBS loan delinquencies using a slightly smaller universe. Their index tracks all CMBS transactions with more than $200,000 of collateral that have been seasoned for at least one year. This will generally adjust for the lower delinquencies that occur in newly originated collateral. As of September 30, 2001, MSDW delinquencies on 166 securitizations were 1.27% of current balances. As of June 30, 2001, this same index tracked 158 securitizations with delinquencies of 1.21%. Over the life of these types of transactions, and as the economy slows, delinquencies and losses will naturally increase.

The Company's below investment grade CMBS represent approximately $626,091 of face value collateralized by underlying pools of first lien commercial mortgages. The CMBS owned by the Company include 1,753 loans with an aggregate principal balance of over $9.0 billion as of September 30, 2001. The Company is in a first loss position with respect to these loans. The face value of securities collaterialized by the first loss loans is $601,167. The Company manages its credit risk through conservative underwriting, diversification, active monitoring of loan performance and exercise of its right to control the workout process as early as possible. All of these processes are based on the extensive intranet-based analytic systems developed by BlackRock.

Realized losses through September 30, 2001 were consistent with underwritten loss expectations. The Company has assumed a default rate of approximately 4.6% over time. Applying a 40% loss severity assumption results in loss of 1.7% of the total original face amount of the portfolio. This assumption was used to establish the loss adjusted yields that are

used to report quarterly income to shareholders. As of September 30, 2001 the Company had realized net losses of 0.04% of underlying principal since origination.

As the portfolio matures and the economy slows rising delinquencies are expected. The following table shows the comparison of delinquencies from the previous quarter:

	June 30, 2001			
	Principal	Number of Loans	% of Collateral	Principal
Past due 30 to 60 days	$17,002	7	0.19%	$25,845
Past due 60 to 90 days	$16,891	2	0.18%	57,291
Past due 90 or more	$34,072	6	0.37%	39,475
Real Estate Owned (REO)	$8,851	1	0.10%	8,818
Total Delinquent	$76,816	16	0.84%	131,429
Total Principal Balance	$9,092,199	1,756		$9,023,664

Of the 22 delinquent loans as of September 30, 2001, fifteen were delinquent due to technical reasons, one was REO and being marketed for sale, two were in foreclosure, and the remaining five loans were in workout negotiations. Realizing the estimated losses on all the properties currently in delinquency would not cause the Company to change its loss adjusted yields. The 22 delinquent loans do not indicate any weakness in any geographic area or property type.

During the third quarter of 2001 the Company also experienced early payoffs of $27,511 representing 0.31% of the existing pool balance. These loans were paid at par with no loss. The losses attributable to those loans will be reallocated to other loans in the portfolio.

Yield Curve: During the third quarter of 2001 the yield on the ten-year U.S. Treasury Note decreased by 83 basis points from 5.41% to 4.58%. The Federal Reserve Board continued its policy of reducing short-term interest rates. The most recent reduction in short rates came on November 6, 2001 with a 50 basis point reduction. This marked the tenth easing move of the year. The Fed Funds target has dropped to 2.00% from 6.50% at the beginning of the year. The next meeting of the Federal Reserve Board is scheduled for December 11, 2001.

The chart below compares the rate for the ten-year U.S. Treasury securities to the one-month LIBOR rate.

	Ten Year U.S Treasury Securities	One month LIBOR	Difference
September 28, 2001	4.58%	2.63%	1.95%
June 30, 2001	5.41%	3.86%	1.53%
March 31, 2001	4.92%	5.09%	0.17%

The decrease in LIBOR from June 30, 2001 to September 30, 2001 had a positive impact on the Company's financing costs and net income.

Approximately $85,000 of the Company's assets earn interest at rates that are determined with reference to LIBOR. The Company also had $316,000 notional amount of interest rate swap agreements where the Company pays a fixed rate of interest and receives a floating rate based on LIBOR. All of the Company's borrowings bear interest at rates that are determined with reference to LIBOR. The Company has a net inverse exposure to LIBOR, such that decreases in LIBOR will cause earnings to increase and increases in LIBOR will cause earnings to decrease.

Real Estate Capital Markets: The valuation of the Company's CMBS assets depends on credit spreads, interest rates and liquidity of the real estate capital markets. The Company finances itself based on the value of these assets. Liquidity for real estate transactions has been maintained through commercial bank lending and CMBS loan origination. Year-to-date returns for the Morgan Stanley REIT index have been positive and in excess of other widely followed equity indices like the S&P 500 or Nasdaq Composite.

Credit Spreads: CMBS spreads widened in the wake of the September 11, 2001 events. Low interest rates and steady credit spreads for borrowers has sparked increased CMBS issuance. CMBS spreads to swaps increased and steepened after September 11, 2001. AAA spreads to swaps widened by 15 BP but was offset by swap spread tightening of 24 BP. Below investment grade CMBS are typically priced using the 10-year Treasury as a benchmark. In the aftermath of September 11, 2001, double-B rated CMBS spreads widened by approximately 30-50 BP and single-B rated classes by approximately 75-100 BP.

	Average Credit Spreads (in basic points)*		
	BB CMBS	BB Corporate	Difference
Sept. 28, 2001	595	614	(19)
June 30, 2001	564	419	145
	B CMBS	B Corporate	Difference
Sept. 28, 2001	1056	983	73
June 30, 2001	983	785	198

Source: Lehman Brothers CMBS High Yield Index & Lehman Brothers High Yield Index

The unrealized loss on the Company's holdings of CMBS at September 30, 2001 was $89,506. This decline in the value of the investment portfolio represents market valuation changes and is not due to credit experience or credit expectations. The adjusted purchase price of the Company's CMBS

portfolio as of September 30, 2001 represents approximately 63% of its par amount. As the portfolio matures the Company expects to recoup the unrealized loss, provided that the credit losses experienced are not greater than the credit losses assumed in the purchase analysis. The Company performs a detailed review of its loss assumptions on a quarterly basis and will adjust them when it believes that credit experience or expectations justify such an adjustment. As of September 30, 2001 the Company concluded that real estate credit fundamentals remain consistent with expectations despite slowing economic activity, and there has been no material change that would cause the Company to revise its GAAP yield.

As the portfolio matures and expected losses occur subordination levels of the lower rated classes of a CMBS investment will be reduced. This will cause the lower rated classes to be downgraded. This is the natural course for this type of security and is built into the loss expectations of the portfolio. This would negatively affect the market value and liquidity of the portfolio, but will not affect its actual credit performance.

Real Estate: The slowdown in real GDP growth continues to affect property markets across the country. (i) Retail properties have seen a relatively small decline in sales however discount retailers have generally had better results than fashion oriented sellers or general merchandisers. Recent declines in consumer confidence and employment will generally favor retailers that sell at a lower price point. Reduced air traffic in the wake of the September 11, 2001 events has impacted sales in markets that experience significant tourist traffic. (ii) Multifamily markets benefit from demand as larger numbers of 20-29 and 65+ year olds enter their prime renting years. In the short-run, however, the economic slowdown will reduce demand for apartments faster than supply can be reduced. We have already seen evidence of softer market conditions in the Southeast, particularly the Atlanta area. Nationally, forecasts by third-parties call for modest increases in apartment vacancies. (iii) Reduction in tenant demand for office space has increased vacancy rates, particularly in markets that had large exposure to high-tech or telecom tenancy. (iv) Lodging markets have slowed in tandem with the slower economy. Growth in revenue-per-available-room ("revpar") is projected to decline by 7.5% in 2001 and remain flat (0% growth) in 2002, according to Merrill Lynch lodging analysts. Since hotels have the shortest lease terms (nightly turnover) they exhibit the greatest sensitivity to changes in GDP growth.

Commercial Lending: The Company also owns five mezzanine whole loans and two preferred equity interests in partnerships that own office buildings. The Company's commercial loan portfolio generally emphasizes larger transactions located in metropolitan markets as compared to the loans in the CMBS portfolio. The credit performance of the Company's commercial mortgage backed securities remains consistent with expectations. There are no delinquencies on the Company's direct holdings of commercial mezzanine loans.

During the nine months ended September 30, 2001 two loans have paid down their principal in full representing over $65,000 in proceeds. In March the Santa Monica Loan paid off in full its $35,000 loan balance and in June The New York Loan paid off in full its $30,600 loan balance. These loans generated a realized return to the Company of over 22.5%. The contribution of these two loans to net income prior to their repayment was approximately $6,000 on an annualized basis.

On July 20, 2001, the Company entered into a $50 million commitment to acquire shares in Carbon Capital, Inc. ("Carbon"), a private commercial real estate income opportunity fund managed by BlackRock Financial Management, Inc., who is also the manager of the Company. This commitment deploys a portion of the Company's excess liquidity into mezzanine lending

with better diversification and on a more cost effective basis. By participating in Carbon, the Company seeks to reduce its maximum exposure to any given mezzanine holding while improving the return on invested capital. The Company does not pay BlackRock management or incentive fees through Carbon and has received a reduced fee for this investment on its own management contract with BlackRock. This transaction was reviewed by outside counsel and approved by the Company's unaffiliated Directors in June of 2001.

It is anticipated that funds will be drawn over time as opportunities are identified. Carbon will be managed by the same management team that has been managing the Company's commercial loan portfolio. The risk profile of Carbon is substantially similar to the Company's commercial loan program and the structure of Carbon is a Real Estate Investment Trust so the tax and regulatory issues are identical.

Investment Grade Real Estate Related Securities: The yields on residential mortgage backed securities (RMBS) fell along with longer dated fixed income securities as the Federal Reserve continued aggressively reducing short term rates.

The proceeds from the Company's two equity raises and commercial mortgage paydowns have been redeployed into RMBS to the maximum amount permitted by the Company's debt to capital covenants. The Company's RMBS portfolio currently consists of approximately $1.3 billion worth of residential mortgage backed securities financed with over $1.2 billion of reverse repurchase agreements. The Company focused primarily on 6.0% and 5.5% fixed rate agency backed residential mortgages purchased at a discount to face value. In the event of a prolonged period of low interest rates the Company anticipates higher than normal prepayments which increase the realized yield on these securities.

During the third quarter 2001, the Company obtained the consent of the holders of the Series A preferred stock to increase the Company's debt to capital ratio for a period of one year. Under the terms of the Series A preferred stock, the Company was not permitted to have a debt to capital ratio of more than 4.5:1. Beginning on August 1, 2001 the Company may maintain a debt to capital ratio of 5.0:1 until July 31, 2002. The Company will use this increased borrowing ability to acquire additional RMBS to take advantage of investment opportunities available in the current steep yield curve environment. The Company will not increase its aggregate leverage ratios on its high yielding CMBS or mezzanine loan portfolios.

Recent Events: On November 7, 2001, the Company completed a follow-on offering of 4,400,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting estimated expenses) were approximately $39.4 million. On November 13, 2001, the underwriters exercised an option to purchase an additional 90,000 shares of Company common stock available through an over-allotment granted to the underwriter.

On November 5, 2001 the Company received a capital call notice to fund a portion of its Carbon Capital investment. The total amount of the capital call was $8,784 and is expected to be paid on November 19, 2001. The use of proceeds will be to acquire three commercial loans all of which are secured by office buildings.

Funds From Operations (FFO): Most industry analysts, including the Company, consider FFO an appropriate supplementary measure of operating performance of a REIT. In general, FFO adjusts net income for non-cash charges such as depreciation, certain amortization expenses and gains or losses from debt restructuring and sales of property. However, FFO does not represent cash

provided by operating activities in accordance with GAAP and should not be considered an alternative to net income as an indication of the results of the Company's performance or to cash flows as a measure of liquidity.

The Company computes FFO in accordance with the definition recommended by the National Association of Real Estate Investment Trusts. The Company believes that the exclusion from FFO of gains or losses from sales of property was not intended to address gains or losses from sales of securities as it applies to the Company. Accordingly, the Company includes gains or losses from sales of securities in its calculation of FFO.

The Company's FFO for the three months ended September 30, 2001 and 2000 was $16,483, and $11,377, respectively, and $41,359 and $28,037 for the nine months ended September 30, 2001 and 2000, respectively. FFO was the same as its reported GAAP net income for the periods. The Company reported cash flows (used in) provided by operating activities of ($441,098) and $29,711, cash flows (used in) provided by investing activities of ($341,150) and of $786,073 and cash flows provided by (used in) financing activities of $814,345 and $(824,652) in its statement of cash flows for the nine months ended September 30, 2001 and 2000, respectively.

Results of Operations: Net income for the three and nine months ended September 30, 2001 was $16,483, or $0.40 per share ($0.38 diluted), and $41,359, or $1.09 ($1.04 diluted), respectively. Net income for the three and nine months ended September 30, 2000 was $11,377, or $0.36 per share ($0.34 diluted), and $28,037 or $1.01 ($0.95 diluted), respectively.

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

	For the Three Months Ended September 30,	
	2001 Interest Income	2000 Interest Income
CMBS	$10,522	$9,489
Other securities available for sale	10,024	12,096
Commercial mortgage loans	2,941	3,573
Mortgage loan pools	-	1,555
Trading securities	11,054	-
Cash and cash equivalents	1,071	255
Total	$35,612	$26,968

	For the Nine Months Ended September 30,	
	2001 Interest Income	2000 Interest Income
CMBS	$35,036	$27,915
Other securities available for sale	21,961	27,198
Commercial mortgage loans	13,137	8,550
Mortgage loan pools	1,575	5,021
Trading securities	15,821	-
Cash and cash equivalents	2,143	909
Total	$89,673	$69,593

In addition to the foregoing, the Company earned $634 and $1,318 from real estate joint ventures during the three and the nine months ended September 30, 2001, respectively.

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

	For the Three Months Ended September 30,	
	2001 Interest Income	2000 Interest Income
Reverse repurchase agreements	$15,413	$11,488
Lines of credit and term loan	1,354	3,277
Total	$ 16,767	$14,765

	For the Nine Months Ended September 30,	
	2001 Interest Income	2000 Interest Income
Reverse repurchase agreements	$ 35,177	$27,579
Lines of credit and term loan	7,143	9,749
Total	$ 42,320	$37,328

The foregoing interest expense amounts for the three and nine months ended September 30, 2001 do not include $1,574 and $(42), of hedge ineffectiveness. See Note 2, Derivative Instruments, for further description of the Company's hedge ineffectiveness.

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

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

The following chart describes the interest income, interest expense, net interest margin, and net interest spread for the Company's portfolio. Interest income for the three months ended September 30, 2001 does not include earnings from real estate joint ventures of $634 and interest expense of $52. There were no earnings from real estate joint ventures for the three months ended September 30, 2000.

	For the Three Months Ended	
	September 30, 2001	September 30, 2000
Interest income	$35,612	$26,968
Interest expense	$16,767	$14,765
Net interest margin	3.64%	4.44%
Net interest spread	2.68%	2.71%

Other Expenses: Expenses other than interest expense consist primarily of management fees and general and administrative expenses. The Company incurred $1,842 and $5,805 in base management fees in accordance with the terms of the Management Agreement for the three and nine months ended September 30, 2001 and $1,681 and $4,585 in base management fees for the three and nine months ended September 30, 2000. The Company incurred $1,461 and $2,614 in incentive compensation for the three and nine months ended September 30, 2001 and $379 and $465 for the three and nine months ended September 30, 2000. In accordance with the provisions of the Management Agreement, the Company will reimburse the Manager for certain expenses incurred on behalf of the Company. No reimbursement of expenses were incurred during the nine months ended September 30, 2001 and 2000. Other expenses - net of $78 and $1,047 for the three and nine months ended September 30, 2001, and ($20) and $1,415 for the three and nine months ended September 30, 2000, were comprised of accounting agent fees, custodial agent fees, directors' fees, fees for professional services, insurance premiums, broken deal expenses, due diligence costs and amortization of negative goodwill.

Other Gains (Losses): During the nine months ended September 30, 2001 and 2000 the Company sold a portion of its securities available-for-sale for total proceeds of $1,263,014 and $2,122,735, which resulted in a realized gain of $175 and $994 for the three months ended September 30, 2001 and 2000, respectively and $7,256 and $1,700 for the nine months ended September 30, 2001 and 2000, respectively. The gain on securities held for trading were $1,875 and $191 for the three months ended September 30, 2001 and 2000, and $2,443 and $519 for the nine months ended September 30, 2001 and 2000, respectively. The foreign currency losses (gains) of ($91) and $29 for the three months ended September 30, 2001 and 2000, and $18 and $18 for the nine months ended September 30, 2001 and 2000 respectively, relate to the Company's net investment in a commercial mortgage loan denominated in pounds sterling and associated hedging.

Dividends Declared: On September 14, 2001, the Company declared distributions to its common shareholders of $.32 per share, paid on October 31, 2001 to common shareholders of record on September 30, 2001.

Tax Basis Net Income and GAAP Net Income: Net income as calculated for tax purposes (tax basis net income) was estimated at $6,542, or $0.12 (basic) per share, and $41,597, or $1.10 (basic) per share, for the three and nine months ended September 30, 2001, compared to a net income as calculated in accordance with GAAP of $16,483, or $0.40 ($0.38 diluted) per share, and $41,359, or $1.09 ($1.04 diluted) per share, respectively.

Differences between tax basis net income and GAAP net income arise for various reasons. For example, in computing income from its subordinated

CMBS for GAAP purposes, the Company takes into account estimated credit losses on the underlying loans whereas for tax basis income purposes, only actual credit losses are taken into account. As there were no actual credit losses incurred in 2001, tax basis income for subordinate CMBS is higher the GAAP income. Certain general and administrative expenses may differ due to differing treatment of the deductibility of such expenses for tax basis income. Also, differences could arise in the treatment of premium and discount amortization on the Company's securities available for sale.

A reconciliation of GAAP net income to tax basis net income is as follows:

	For the Three Months Ended September 30, 2001	For the Nine Months Ended September 30, 2001
GAAP net income	$16,483	$41,359
FAS 133 adjustment	-	1,903
Loss (Gain) on trading securities	(10,657)	(10,192)
Loss on Impairment of asset	-	5,702
Subordinate CMBS income differences	716	2,825
Tax basis net income	$6,542	$41,597

	For the Three Months Ended September 30, 2001	For the Nine Months Ended September 30, 2001
GAAP net income	$11,377	$28,037
Subordinate CMBS income differences	507	2,158
Use of capital loss carry forward	(602)	(1,625)
CORE Cap merger expenses	-	(2,300)
Tax basis net income	$ 11,282	$ 26,270

Changes in Financial Condition

Securities Available for Sale: The Company's securities available for sale, which are carried at estimated fair value, included the following at September 30, 2001 and December 31, 2000:

Security Description	September 30, 2001 Estimated Fair Value	Percentage
Commercial mortgage-backed securities:		
CMBS IO's	$ 83,695	8.0%
Investment grade CMBS	15,771	1.5
Non-investment grade rated subordinated securities	280,191	26.9
Non-rated subordinated securities	23,546	2.3

	403,203	38.7
Single-family residential mortgage-backed securities:		
Fixed Rate Securities	61,719	5.9
Home Equity Loans	30,707	3.0
Hybrid adjustable rate mortgages	60,836	5.8
Agency adjustable rate securities	106,408	10.2
Agency fixed rate securities	379,087	36.4
	638,757	61.3
	$1,041,960	100.0%

Borrowings: As of September 30, 2001, the Company's debt consisted of line-of-credit borrowings, term loans and reverse repurchase agreements, collateralized by a pledge of most of the Company's securities available for sale, securities held for trading, mortgage loans held for sale and its commercial mortgage loans. The Company's financial flexibility is affected by its ability to renew or replace on a continuous basis its maturing short-term borrowings. As of September 30, 2001, the Company has obtained financing in amounts and at interest rates consistent with the Company's short-term financing objectives.

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

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

	For the Nine Months Ende September 30, 2001	
	September 30, 2001 Balance	Maximum Balance
Reverse repurchase agreements	$1,361,152	$1,748,891
Line of credit and term loan borrowings	$111,035	$205,889

Hedging Instruments: Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities.

As a result, on January 1, 2001 the Company reclassified certain of its agency debt securities, with an amortized cost of $64,432 from available-for-sale to trading. An interest rate swap agreement with a $25,000 notional amount that had been designated as hedging these debt

securities was similarly reclassified. The unrealized gain of $895 related to the debt securities and the unrealized loss of $2,830 related to the interest rate swap were removed from other comprehensive income and recorded as the cumulative transition adjustment to earnings upon adoption of SFAS 133. The net cumulative effect of adopting SFAS 133 was ($1,903) or ($0.06) per share, and is reflected as cumulative transition adjustment on the statement of operations.

In addition, on January 1, 2001, the Company re-designated interest rate swap agreements with notional amounts aggregating $98,000 that had been hedging available-for-sale debt securities as cash flow hedges of its variable rate borrowings under reverse repurchase agreements. The fair value of these swap agreements on January 1, 2001, an unrealized loss of ($9,853), remained in other comprehensive income at the date of adoption of FAS 133, and therefore, did not result in a transition adjustment.

In addition, on January 1, 2001 the Company re-designated interest rate swap agreements with notional amounts aggregating $57,744 that had been hedging available-for-sale debt securities as trading securities. These interest rate swap agreements were sold in January 2001; the loss of $795 is included in gain on securities held for trading.

Capital Resources and Liquidity: Liquidity is a measurement of the Company's ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund investments, loan acquisition and lending activities and for other general business purposes. The primary sources of funds for liquidity consist of collateralized borrowings, principal and interest payments on and maturities of securities available for sale, securities held for trading and commercial mortgage loans, and proceeds from sales thereof.

To the extent that the Company may become unable to maintain its borrowings at their current level due to changes in the financing markets for the Company's assets, the Company may be required to sell assets in order to achieve lower borrowing levels. In this event, the Company's level of net earnings would decline. The Company's principal strategies for mitigating this risk are to maintain portfolio leverage at levels it believes are sustainable, to diversify the sources and types of available borrowing and capital and to maintain at least 25% of equity in liquid assets that can be converted into cash if required. The current liquid assets ratio is 54%. The Company has utilized committed bank facilities, preferred stock, and will consider resecuritization or other achievable term funding of existing assets.

On February 14, 2001 the Company completed a secondary offering of 4,000,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting underwriting fees and expenses) were approximately $33,200. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 600,000 additional shares of common stock to cover over-allotments. This option was exercised on March 13, 2001 and resulted in net proceeds to the Company of approximately $5,000.

On May 11, 2001 the Company completed a follow on offering of 4,000,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting underwriting fees and expenses) were approximately $37,800. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 600,000 additional shares of common stock to cover over-allotments. This option was exercised on June 6, 2001 and resulted in net proceeds to the Company of approximately $5,675.

On November 7, 2001 the Company completed a follow-on offering of 4,400,000 shares of its common stock in an underwritten public offering. The aggregate net proceeds to the Company (after deducting estimated expenses) were approximately $39.4 million. On November 13, 2001, the underwriters exercised an option to purchase an additional 90,000 shares of Company common stock available through an over-allotment granted to the underwriters. The aggregate net proceeds to the Company (before deducting expenses) were approximately $810.

On November 7, 2001 the Company received a capital call notice to fund a portion of its Carbon Capital, Inc. investment. The total amount of the capital call was $8,784 and is expected to be paid on November 19, 2001. The remaining commitment is $41,216.

As of September 30, 2001, $156,188 of the Company's $185,000 committed credit facility with Deutsche Bank, AG was available for future borrowings, and $160,945 was available under the Company's $200,000 term facility with Merrill Lynch.

The Company's operating activities (used) provided cash of $(441,098) and $29,711 during the nine months ended September 30, 2001, and 2000, respectively, primarily through net income and, in 2001, net purchases of trading securities.

The Company's investing activities (used) provided cash totaling $(341,150) and $786,073 during the nine months ended September 30, 2001, and 2000, respectively, primarily to purchase securities available-for-sale and to fund commercial mortgage loans, offset by principal payments received on securities available-for-sale, mortgage loans, and proceeds from sales of securities available-for-sale.

The Company's financing activities provided (used) cash of $814,345 and $(824,652) during the nine months ended September 30, 2001 and 2000, respectively, primarily from repayment of short-term borrowings and payment of distributions, offset in 2001, by proceeds from the issuance of common stock and short term borrowings.

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

The Company is subject to various covenants in its lines of credit, including maintaining a minimum GAAP net worth of $140,000, a debt-to-equity ratio not to exceed 5.0 to 1, a minimum cash requirement based upon certain debt to equity ratios, a minimum debt service coverage ratio of 1.5, and a minimum liquidity reserve of $10,000. Additionally, the Company's GAAP net worth cannot decline by more than 37% during the course of any two consecutive fiscal quarters. As of September 30, 2001, the Company was in compliance with all such covenants.

The Company's ability to execute its business strategy depends to a significant degree on its ability to obtain additional capital. Factors which could affect the Company's access to the capital markets, or the costs of such capital, include changes in interest rates, general economic conditions and perception in the capital markets of the Company's business, covenants under the Company's current and future credit facilities, results of operations, leverage, financial conditions and business prospects. There can be no assurance that the Company will be able to effectively fund future growth. Except as discussed herein, management is not aware of any other trends, events, commitments or uncertainties that may have a

significant effect on liquidity.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk: Market risk is the exposure to loss resulting from changes in interest rates, credit curve spreads, foreign currency exchange rates, commodity prices and equity prices. The primary market risks to which the Company is exposed are interest rate risk and credit curve risk. Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond the control of the Company.

Credit curve risk is highly sensitive to dynamics of the markets for commercial mortgage securities and other loans and securities held by the Company. Credit curve risk is valued based on a spread over comparable maturity Treasury obligations. This spread represents the additional compensation required by investors to assume the credit risk of a debt obligation. Excessive supply of these assets combined with reduced demand will cause the market to require a higher yield. This demand for higher yield will cause the market to use a higher spread over the U.S. Treasury securities yield curve, or other benchmark interest rates, to value these assets. Changes in the general level of the U.S. Treasury yield curve can have significant effects on the market value of the Company's portfolio.

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

The following tables quantify the potential changes in the Company's Portfolio Net Market Value and net interest income under various interest rate and credit-spread scenarios. Portfolio Net Market Value is defined as

the value of interest-earning assets net of the value of interest-bearing liabilities. It is evaluated using an assumption that interest rates, as defined by the U.S. Treasury yield curve, or credit spreads, as defined by the U.S. Interest rate swap curve, increase or decrease up to 200 basis points and the assumption that the yield curves of the rate shocks will be parallel to each other. A significant amount of the Company's Portfolio is invested in residential mortgages that can prepay principal at par. This option causes the value of the mortgages to increase less as interest rates decline due to the higher probability of prepayment. Portfolio Net Market Value in the Credit Spread Movements scenario is calculated using the assumption that the U.S. Treasury yield curve remains constant. The Company believes that 200 basis point variations encompasses periods of significant volatility in these markets.

Net interest income is defined as interest income earned from interest-earning assets net of the interest expense incurred by the interest bearing liabilities. It is evaluated using the assumptions that interest rates, as defined by the U.S. LIBOR curve, increase or decrease by 200 basis points and the assumption that the yield curves of the LIBOR rate shocks will be parallel to each other.

All changes in income and value are measured as percentage changes from the respective values calculated in the scenario labeled as "Base Case." The base interest rate scenario assumes interest rates as of September 30, 2001. Actual results could differ significantly from these estimates.

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

Change in Treasury Yield Curve, +/- Basis Points	Projected Change in Portfolio Net Market Value
-200	4.7%
-100	4.2%
-50	2.6%
Base Case	0
+50	(3.5)%
+100	(8.0)%
+200	(19.7)%

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

Change in Credit Spreads, +/- Basis Points	Projected Change in Portfolio Net Market Value
-200	19.1%
-100	11.4%
-50	6.2%
Base Case	0
+50	(7.1)%
+100	(15.2)%
+200	(34.1)%

Projected Percentage Change In Portfolio Net Interest Income and Change in
Net Income per Share Given LIBOR Movements

Change in LIBOR, +/- Basis Points	Projected Change in Portfolio Net Interest Income	Projected Change in Net Income per Share
-100	11.4%	$0.22
-50	5.7%	$0.11
Base Case	0	0
+50	(5.7)%	($0.11)
+100	(11.4)%	($0.22)

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

All loans are subject to a certain probability of default. The nature of the CMBS assets owned are such that all losses experienced by a pool of mortgages will be borne by the Company. Changes in the expected default rates of the underlying mortgages will significantly affect the value of the Company, the income it accrues and the cash flow it receives. An increase in default rates will reduce the book value of the Company's assets and the Company earnings and cash flow available to fund operations and pay dividends. This change in value can be independent of changes in spreads, as actual credit experience and pricing of credit are not necessarily correlated.

The Company manages credit risk through the underwriting process, establishing loss assumptions, and careful monitoring of loan performance. Before acquiring a security that represents a pool of loans, the Company will perform a rigorous analysis of the quality of substantially all of the loans proposed for that security. As a result of this analysis, loans with unacceptable risk profiles will be removed from the proposed security. Information from this review is then used to establish loss assumptions. The Company will assume that a certain portion of the loans will default and calculate an expected, or loss adjusted yield based on that assumption. After the securities have been acquired the Company monitors the performance of the loans, as well as external factors that may affect their value. Factors that indicate a higher loss severity or timing experience is likely to cause a reduction in the expected yield and therefore reduce the earnings of the Company, and may require a significant write down of assets.

For purposes of illustration, a doubling of the losses in the Company's credit sensitive portfolio, without a significant acceleration of those losses would reduce the expected yield on adjusted purchase price from 9.78% to 8.35%. This would reduce GAAP income going forward by approximately $0.16 per common share and cause a significant write down in assets at the time the loss assumption is changed. The amount of the write-down depends on several factors but it could be in excess of $1.00 per share.

Asset and Liability Management: Asset and liability management is concerned with the timing and magnitude of the repricing and/or maturing of assets

and liabilities. It is the objective of the Company to attempt to control risks associated with interest rate movements. In general, management's strategy is to match the term of the Company's liabilities as closely as possible with the expected holding period of the Company's assets. This is less important for those assets in the Company's portfolio considered liquid as there is a very stable market for the financing of these securities. The Company is actively evaluating secured financing structures to finance its less liquid portfolios of CMBS. This portfolio is currently being financed with 30 day reverse repurchase agreements. This strategy is significantly less expensive for the Company; however, the risk of this strategy not being sustainable over the long term can be significant. The Company has managed this risk by (a) diversifying its counterparties; (b) selecting counterparties with whom the Manager has broader business relationships; and (c) maintaining back-up financing facilities. The failure to maintain these counterparty relationships would result in a reduction in earnings for the Company.

The Company uses interest rate duration as its primary measure of interest rate risk. This metric, expressed when considering any existing leverage, allows the Company's management to approximate changes in the net market value of the Company's portfolio given potential changes in the U.S. Treasury yield curve. Interest rate duration considers both assets and liabilities. As of September 30, 2001 the Company's duration on equity was approximately 6.12 years. This implies that a parallel shift of the U.S. Treasury yield curve of 100 basis points would cause the Company's net asset value to increase or decrease by approximately 6.12%. Because the Company's assets, and their markets, have other, more complex sensitivities to interest rates, the Company's management believes that this metric represents a good approximation of the change in portfolio net market value in response to changes in interest rates, though actual performance may vary due to changes in prepayments, credit spreads and increased market volatility.

Other methods for evaluating interest rate risk, such as interest rate sensitivity "gap" (defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period), are used but are considered of lesser significance in the daily management of the Company's portfolio. The majority of the Company's assets pay a fixed coupon and the income from such assets are relatively unaffected by interest rate changes. The majority of the Company's liabilities are borrowings under its line of credit or reverse repurchase agreements that bear interest at variable rates that reset monthly. Given this relationship between assets and liabilities, the Company's interest rate sensitivity gap is highly negative. This implies that a period of falling short-term interest rates will tend to increase the Company's net interest income while a period of rising short-term interest rates will tend to reduce the Company's net interest income. Management considers this relationship when reviewing the Company's hedging strategies. Because different types of assets and liabilities with the same or similar maturities react differently to changes in overall market rates or conditions, changes in interest rates may affect the Company's net interest income positively or negatively even if the Company were to be perfectly matched in each maturity category.

The Company currently has positions in forward currency exchange contracts to hedge currency exposure in connection with its commercial mortgage loan denominated in pounds sterling. The purpose of the Company's foreign currency-hedging activities is to protect the Company from the risk that the eventual U.S. dollar net cash inflows from the commercial mortgage loan will be adversely affected by changes in exchange rates. The Company's current strategy is to roll these contracts from time to time to hedge the expected cash flows from the loan. Fluctuations in foreign exchange rates

are not expected to have a material impact on the Company's net portfolio value or net interest income.

Forward-Looking Statements: Certain statements contained herein are not, and certain statements contained in future filings by the Company with the SEC in the Company's press releases or in the Company's other public or shareholder communications may not be, based on historical facts and are "Forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms, or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, the financial and securities markets and the availability of and costs associated with sources of liquidity. Additional information regarding these and other important factors that could cause actual results to differ from those in the Company's forward looking statements are contained under the section entitled "Risk Factors" in the Company's Registration Statement on Form S-3 (File No. 333-64900), as filed with the SEC on July 20, 2001, and in the Company's Registration Statement on Form S-4 (File No.333-33596), as filed with the SEC on March 30, 2000, as amended by Amendment No.1 to the Company's Registration Statement on Form S-4, as filed with the SEC on April 11, 2000, and the Company's prospectus supplement, dated May 7, 2001, to the prospectus dated February 13, 2001, as filed with the SEC on May 8, 2001 (File No. 333-75473). The Company hereby incorporates by reference those risk factors in this Form 10-Q. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

At September 30, 2001 there were no pending legal proceedings to which the Company was a party or of which any of its property was subject.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

Not applicable

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

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

3.1 Restated Articles of Amendment of Anthracite Capital, Inc.

b) None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ANTHRACITE CAPITAL, INC.

Dated: November 13, 2001

By: /s/ Hugh R. Frater

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

Dated: November 13, 2001

By: /s/ Richard M. Shea

Name: Richard M. Shea
Title: Chief Operating Officer and Chief Financial Officer
(principal accounting officer)